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## Youth Employment in the Western Balkans – Markets and Incentives

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Over the past several years, growing attention has been paid to the problems of youth employment in the Western Balkans. As is well known, some of the world's lowest youth employment rates are to be found in this region. Apart from the difficulties that young people face in entering the labour market, many among them are engaged in precarious work, often in the informal economy.

It is well established that youth unemployment, but also youth under-employment and youth inactivity outside of intensive participation in education, impose heavy costs on society. Prolonged unemployment early in life can affect the prospects of young people's access to decent work and induces lasting scarring effects. High unemployment reduces the efficiency of investment in education and training, shrinks taxation base and causes higher welfare costs.

However, despite huge efforts worldwide, it is not yet well established what should be done to foster youth employment in a sustainable fashion. Why? All I can offer are two perhaps trivial, mutually connected answers. First, young people are as diverse as general population, except for characteristics related to their generational homogeneity. Second, economies and general labour markets in which youth labour markets are embedded are very diverse as well.

Clearly, economic growth is the best universal remedy for unemployment, and apparently for youth unemployment even more so. Youth employment is strongly pro-cyclical. In the Western Balkans, there is evidence that even in the situation of overall jobless growth, youth employment grew in the favourable conditions of relatively strong GDP growth until 2008 (Arandarenko and Nojkovic, 2010). Youth as a stock (labour market contingent) are a vulnerable

group, no doubt, but not necessarily at the margin. To improve their relative position they need a high worker turnover and high gross job reallocation rates, not necessarily high net job creation rates.

There are different types of vulnerability in the labour market – shallow and deep, transitory and lasting. In principle, for most youth, their vulnerability should be shallow and transitory, or purely situational. They enter the labour market for the first time, and they do not have (relevant) work experience. Everyone has been in that situation; not every person of working age has ever been Roma, or a person with disability, or a refugee, or illiterate. On average, today's young labour market entrants are better educated and physically more fit (still ascending the Mount Waaler) than any other generation in history. Crisis or not, their age-income profiles will most likely be higher than those of their parents, and lower than those of their children.

Based on the 'accepted view' on the necessity to address the youth employment crisis in the region, and the 'challenge' sketched above, below I offer the three different, very stylised approaches – policy options for the promotion of youth employment.

Policy Approach 1. Care about growth only. Do not use special 'youth lenses' while creating growth-enhancing reforms – scepticism towards any exclusive youth-friendly policy or programme because of their distortive character. Simply, in most settings youth will benefit from a strong growth more than other age groups.

Policy Approach 2. Care about equitable and youth-friendly economic growth, but refrain from openly distortive policies. While reforming labour market institutions, pay attention that they better serve the interests of youth – introduce more flexibility: promote atypical employment contracts, reduce EPL; lower/relax the minimum wage; reduce labour taxes, especially for low-wage labour; use moderately the most efficient ALMPs based on thorough net impact evaluations and international experience.

Policy Approach 3. As a matter of strategic priority, care about youth as the main driving force of future growth. Reform labour market institutions in order to enhance youth employment and activation. In addition, conduct large-scale active labour market programmes for youth. Consolidate them into a universal youth package in order to prevent discouragement and

scarring – offer extensive counselling and guidance; training, apprenticeship and internship programmes to gain necessary experience; introduce or expand wage subsidies and tax reliefs for the employment of young people; support youth entrepreneurship; facilitate youth access to (micro)finance; create youth-tailored public works for the most vulnerable; prioritise youth-friendly economic sectors, such as ICT, tourism, catering, social services, sport and culture, green economy.

Which policy option is the most suitable in the Western Balkans?

Youth employment rates are extremely low everywhere in the region, to the extent which is economically harmful, but also politically and socially dangerous. Therefore, the preferred policy options are still 2 and 3; including of course any combination of them. However, the region, perhaps seen from outside as relatively homogenous, actually is very diverse.

One less exploited but telling example of the complexity of the region is the diversity of age structures across the Western Balkans' countries, which is largely due to differences in the timing of the fall in fertility rates. Besides, war losses and emigration waves created various additional dents in the population structure. For Serbia, Bosnia and Herzegovina and Montenegro fertility transition occurred so long ago that the bulge in the population pyramid is now composed of the middle-aged and older people, the baby boomers. FYR Macedonia has a rather balanced population structure with the bulge covering the age groups 25-40. In Albania the bulge is precisely in the age group 15-24, although the total population is on decline because of large economic emigration. In Kosovo, with median age of 27.1, the bulge is in the below 15 age group. To make things more complex, different ethnic groups have different demographic profiles within one country.

Policy consequences – some countries might find it rational and affordable to tolerate or even promote outmigrations of the 'next generation'; others hardly so. Dynamic economic growth requires a combination of energy of the youth and experience of the older (to paraphrase a Serbian electoral slogan which brought to power the Pensioners' Party).

Why is youth employment such a problem if working-age population shrinks, in some countries at an alarming rate? (This is, by the way, another illustration of the 'lump of labour' fallacy.) The answer should be complex and nuanced, based on thorough empirical and comparative analysis,

comprising institutions ('market' rules), firms (demand) and families (supply). In essence, my hypothesis is that a uniquely unfortunate combination of ill-conceived and inadequately configured labour market institutions, severe demand limitations<sup>1</sup>, and circumstances related to young persons' own and their families' decisions on their activity on the labour market, draws the youth employment rate in the region down to world record lows.

Inspected one by one, labour market institutions in the region tend to be more hostile than friendly towards young people. Labour legislation prefers open-ended and fixed-term contracts, while most other flexible and atypical work contracts, including part-time, more suitable for students, are discouraged by the minimum social contribution thresholds, or are simply not recognised. Minimum wages are high to very high in relation to average wages, which limits the opportunities of youth without qualifications to enter the formal, decent-job sector. Labour taxes tend to be high at low-wage level, additionally pushing vulnerable youth away from the formal sector. Relatively strict employment protection legislation slows down labour market flows to the detriment of better educated young labour market entrants.

Dual labour markets limit the access of youth into the primary sector, and create a long queue of young applicants attempting to maximise their lifetime income by entering the privileged public sector. This increases youth unemployment. The demand for higher education grows rapidly, partly in response to increasing returns to education, but partly in an effort to obtain a low-quality diploma as a formal requirement to get access to the primary sector. This increases youth inactivity.

The supply side at the extensive margin, the decision to participate in the labour market, is less researched and more puzzling. In our regional study<sup>2</sup>, we found that even in good times, although youth employment grew faster than adult employment, the youth activity rate grew at a slower pace than its counterpart for the adults. In bad times, the youth activity rate drops faster than the adult one. The increased participation in education as a sort of automatic stabiliser appears as a natural explanation, but it is not the whole story.

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<sup>1</sup> See for example Gligorov, V. et al. (2008), 'Western Balkan countries: adjustment capacity to external shocks, with a focus on labour markets', *wiiw Research Reports*, No. 352.

<sup>2</sup> Arandarenko, M. and A. Nojkovic (2010), *Impact of global financial crisis on youth employment in the Western Balkans*, ILO, Geneva.

Life expectancy in the region is longer today than ever before, despite the fact that it is trailing behind the European average. Demographic projections (often inclusive of migrations) assess that by 2050 population in all countries (excluding Kosovo) will shrink by 20-30% of its current level and their population pyramids will be much less diverse than today. These facts are hardly known to an average young person, and yet for many of them the 'atavistic' sense of urgency to join the labour force and create their own family has lost its appeal. Our recent research on inactivity<sup>3</sup> attempted to, among other things, look closer at the category which is supposed to be the most troubled among youth – NEETs. Using the panel feature of LFS, however, we found in the transition matrices that almost half of the NEETs change their status between two surveys, mostly joining the labour force. Perhaps many among them are simply taking some quality time before deciding what to do next in their life, which will anyway be longer, healthier and less crowded than our own lives? In the age group 25-29 we hardly found any NEETs without family obligations.

My point is only that there is a need to better understand the motives behind the labour market decisions that young people make. If these decisions appear to be suboptimal, this is not because youth are irrational, but because their rationality is bounded by the distorted market signals. Still, I do not believe that young people behave irrationally if they overwhelmingly opt for more education – after all, today's teenagers will exit the labour force around 2060 or even later. The role of remittances, non-labour incomes, family ties and other cultural factors delaying the labour market entry, have been researched in the region, but these issues deserve more attention and focus on youth labour market outcomes. The decisions to emigrate and changing patterns of emigration from the region are other less explored areas.

The room for improvement in employment and active labour market policy in the region, including their specific youth aspect, remains very significant. The list of labour market institutions to be reformed is long and demanding, and the directions are already rather well known. In my opinion, applying in the first place the Policy Approach 2 would be the safe and useful way to go in most countries, selectively combining it with certain programmes from the Policy Approach 3 (most of which already exist to a certain degree), tailored to address the most

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<sup>3</sup> Arandarenko, M. et al. (2012), 'From inactivity to work: analysis of the impact of public policies and factors affecting inactivity', Foundation for the Advancement of Economics (FREN), Belgrade.

pressing imbalances affecting the youth. The important thing is to try to avoid sudden policy swings, which have been especially prominent in youth policy – from doing almost nothing to starting extremely ambitious programmes for which there is no well-prepared exit strategy. Creating the optimal 'youth employment policy mix' is the evolving task which should be solved country by country, based on precise and thorough diagnosis of the labour market situation and the careful assessment of growth constraints and opportunities.