Youth Unemployment: A Reply*

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Introduction

The issue of quantity versus price adjustments is now familiar in economics. In our original paper, we focussed on the adjustments in the Canadian labour market resulting from the influx of the baby-boom generation over the 1960s and 1970s. In our view, the increasing numbers of young entrants contributed to increased youth unemployment rates, especially over the 1970s when the bulk of the baby-boom generation entered the labour market. However, by the early 1980s the trend was reversed as a result of smaller cohorts entering the labour market. The severity of the 1982-83 recession in Canada masked these demographic effects and increased youth unemployment rates through 1983 resulting in a bevy of policy initiatives. Nonetheless over this period the *relative* employment position of the youth in the labour market continued to improve. For example, the relative youth unemployment rate fell consistently through the 1980s, from 76 per cent above the Canadian average in 1981 to 57 per cent above by 1985. Consequently, the policy initiatives were destined to appear successful, since the underlying demographic trends were for considerable improvements in youth unemployment rates.

These have, in fact, occurred. Labour force data for 1986 lend further confirmation to the trends outlined in our previous paper. The youth unemployment rate fell to 15.2 per cent from 16.5 per cent in 1985. Youth unemployment as a percentage of total unemployment stood at 35.1 per cent, down from the 1985 figure and a decline of over 10 percentage points from the 1980 figure. The youth unemployment rate relative to the overall unemployment rate has also declined from 1.75 in 1980 to 1.57 in 1986. This measure controls for the relative cohort size. In contrast the young adult share in unemployment increased to 30.0 per cent, up from a 1980 figure of 24.2 per cent, and the young adult unemployment rate continued above the national average for the third consecutive year. The ratio, 0.92 in 1980, now stands at 1.03.

In addition, recent press reports have indicated that the retail and hospitality sectors, which have traditionally relied on large pools of young people to work in low paying, low skill jobs, are beginning to experience labour shortages, and that a 'new era' in the summer youth job market has emerged as the focus has turned from convincing employers to create jobs to finding and persuading young people to take them.

The comment by Kennedy (1987) draws attention to the other side of labour market adjustments, namely wage adjustments. Youth earnings are shown to have been depressed as a result of these structural developments and, like the unemployment experience, no evidence of improvement had emerged by 1983. Moreover, consistent with our analysis, the earnings data confirm that the youth problem is now emerging in Canada's young adults as the bulk of the baby-boom generation moves into these ages (25

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to 34 years). The policy implications are similar – attention needs to be devoted to these age groups if unemployment is to be reduced. The major question is whether the 'youth problem' is shifting or broadening.

Unemployment or Wage Adjustments?

Traditional economic analysis indicates that an increased supply of young workers will result in higher relative unemployment or lower relative earnings, or both. The more elastic the demand for youth labour, the greater is the effect of a large cohort on employment and the less its effect on wages. In addition, the existence of a minimum wage that exceeds the market wage, or stickiness in the wages of youth results in larger adverse employment effects. Therefore, the degree to which cohort size impacts relatively more on unemployment or wages depends crucially on the responsiveness of relative wages.

The OECD (1986) reported evidence of a significant positive cohort size effect on youth unemployment for a number of countries including Canada. Their results led to the conclusion that the relationship appears to be much stronger in North America than elsewhere. They noted, however, that, unlike in Europe, in the United States and to a more limited extent in Canada, a fall in relative youth wages may have moderated the effects of generational crowding on youth unemployment. These effects are explored using a two-equation model attributed to Freeman and Bloom (1986).[1] A statistically significant but relatively small (−0.22) elasticity of expected relative wages to relative cohort size is reported. The labour demand curve for youth appears to be elastic with a highly significant and sizeable (1.39) coefficient on the relative wage variable in the relative unemployment rate equation,[2] thus confirming the trade-off between unemployment and wages as adjustment mechanisms. Together, they suggest a net elasticity of approximately −0.3 of relative cohort size on the relative unemployment rate of youth which is larger than the wage effect.

Are these effects of cohort size temporary or permanent? In the US the earnings and unemployment differences between younger and older workers appear to be positively associated with cohort size. There is evidence of some catch-up in relative earnings as young cohorts age and that the catch-up in terms of unemployment is complete within about a decade of entry into the labour force. For Canada, unemployment rate differences do tend to narrow, but the similarity with the US experience is not as striking. They neither contradict the US evidence nor do they provide strong support (OECD, 1986:125). Recent empirical evidence (Dooley, 1986) confirms that cohort size depresses entry earnings and suggests some catch-up in relative earnings over time.

Conclusions

Evidence shows that cohort size clearly affects economic opportunities. The degree to which it impacts relatively more on unemployment or earnings depends crucially on the responsiveness of relative wages. Greater labour demand elasticity reduces the responsiveness of relative wages and hence earnings effects. Market segmentations, minimum and sticky wages all reduce responsiveness and hence result in greater unemployment responses. These adverse effects may last for several years – convergence may take a decade or more.

Both our original paper and the comment by Kennedy are consistent with these theoretical results. Taken together they provide indirect evidence of limited responsiveness of relative youth wages in Canada, at least in the short run. Increased cohort size certainly increased youth unemployment and moderately depressed earnings, at least for males. In the 1980s, youth unemployment rates have declined with the departure of the baby-boom, whereas relative earnings do not appear to be as responsive. Since the adverse earnings effects may persist for several years it is, perhaps, too early to expect evidence of a reversal.

Generational crowding explanations of the youth problem have important policy implications. While they acknowledge that the economic positions of large cohorts can be temporarily or even permanently depressed, this need not have an adverse effect on the subsequent smaller youth cohorts. For various reasons, young workers may have a relatively higher probability of

being unemployed and experience relatively lower earnings. Generational crowding worsens these probabilities. Consequently, policies directed at youth may still be required with the departure of the generational crowding effect. But these explanations and the empirical evidence on both unemployment and earnings also point to an emerging labour market problem among Canada's young adults. *Now* is the time to build on recent youth policy initiatives and develop appropriate programs and policies to ameliorate the continued adverse generational crowding effects on the economic opportunities of Canada's young adults.

Notes

* For the record it should be noted that the title of our original paper was 'Youth *Un*employment in Canada: A Misplaced Priority?,' since it was motivated by the bevy of political initiatives directed at the high youth unemployment rates of the early 1980s. The comment by Kennedy (1987) refers to the title which appeared in error in the published version.

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1 Pooled cross-section, time-series data for young male workers in several countries including Canada over 1966–83 were used to estimate the model.

2 The cohort size variable was not introduced separately into this equation so no independent effects on relative unemployment can be assessed.

References

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