

# Regular Education as a Tool of Counter-cyclical Employment Policy

---

Christopher A Pissarides  
London School of Economics

# Introduction

---

- Experience of young workers after school is short-duration job search and frequent job change
- Job loss is not serious for them if there are enough other jobs to take
- But lack of job creation in recession can be serious if unemployment durations become too long

# Policy responses

---

- Policy makers respond with various measures, such as help with job search, training, job creation in public sector
- The question investigated here is: Should regular education be used as one such measure?

# Plan

---

- Private decisions
- Impact of recession
- Social efficiency
- Policy response
- Types of education
- Timing issues
- Standards

# Private decisions

---

- Based on Becker classic work on human capital: demand for education up to the point where the current cost equals the expected future higher pay
- Discount future higher pay by the probability of becoming unemployed.
- It increases the returns to education because better educated individuals experience less unemployment

# Costs of education

---

- For the individual, the costs are foregone income during school attendance and direct costs
- For society, the costs are foregone output of those in school, and the input (opportunity cost) of teachers

# Implications of recession

---

- In recession, foregone income and output both down because of higher unemployment
- Demand for education up.
- Three channels through which higher unemployment influences demand for education

# Impact of higher unemployment 1

---

- Effect on expected foregone income
- Effect is likely to be big because of
  - differential impact of unemployment and rising costs with duration
  - risk aversion
  - Impact on demand for “gap” year



# Impact of higher unemployment

## 1/cont.

---

- The incomes of those affected by unemployment suffer a lot
- Rising unemployment durations have both big contemporaneous effects and future “scarring” effects
- Scarring effects for youths not as big as for adults but still present

# Impact of higher unemployment

## 1/cont.

---

- Risk aversion likely to have big impact because of the high cost on those affected by unemployment
- Gap year demand could collapse because if young people cannot get jobs to finance it, they stay on in school instead

# Impact of higher unemployment 2

---

- Probability of future unemployment lower with more education
- No reason why the response to this should be larger in recession, because by the time education ends recession will be over (If not too long!)
- Maybe recession makes young people more aware of the risks

# Impact of higher unemployment 3

---

- ❑ Family incomes decline and older children may be asked to leave school to support depleted incomes
- ❑ Not an efficient response to recession, education decision should be made on the basis of costs and expected returns, not current liquidity
- ❑ But imperfect capital markets could lead to it

# Empirical evidence

---

- ❑ Strong evidence in favour of higher demand for education in recession
- ❑ Variety of elasticity estimates and no computations of quantitative impact
- ❑ No benchmark number for the elasticity

# Social efficiency

---

- Are there likely to be differences between social and private costs of education?
- Missing capital markets may reduce private demand below social
- Missing insurance markets may push private demand above social – insurance against unemployment, inefficient demand for education

# Social vs. private decisions

---

- ❑ Social costs: foregone output of students and teachers
- ❑ Private costs: foregone income and fees of students
- ❑ Social benefit: increased productivity
- ❑ Private benefits: increased incomes
- ❑ Same? Impact of recession on each?

# Missing capital markets

---

- ❑ Missing capital markets likely to be important in countries where there is reliance on family incomes to finance education
- ❑ Also in countries where there is no good family protection against income loss



# Missing capital markets cont.

---

- But with modern educational financing (loans, grants), and economic development, family pressure on young to give up education to help family finances unlikely to be important

# Missing insurance markets

---

- But insurance against youth unemployment not likely to be perfect because of moral hazard
- So deviation likely to be in direction of more private demand for education in response to rise in unemployment than is socially optimal

# Missing insurance markets

---

- ❑ Recession increases the risk of job loss
- ❑ If risks could be pooled so each person paid a premium equal to the average loss, private decisions to increase education demand are efficient
- ❑ But risks cannot be pooled because of moral hazard in job search

# Social costs

---

- How do the costs of using education as insurance compare with the costs of moral hazard?
- No quantitative models of this trade-off but costs of education high (foregone output, teacher shortage, late entry of “overeducated” workers) and moral hazard reduced with active measures
- Education unlikely to dominate as insurance instrument

# Government responses

---

- Governments should make more resources available for regular education in recession, to maintain standards in the face of increased demand
- By how much?
- As much as the increase in private demand provided allowance is made for the missing insurance markets

# Joint policies

---

- ❑ Best way to deal with insurance demand for education is separately, through UI benefits and ALPM
- ❑ Combination of ALMP that insure young person against long duration unemployment and expansion of education finance to satisfy demand
- ❑ Student loans and grants kept at current levels

# Effectiveness of ALMP

---

- For maximum short-term impact of ALMP employment subsidies or direct job creation by the government seems to be best
- But apprentice-type training for youths also likely to have long-term impact

# Types of education

---

- What type of education should the government support in recession?
- Since demand for extra places is temporary, it should be for types that are less expensive
- Demand for inexpensive courses such as social services has been rising in Sweden



# Types of demand cont

---

- Demand for expensive courses such as medicine or sciences has been declining in Sweden
- So meeting demand types seems good option
- General education better than specific because specific training better left to firms

# Implications for labour market

---

- ❑ Increasing education provision removes youths from the labour market one-for-one
- ❑ No impact on job creation
- ❑ So it is likely that youth employment rate would increase and demand for other ALMP would decrease
- ❑ Likely also to benefit women's market, which is competitive with young market

# Timing issues

---

- When should more spending on education be authorised and for how long?
- Demand for education in recession likely to behave like discouraged worker effect
- Young person tries his/her luck in the labour market and if unsuccessful goes back to school

# Timing of expansion

---

- ❑ So government will need to provide extra places after start of recession
- ❑ But needs to be ready with policy as soon as it becomes clear that there will be recession
- ❑ It might consider allowing delayed entry to facilitate job search and information gathering after completing an educational cycle

# Duration?

---

- ❑ Some evidence from US that in recession the demand for short courses increases
- ❑ Students stay in college until course is completed
- ❑ So lock-in effects present: those in college do not search and the flow into jobs when job creation recovers is slow to pick up
- ❑ But because of short courses not likely to be too serious

# Other implications

---

- ❑ After end of recession, there are more graduates than in normal times
- ❑ Graduate incomes might suffer and if youths react to current observations, demand for education might fall too much
- ❑ Freeman-like cobweb cycles may be the outcome

# Educational achievement

---

- In order to maintain standards, universities should come under no pressure to accept more students without extra teaching resources and space
- This might be expensive to achieve, especially space

# Fall in standards?

---

- ❑ Some fall in standards may be inevitable because of it
- ❑ Also because new entry is not likely to be as academically able as steady-state entry
- ❑ Policy question is, is a fall in standards not a good alternative to unemployment?



# Standards in recession

---

- Inevitable fact is that in recession labour market outcomes, government revenues and standards of service suffer
- Spreading costs through reductions of standards across a broad range of services, including education, may be better outcome than shifting all burden on to individuals in the labour market

# Key conclusion

---

- The key conclusion is that recessions are times when both the private and social cost of regular education are low
- They are good times to take advantage of and enhance society's human capital

# Policy dilemmas

---

- ❑ But social and private demand are not well matched
- ❑ Social efficiency requires more resources for unemployment insurance, active policies and education
- ❑ Spreading limited resources across these seems preferable to bunching on one