

the LABOUR
MARKET *in*
WINTER

*the state of working
britain 2010*



edited by

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The State of Working Britain 3:

The UK Labour Market, the 2008-2009 Recession and the Aftermath

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“a good knowledge of what happened remains the best safeguard against recurrence”

J. K. Galbraith – The Great Crash

Outline

1. The UK labour market before during & after recession
2. Things that annoy me (youth, part-time, immigration)
3. Trends
4. Conclusions

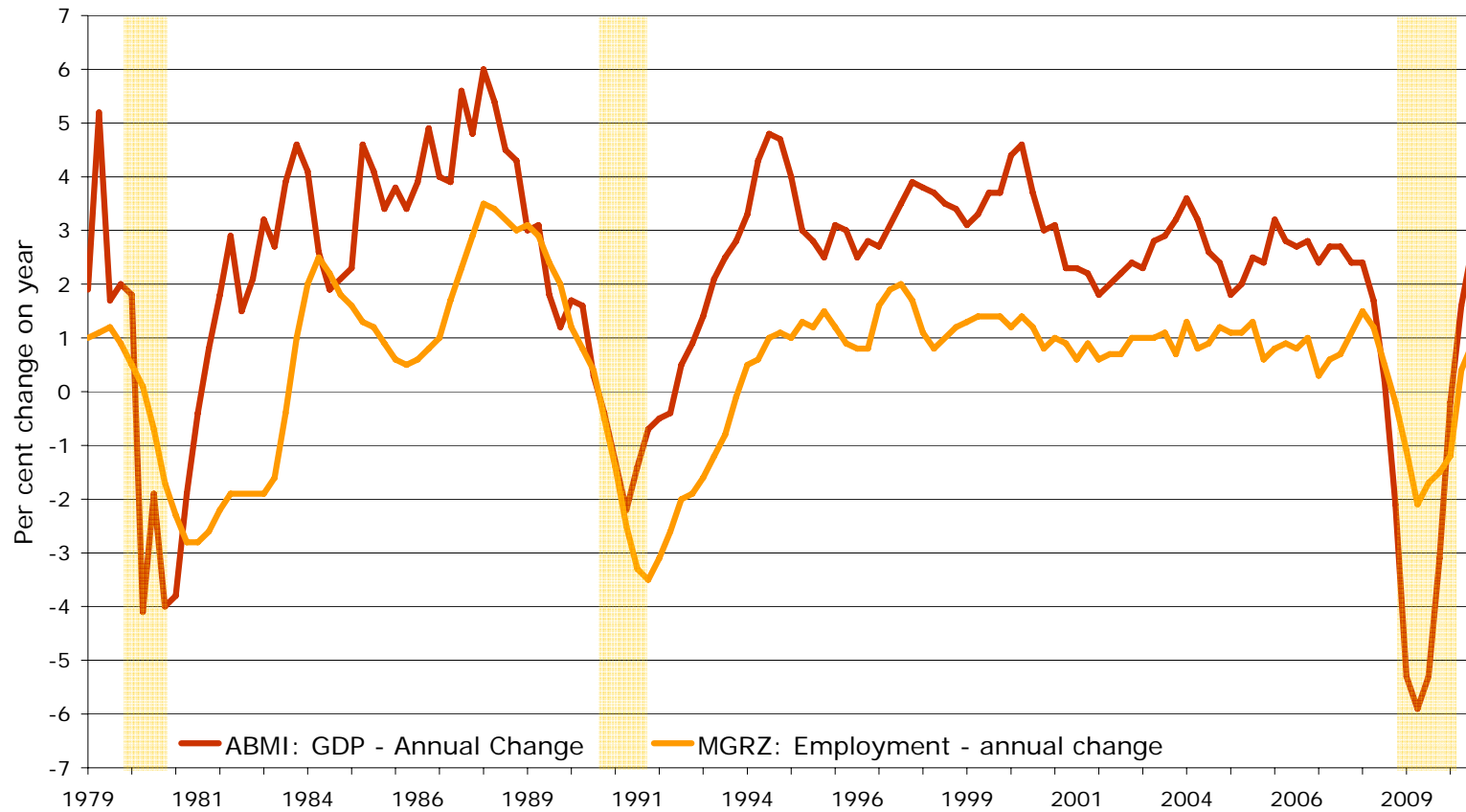
The Legacy

When Labour left office in 2010 the economy had just emerged from the recession of 2008-2009 which inflicted a larger cumulative loss of UK output than any of the other post-war recessions.

Nevertheless, employment rates remained higher and unemployment rates remained lower than many expected given the experience of previous recessions.

Annual change in Employment and GDP 1979-2009

Fig 1 - Annual % change in Gross Domestic Product and LFS employment, Q1 1979 to Q3 2010



Source: LFS, ONS.

Employment in the recession

During the latest recession, GDP fell by over 6%, far worse than in the recessions of the 1980s or 1990s

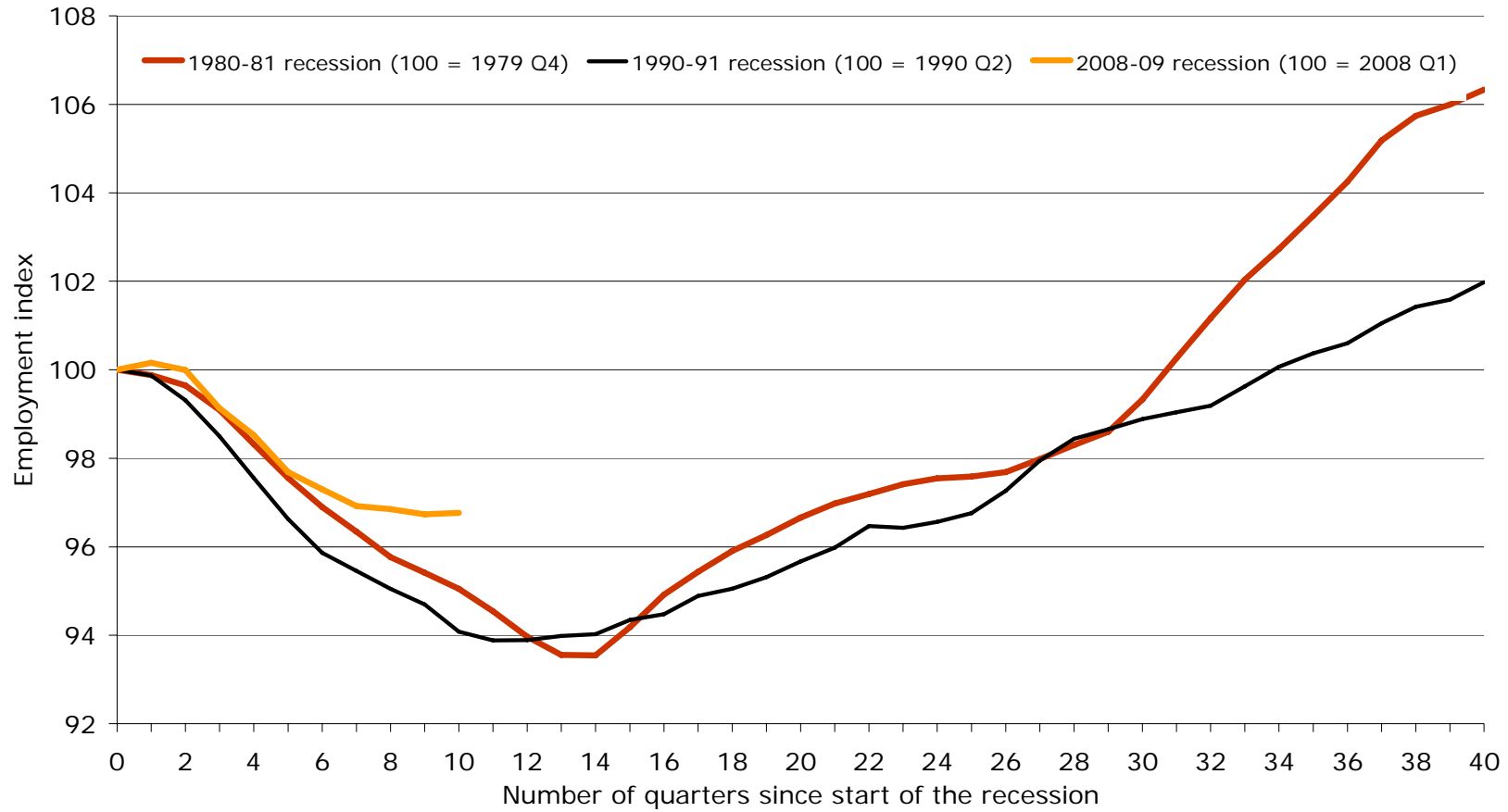
With six quarters of falling output, it was both longer and deeper than the previous two.

In the 1980 recession, the percentage fall in employment was broadly in line with the percentage fall in GDP.

In the 1990s, the relative fall in the employment rate fall in the 1990s was somewhat larger than the percentage decline in GDP.

However, the latest recession was strikingly different.

Employment Levels from the start of the recession for the 1980s, 1990s and 2008/09 recessions.



Index at Start of Recession = 100 for 1979Q4, 1990 Q2 and 2008 Q1 respectively

Source: ONS.

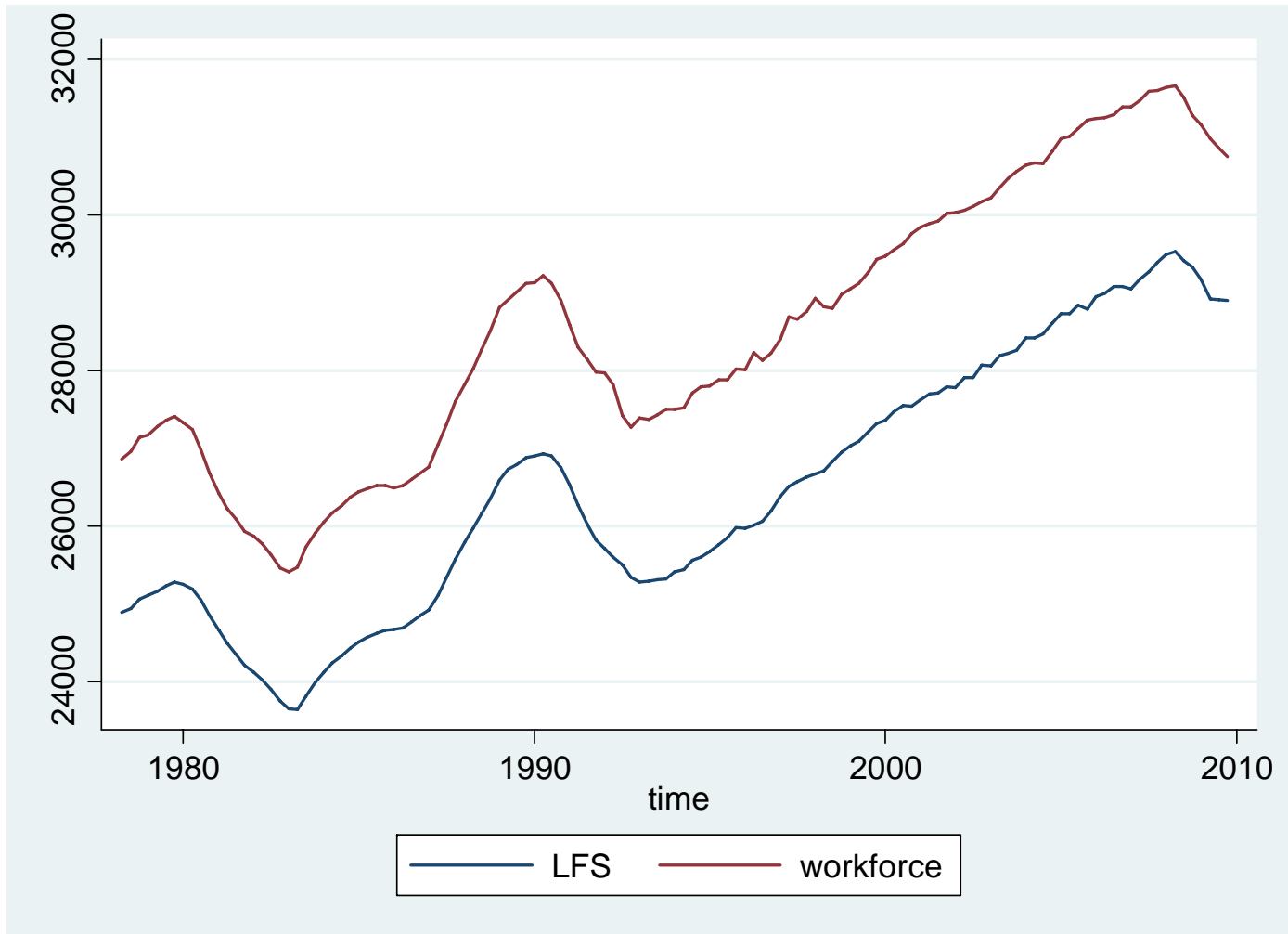
Employment levels from the Start of Recession

In the previous two recessions, the fall in employment was only halted some 12 to 14 quarters after the onset of recession. Employment also remained below its before-recession levels for 18 months or so after the recovery in output started.

However this time round, whilst the fall in GDP fall was worse than in past recessions, the loss of employment was much smaller, less than 3% of the initial level (a fall of around 1 million jobs)

The period over which the level of employment fell was also much shorter than in the past

Employment Levels



Unemployment and the Recession

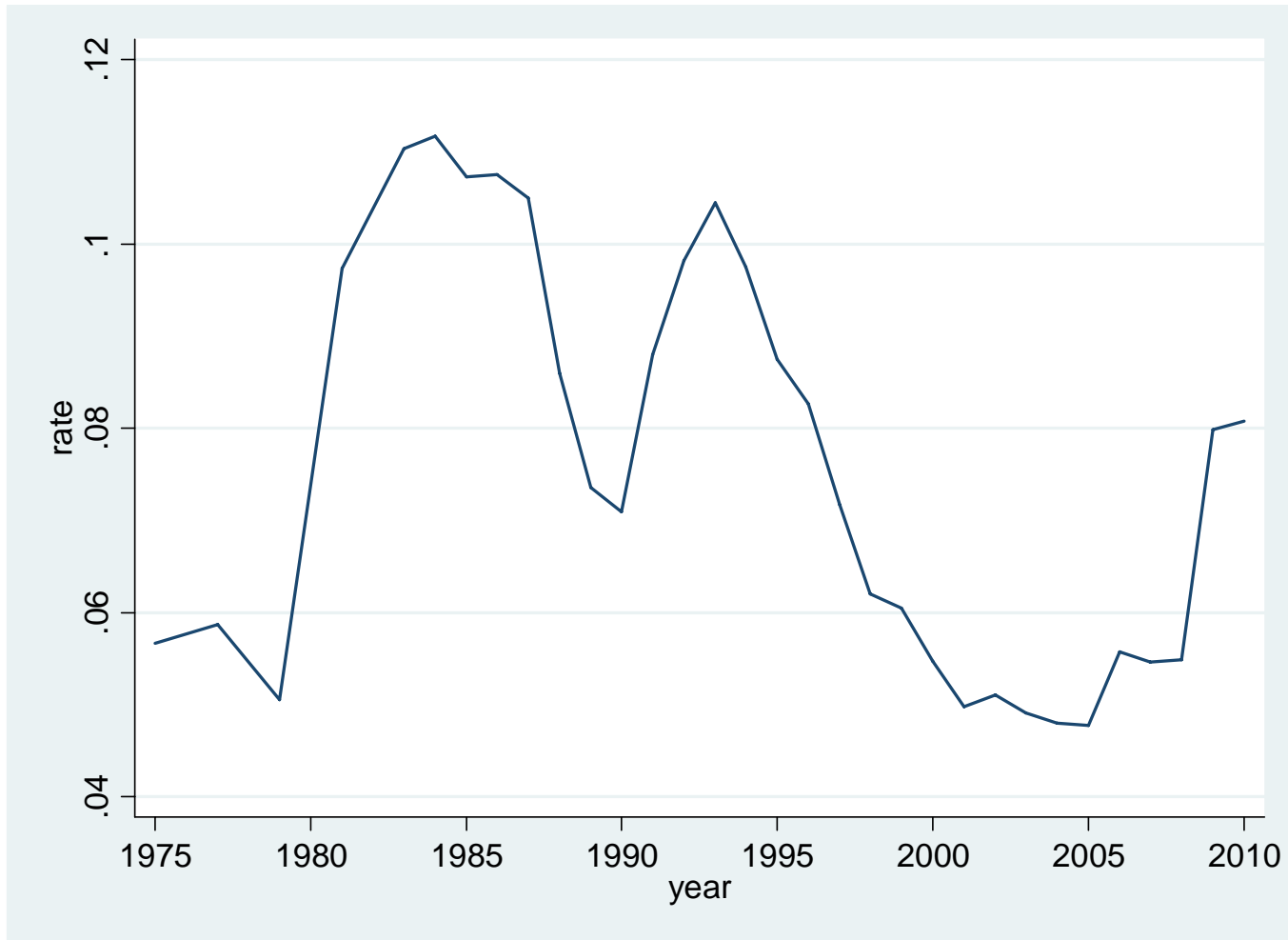
As with employment, the rise in (ILO/OECD) unemployment this time around was small relative to the fall in GDP.

Following the 1980 recession, unemployment rose for some 5 years after the recession end, reaching a peak of 12% in 1986.

In the 1990s, unemployment took 3 years to reach its height following the 1990 recession and while still in excess of 10% was lower than in the 1980s.

In this latest recession, there was a sharp rise in unemployment, but, significantly, appears at the moment to have stabilised earlier, (at around 8%) - even before the recession had ended.

The ILO Unemployment Rate for UK 1975-2010



Heterogeneity in experience across countries

	% Change in GDP 2008 Q1-2009 Q2	% point change in unemployment 2008 Q1 — 2009 Q4
<i>Small unemployment fall relative to decline in GDP</i>		
UK	-5.9	2.7
Sweden	-6.1	2.9
<i>Small unemployment fall relative to GDP (w emp. subs)</i>		
Italy	-6.5	1.8
Germany	-6.3	-0.1
Netherlands	-5.8	1.2
Japan	-7.1	1.3
<i>Similar unemployment and GDP falls</i>		
France	-3.1	2.4
<i>Larger unemployment falls than GDP</i>		
US	-3.5	5.0
Spain	-4.3	9.7
Ireland	-9.6	8.2
<i>Little or no GDP fall</i>		
Australia	+1.5	1.5

Countries like France and Canada escaped relatively lightly from the recession with a 3% fall in GDP and a similar rise in unemployment.

In the US, Spain and Ireland, the rise in unemployment exceeded the fall in output.

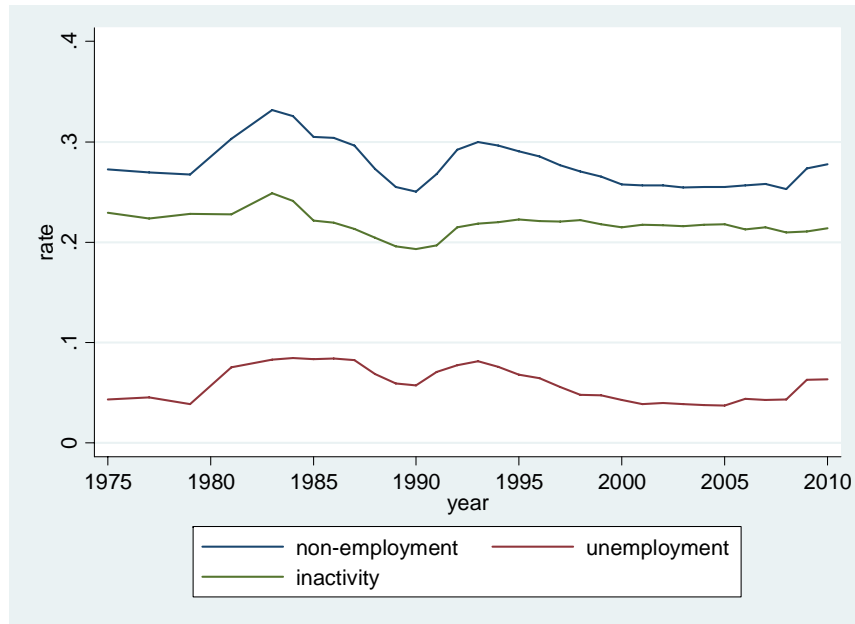
However there are other countries with smaller than expected employment falls

Some of these countries adopted a deliberate strategy to encourage short-time working rather than lose jobs. In Germany the government has supported a policy of short-time working. Similar employment subsidy schemes are operating in Italy, the Netherlands and Japan.

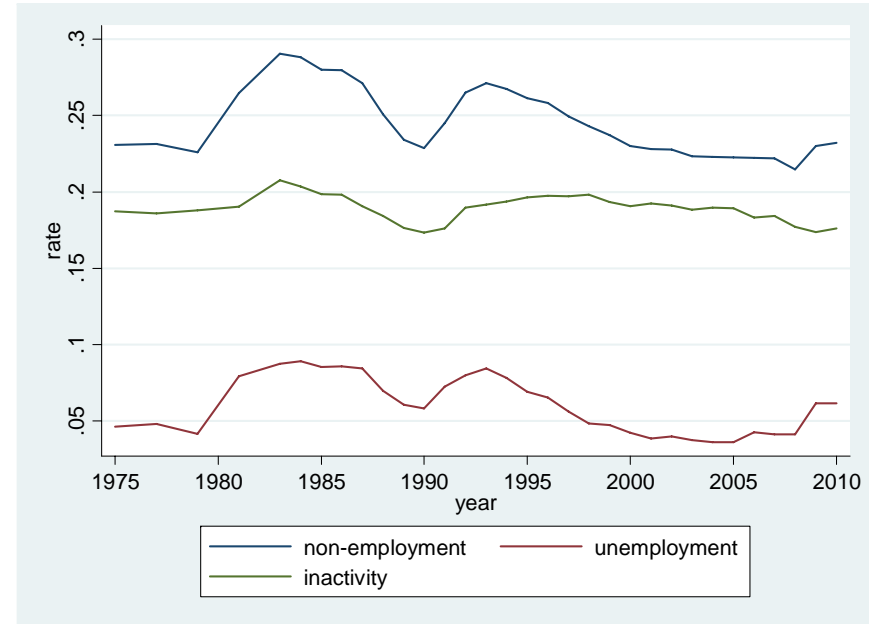
The UK is one of a smaller number of countries to have experienced relatively low employment losses without a deliberate government funded strategy of short hours working.

Of course the unemployment rate is not the only measure of labour market performance, need to be aware of a range of other indicators of which non-employment and inactivity feature strongly

With students



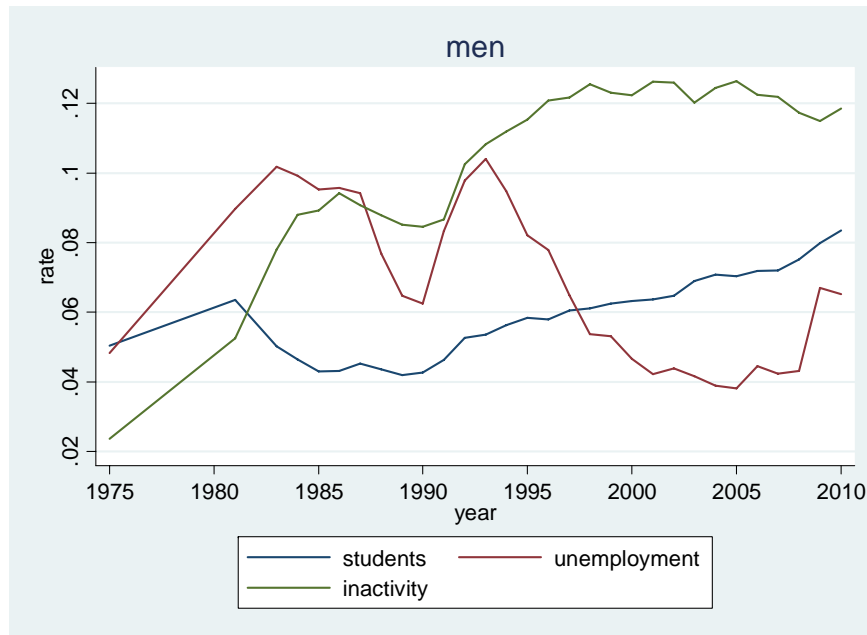
Without students



Neither non-employment nor inactivity yet back to their peaks in previous recessions

(students tend to mask falling inactivity over recent years (rising participation))

Aggregate does however obscure very different patterns by gender



Men not doing very well, though deterioration slowed and may have begun to reverse (a little) prior to 2008

What underlies all this?

Clues in the underlying labour market flows

Inflows & Outflow Rates: Employment, Unemployment and Inactivity



Employment outflows were lower than in previous recessions, with 94% of those in work staying in work through the year compared to 91% in the last two recessions.

Outflow from unemployment into employment remained higher this time round than in the past downturns, with around 35% of those unemployed getting work compared to 30% in previous recessions.

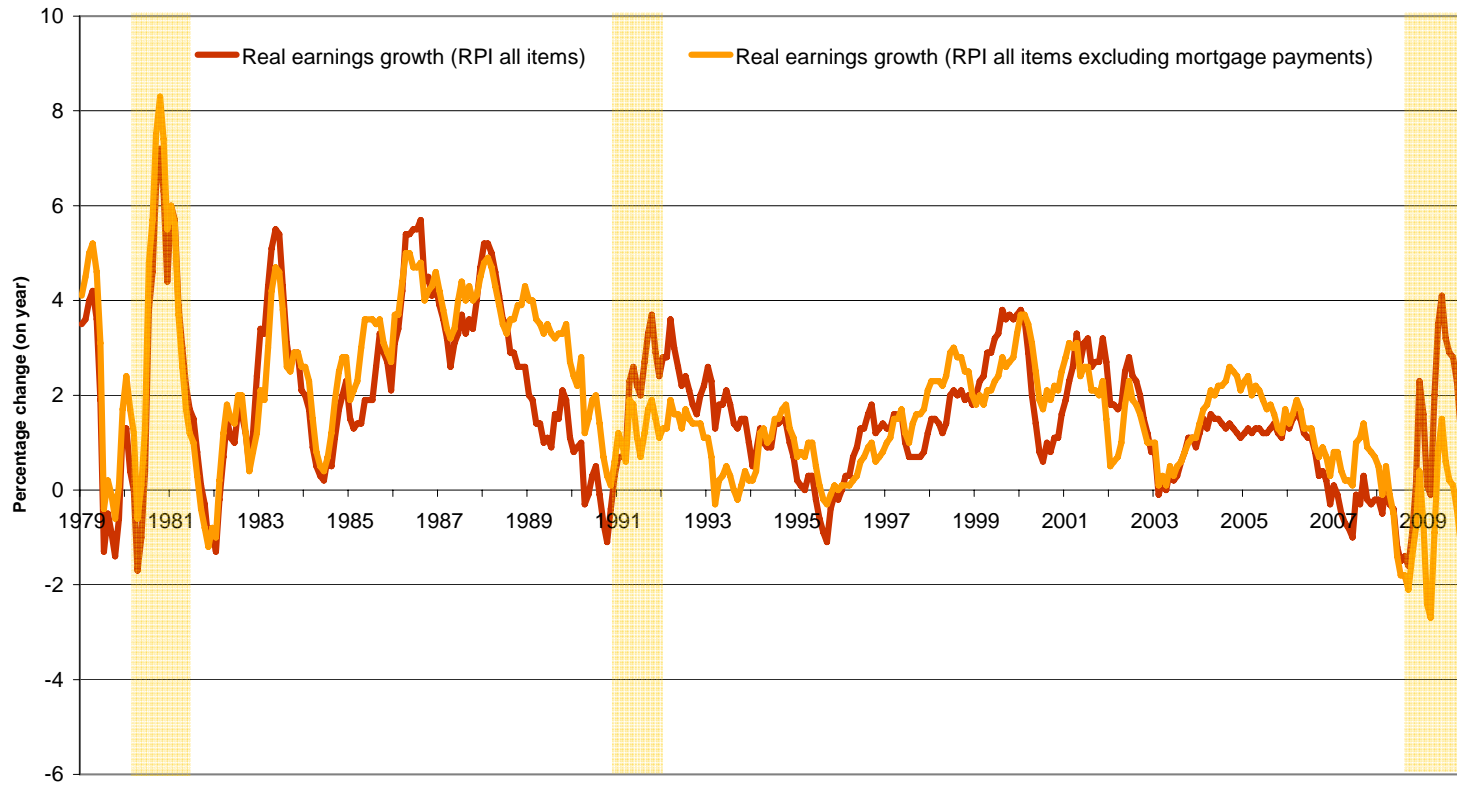
Outflows from inactivity into unemployment have risen in recent years, perhaps as a result of schemes like the New Deals for Lone Parents, Disabled People and 50+

The Working Tax Credit schemes expanded and augmented under Labour, may also have helped maintain flows into employment allied to the New Deals.

(2/3 of unemp. rise due to change in rate of job loss – Elsbey, Smith et al (2010))

Real Wage Growth (consumer and producer wages)

Annual % change in Real earnings growth, adjusted by (i) RPI all items and (ii) RPI excluding mortgage payments



Source Labour Force Survey, ONS

In all three recessions, price and nominal wage growth slowed.

In the latest recession real consumer wages rose markedly, (mortgage rates were cut following the slackening of monetary policy and VAT was temporarily reduced to 15%).

However, because nominal wages static and producer prices high, real wage growth *to firms* fell by around 3%.

This gap between consumer wage growth and that faced by producers will have helped firms cope, while sustaining demand.

This “wedge” has not been sustained. So while labour costs for firms are subdued but demand is also subdued.

(Since UK output fell much faster than employment or hours worked, then productivity also fell sharply. Falling productivity puts downward pressure on wages. Cushioned by high profitability going into recession).

A 10% real wage cut has approximately same effect on spending as 3 million jobs over a year

(eg average wage £25,000 and approx 30 million in work = $25 \times 30 = \text{£}750\text{billion}$)

Extra 3 million in work = $25 \times 3 = \text{£}75\text{billion}$

10% real wage cut = $2.5 \times 30 = \text{£}75\text{billion}$

)

Sector-Specific Shocks

If the recession hit sectors with different capital intensities (productivity differentials) by differing amounts, then a high productivity, high capital intensity sector, subject to a negative shock is likely to experience a sharper fall in output than employment.

Manufacturing and construction –once again - have been hardest hit with 8 to 10% of employment lost compared to services at under 2%.

Since high productivity manufacturing experienced the largest employment loss, it is unlikely that the simple shock to a high productivity sector story explains much of what we have observed in the UK.

Sectoral trends in employment

	1979-83	1983-90	1990-93	1993-2007	2008Q2- 2009Q4
% Δ Employment	-7.3	+15.0	-6.3	+15.6	-2.9
% Δ Manufacturing	-21.5	-5.6	-16.7	-27.8	-9.7
% Δ Finance	+3.7	+45.4	-1.5	+51.7	-4.3
% Δ Construction	-9.2	+35.2	-20.6	+18.9	-8.2
% Δ Retail, Hospitality	-3.9	+20.7	-3.6	+12.8	-3.9
% Δ Public Admin.	0	+13.8	+1.5	+21.9	+3.5

Source: Workforce jobs series ONS. Authors' calculations.

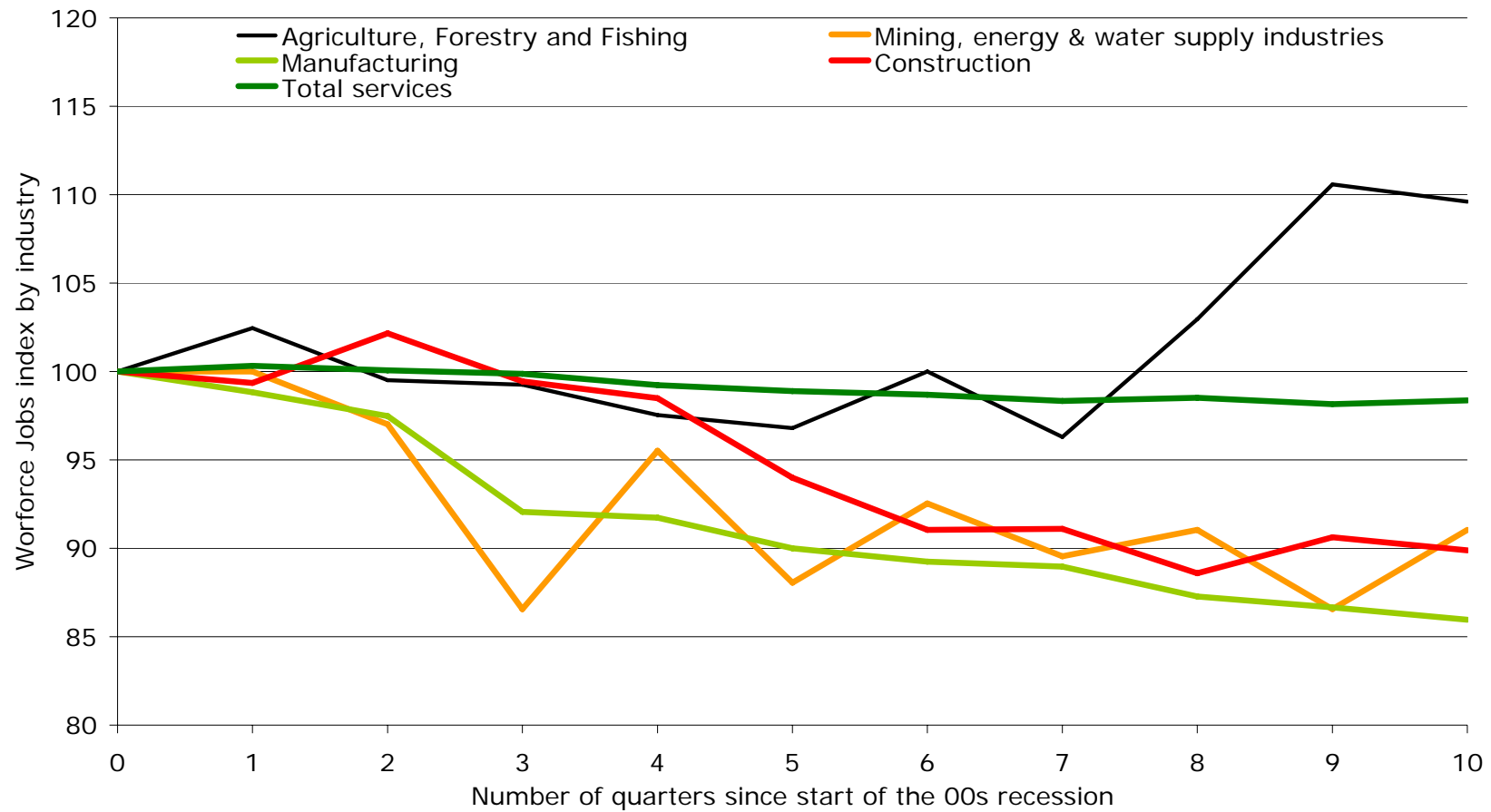
However, within the service sector there is considerable variation.

Employment has fallen by around 4% in finance retail (and transport). While these rates are well below construction and manufacturing as proportionate declines, because these latter sectors are larger, they account for around half of the total jobs lost.

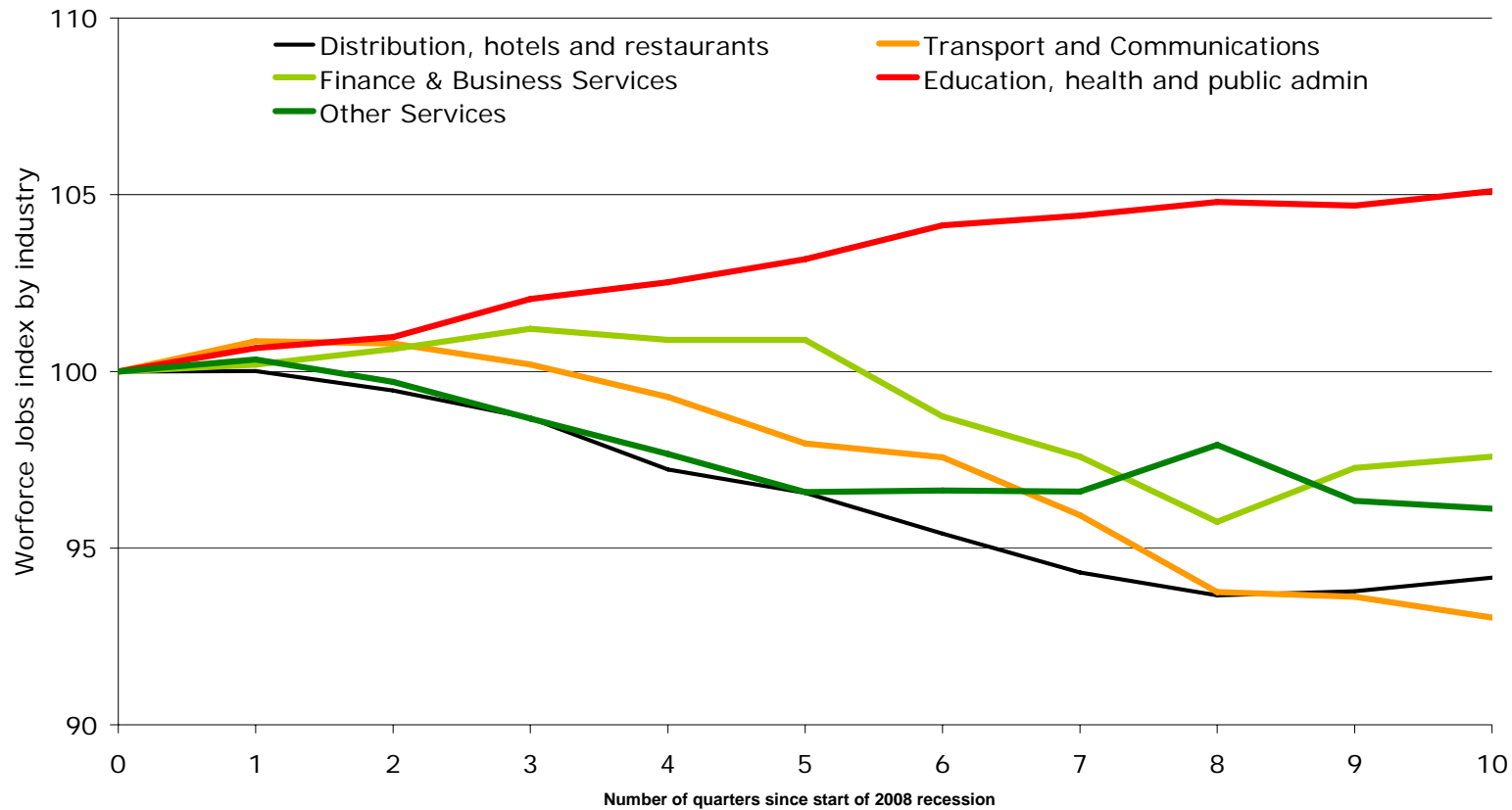
In the public services of education, health and administration employment has **grown** by some 5%, a result of the continued investment in these sectors by the government over the recession.

Employment Index from 2008q1 for Major Industry Groupings

Workforce Jobs levels from the start of the 2008/09 recession by major industrial groups (100 = 2008 Q1)



Workforce Jobs levels from the start of the 2008/09 recession by majorservice sector industrial groups (100 = 2008 Q1)



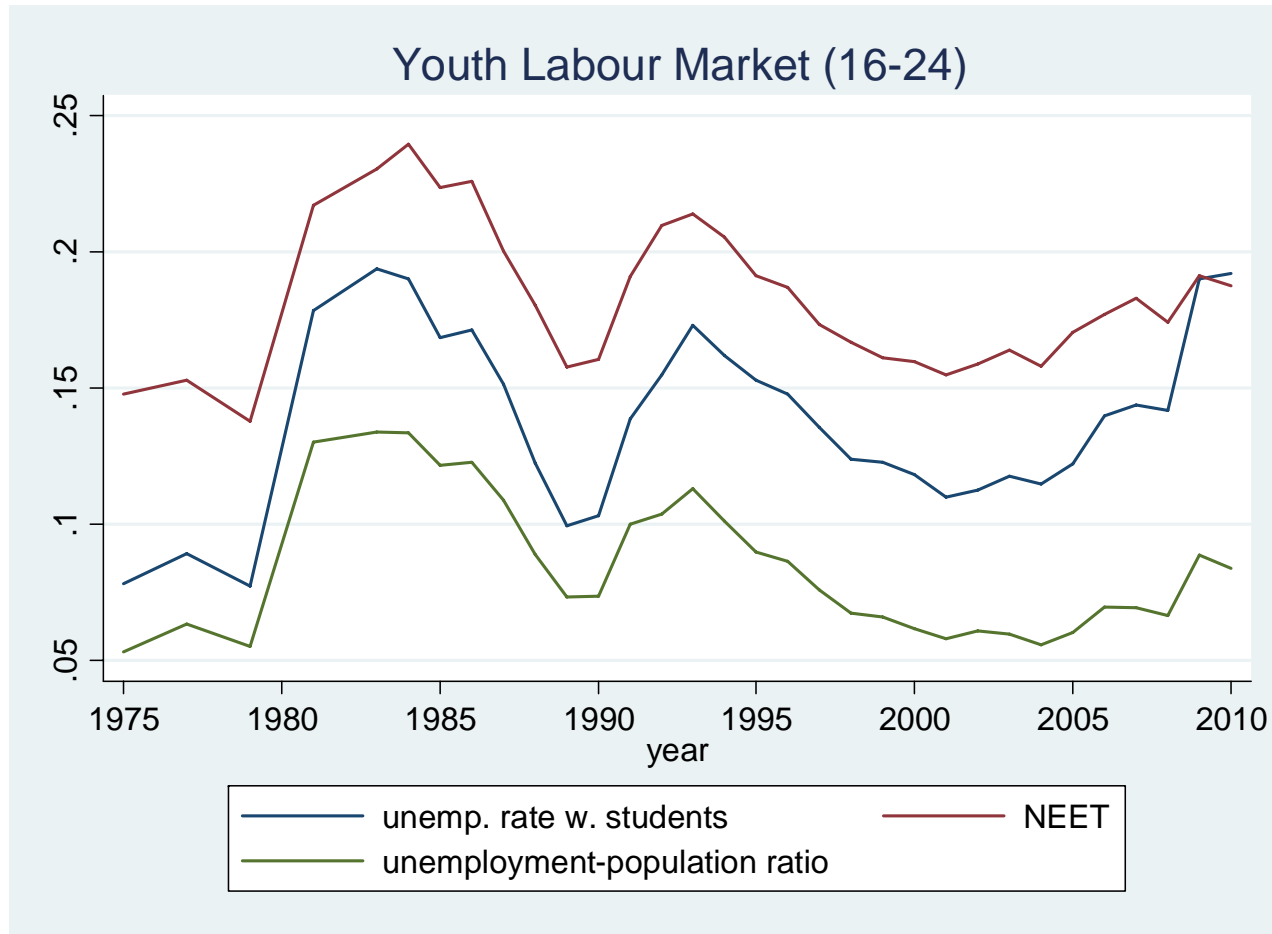
Any Service sector employment growth dominated (so far) by public sector during the recession. Helped sustain demand

Youff

Typically the youth unemployment rate is always higher (on average by 2:1

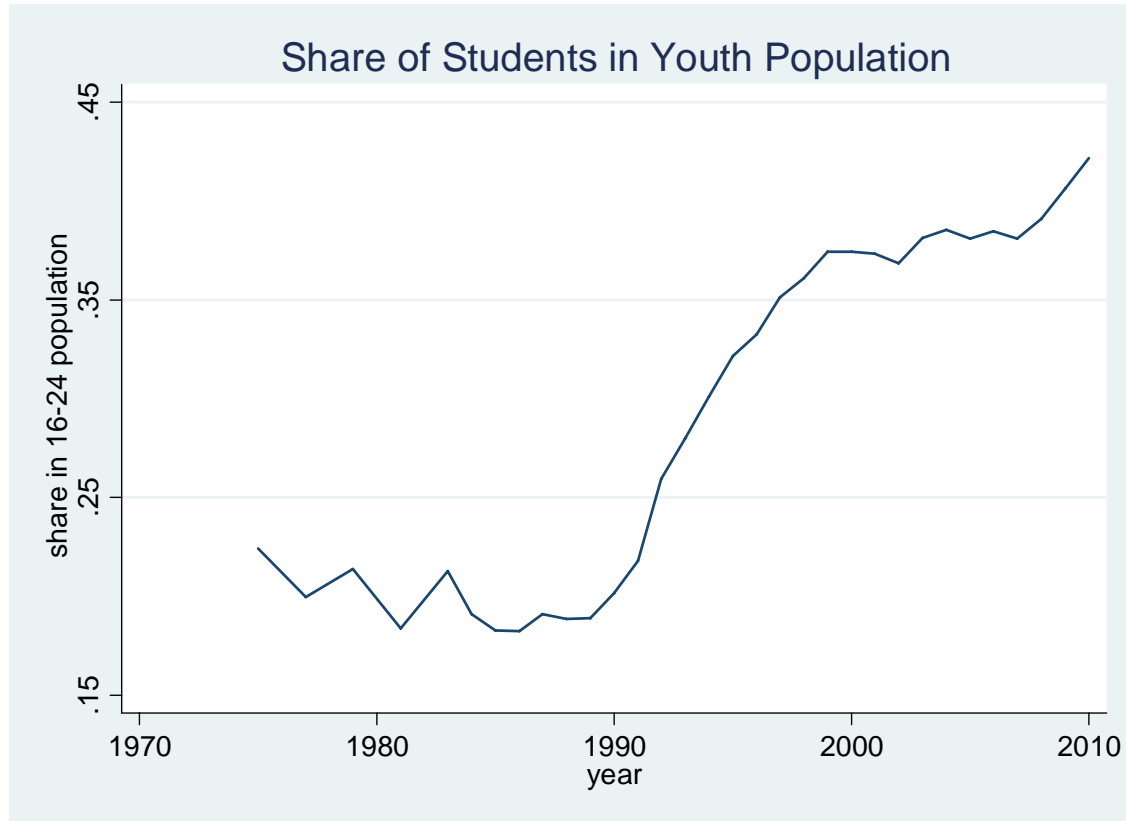
but duration of youth unemployment always lower than for other age groups.

Worry about scarring effects, but are things really different (worse) this time round?



Youth unemployment rate is now higher than in previous 2 recessions

but both u. pop rate and NEET rate below 1990s peak (which in turn lower than 1980s)



Large (partly counter cyclical) rise in student numbers shrinks the youth labour force and exaggerates the youth unemployment rate $u = U/(E+U)$

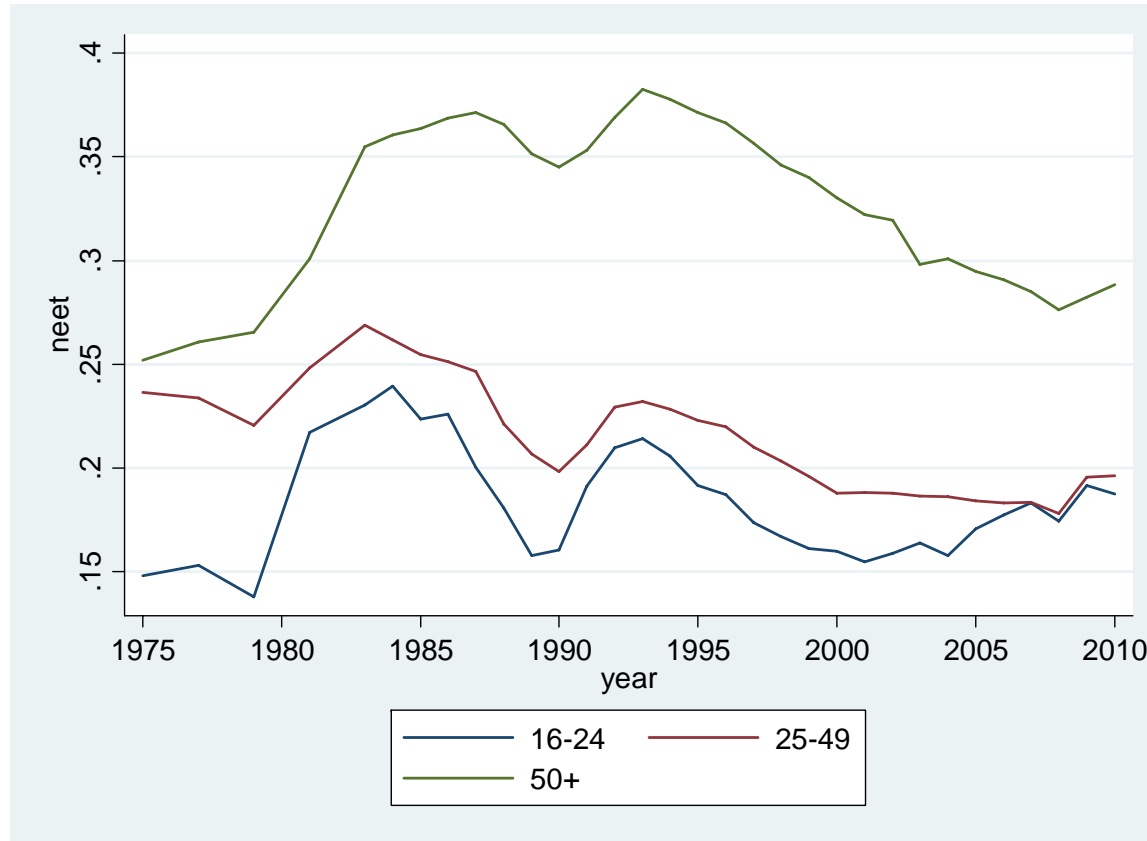
Youth Labour Market Performance 2009

	Unemployment rate, $U/(U+E)$	Participation rate, $(U+E)/(U+E+N)$	Unemp. Population ratio $U/(U+E+N)$
	(1)	(2)	(1)*(2)
UK	18.9	64.2	12.1
Spain	37.9	49.5	18.7
France	22.4	38.8	8.7
Germany	11.0	52.3	5.8
US	17.6	56.9	10.0

Source: OECD employment outlook

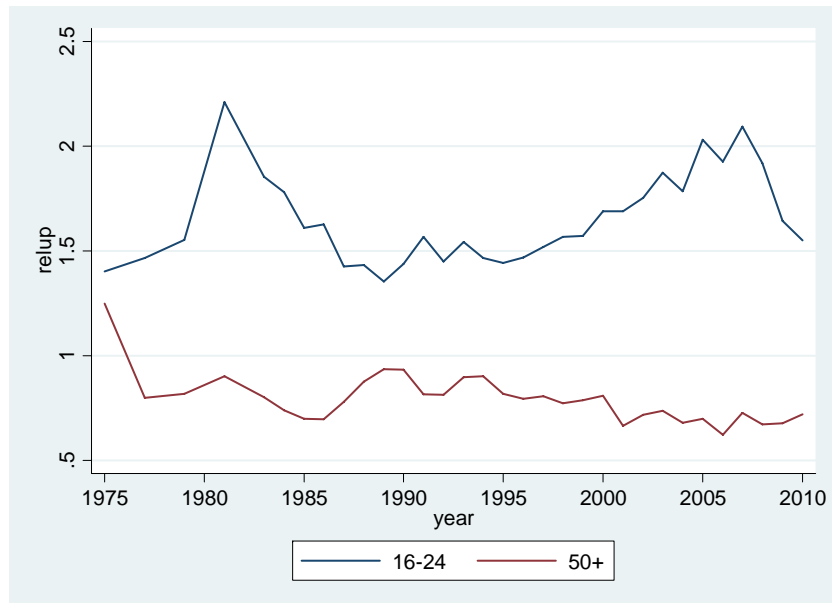
So the poor performance youth when measured by the unemployment rate in France, Spain (and the UK) is exaggerated by low levels of labour market participation which is in turn – in the main – caused by higher levels of participation in tertiary education

Have things turned against youth this time?

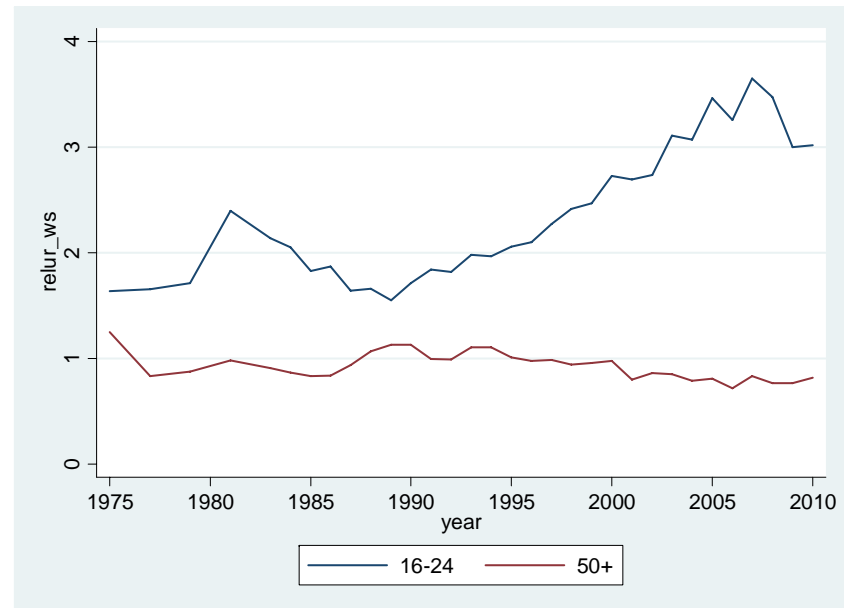


Not yet. NEET for adults is still higher than that for youth

Youth unemp. pop. relative to 25-49



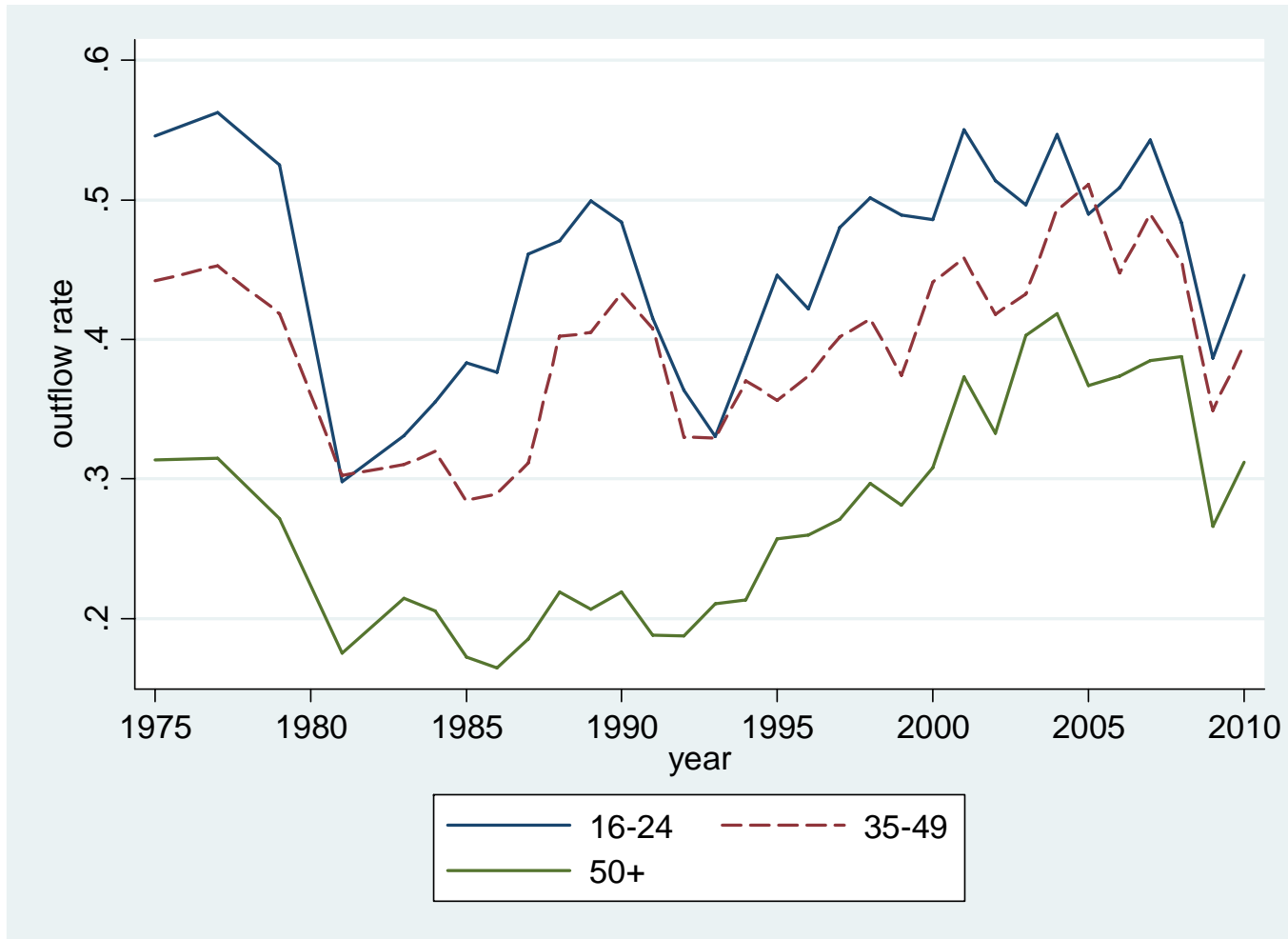
Youth unemp. rate. relative to 25-49



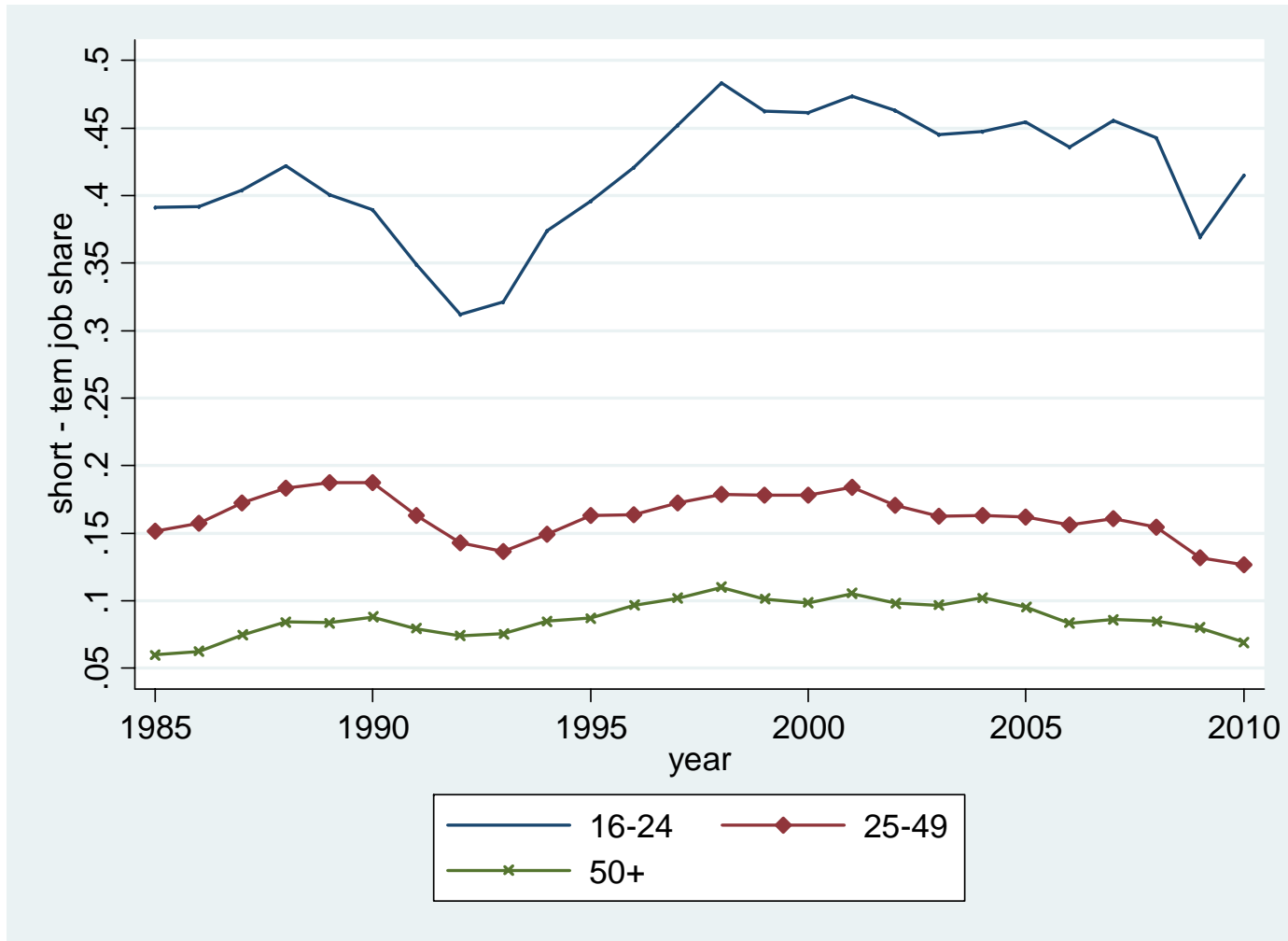
Relative u pop is falling

Only relative unemployment *rate* rising (and not in latest downturn)

Outflow rates from unemployment for youth still higher than in previous recessions and higher compared to other age groups



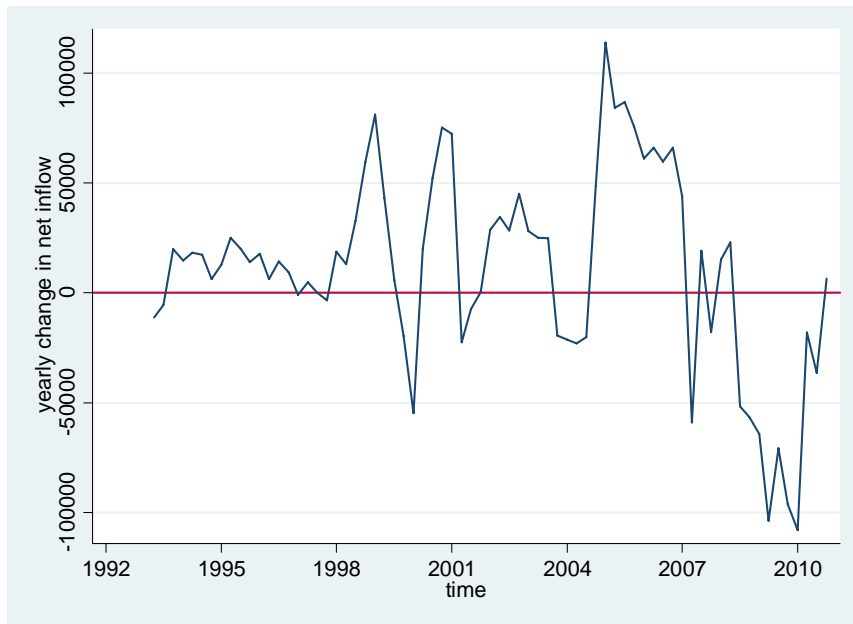
Relative hiring rates also don't look out of line



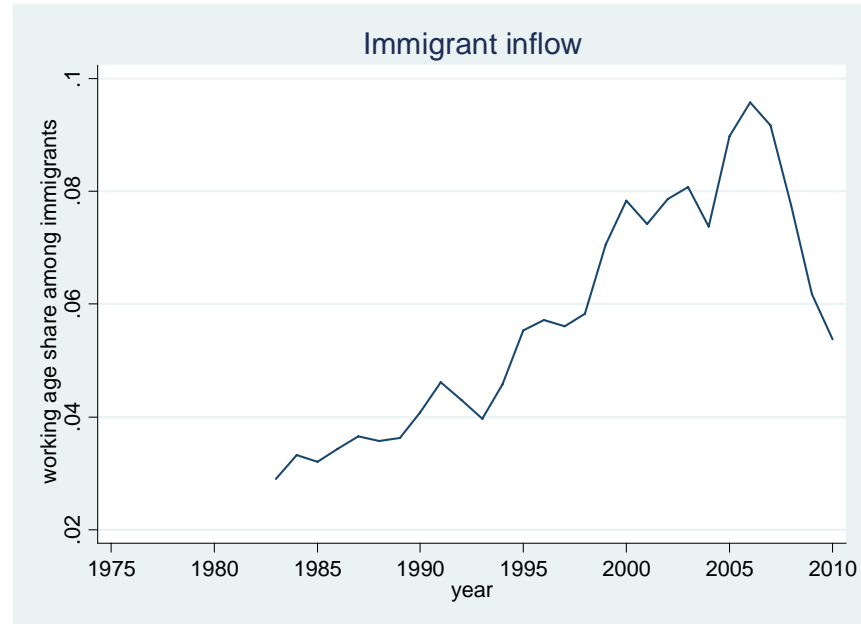
Immigration

Existing UK studies consistently find no significant effects of immigration on average wages and employment (in good times) – but may be small effects among low skilled

Numbers of new migrants fell back during recession, but stock of migrants stable, suggesting that the duration of stay was also rising.

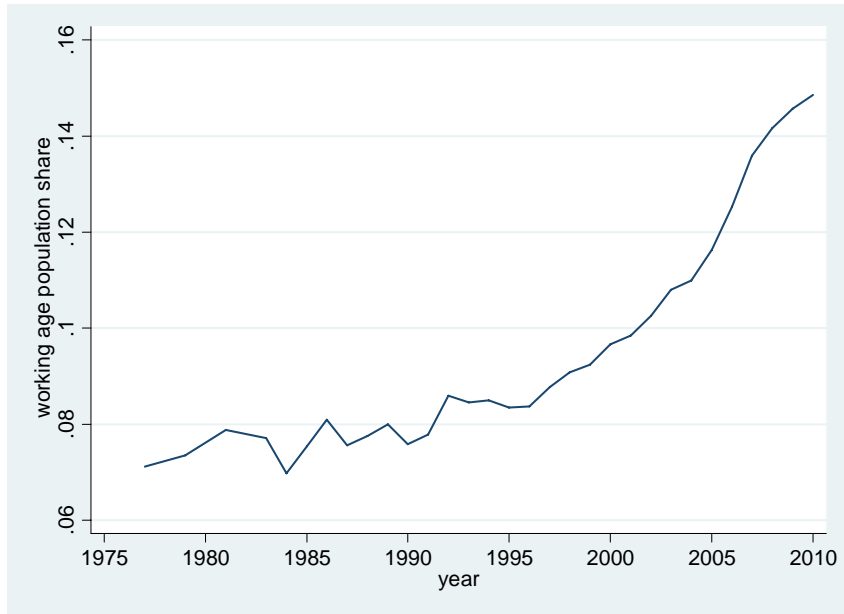


Change in inflow –ve since 2008

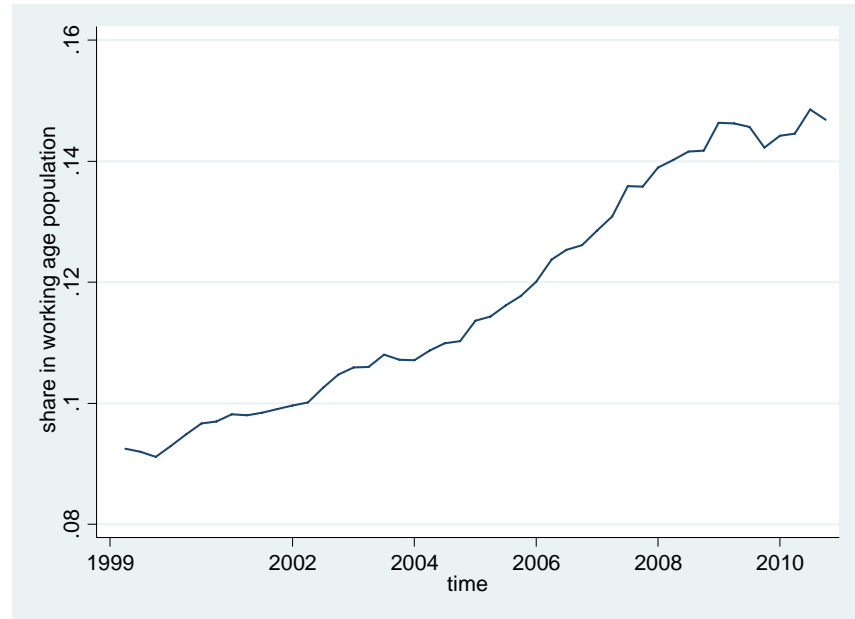


↓ share of inflow in immigrant stock

Stock

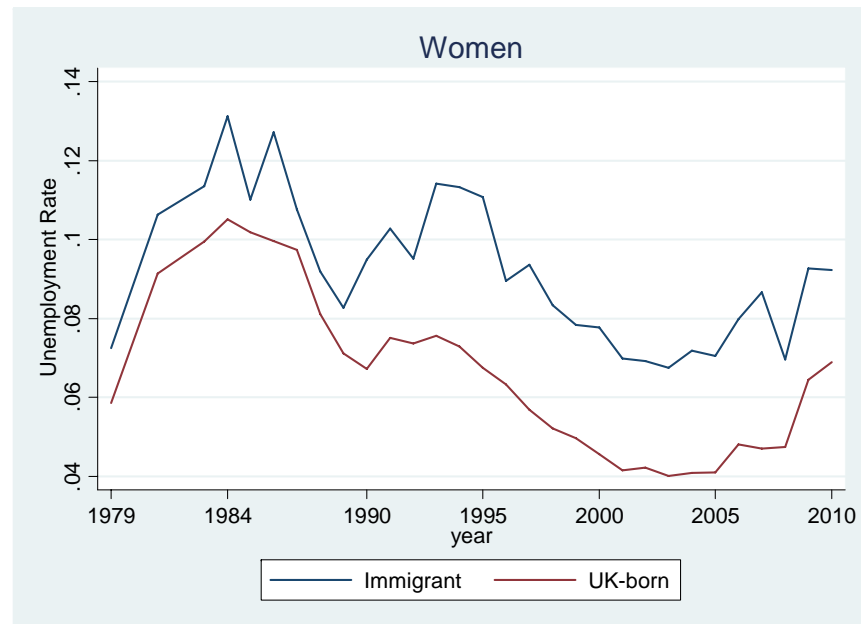
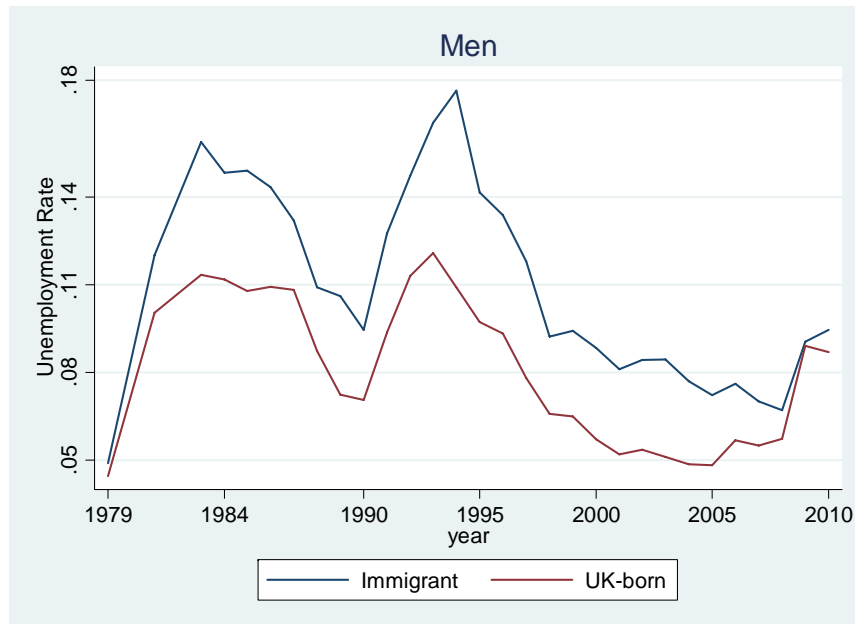


Recent Stock



Source: Labour Force Survey

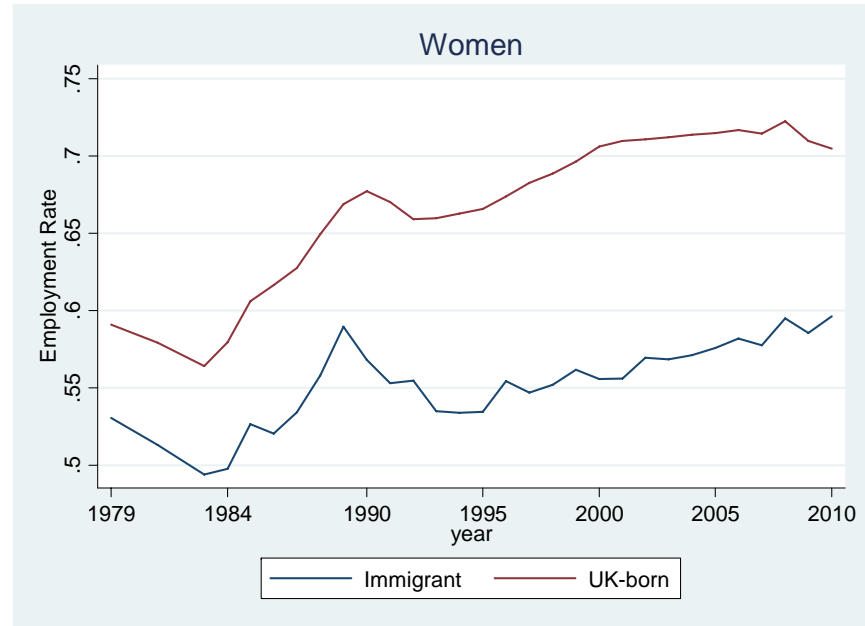
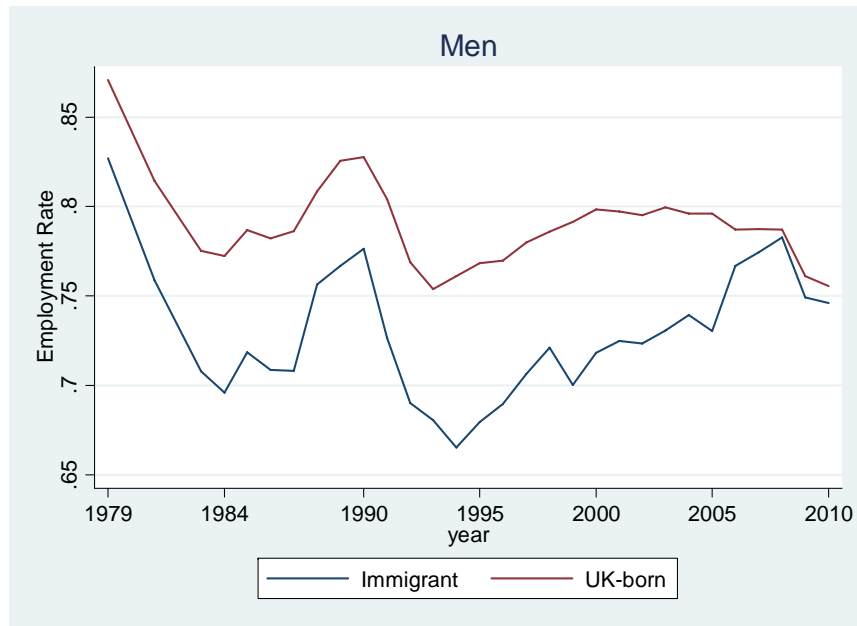
In the past immigrants much more vulnerable to economic cycle. Does not appear to be the case this time



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Why?

Immigrants are (even) more skilled relative to UK-born this time round - though this means gap should be positive (and isn't)

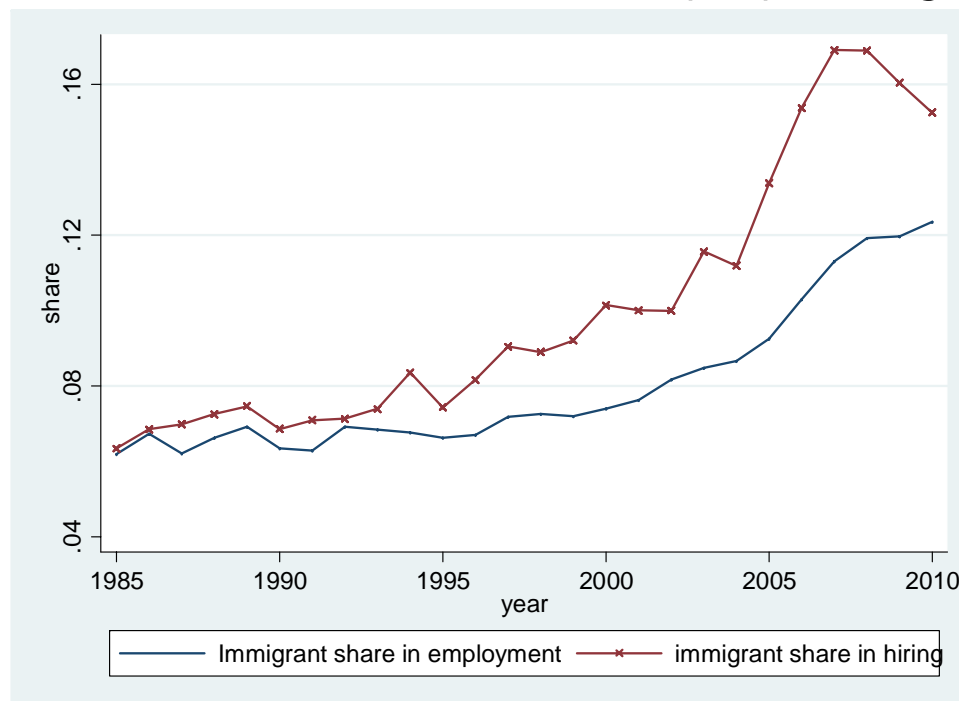


(Male) employment rate converged just prior to last recession

However what this does **not** mean is immigrants taking all the jobs

Immigrants do not account for all new hires (but a little more than in proportion to employment share – because younger & more skilled).

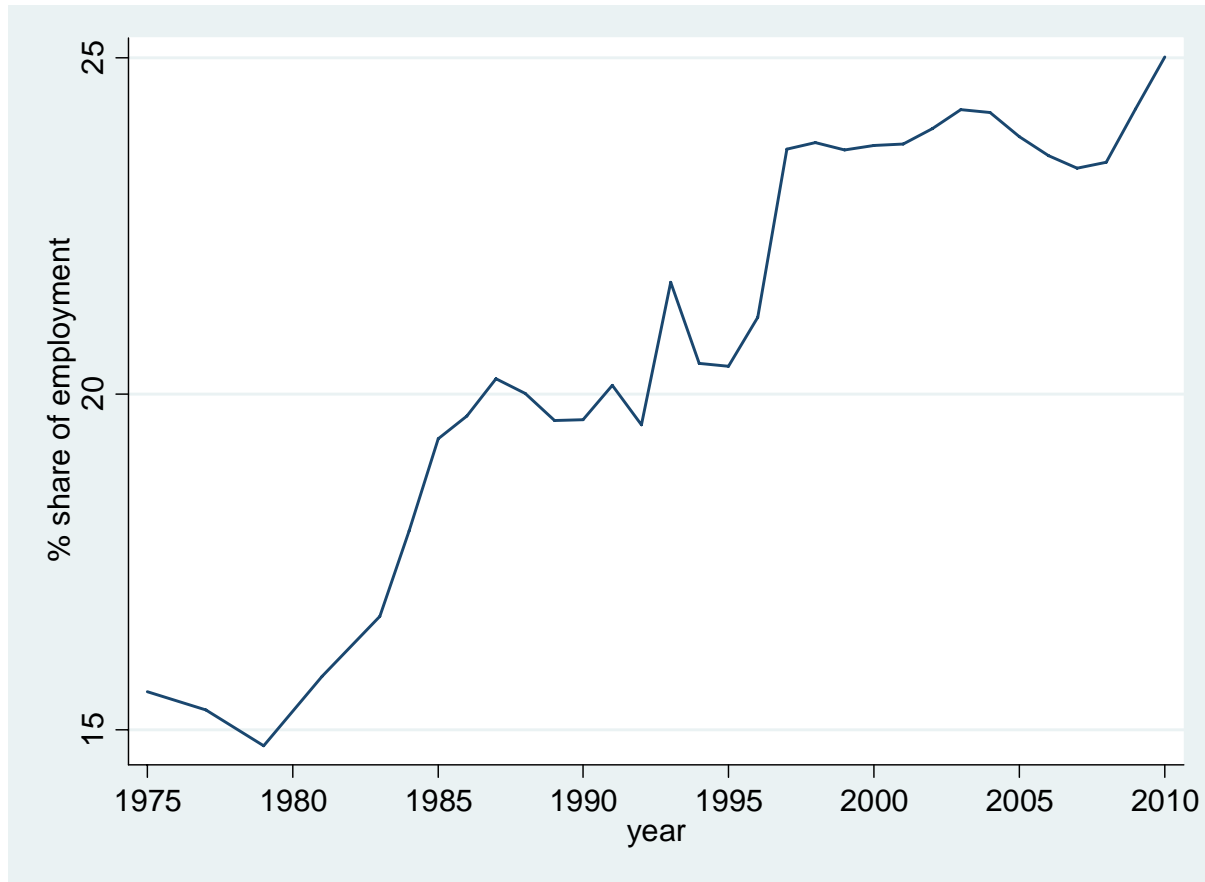
Rising immigrant and static UK-born populations explain why rise in (net) stock is accounted for mostly by immigrants



Job types

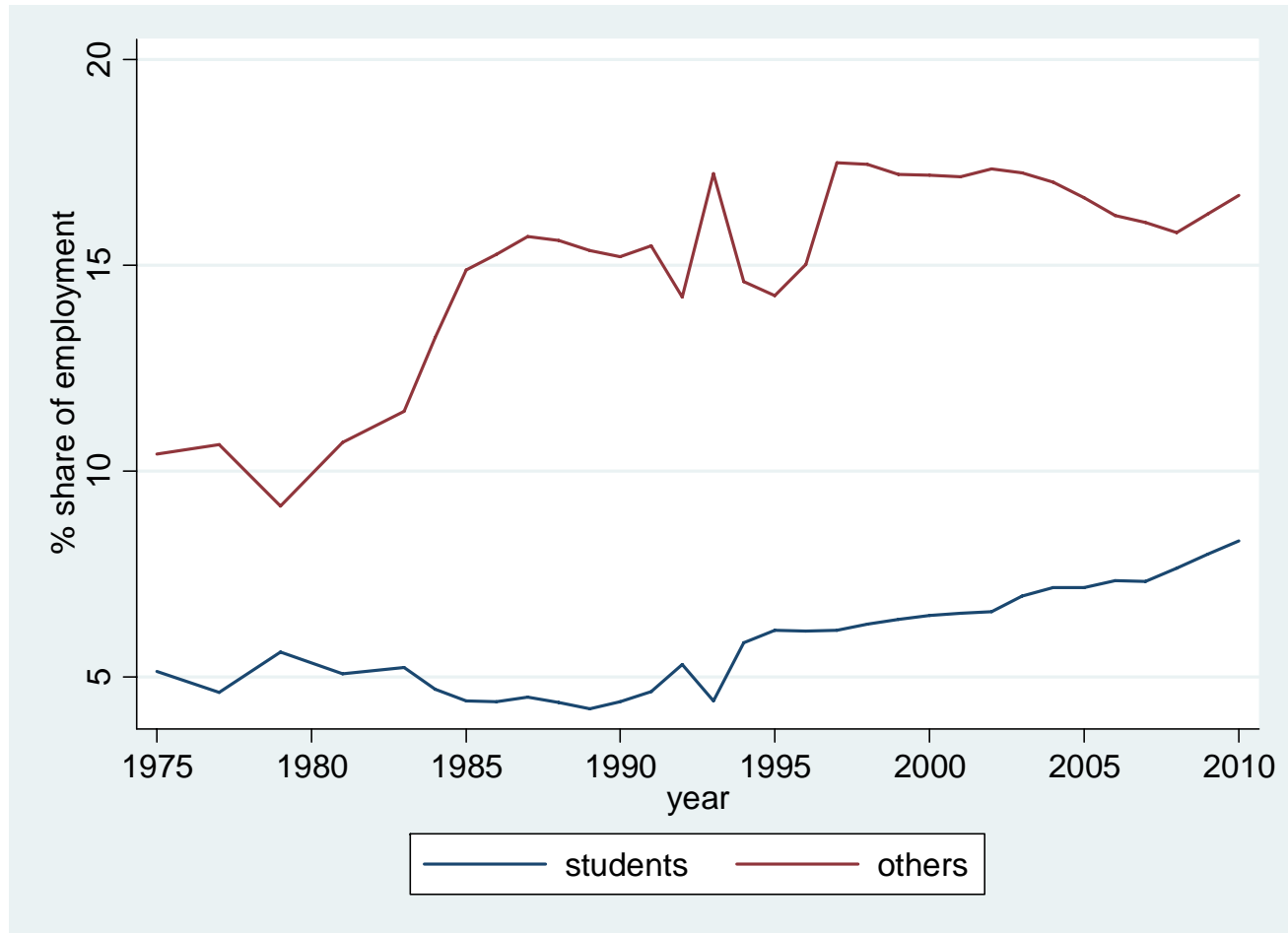
Any changes in forms of working ?

Part-time work has been rising (for a long time)

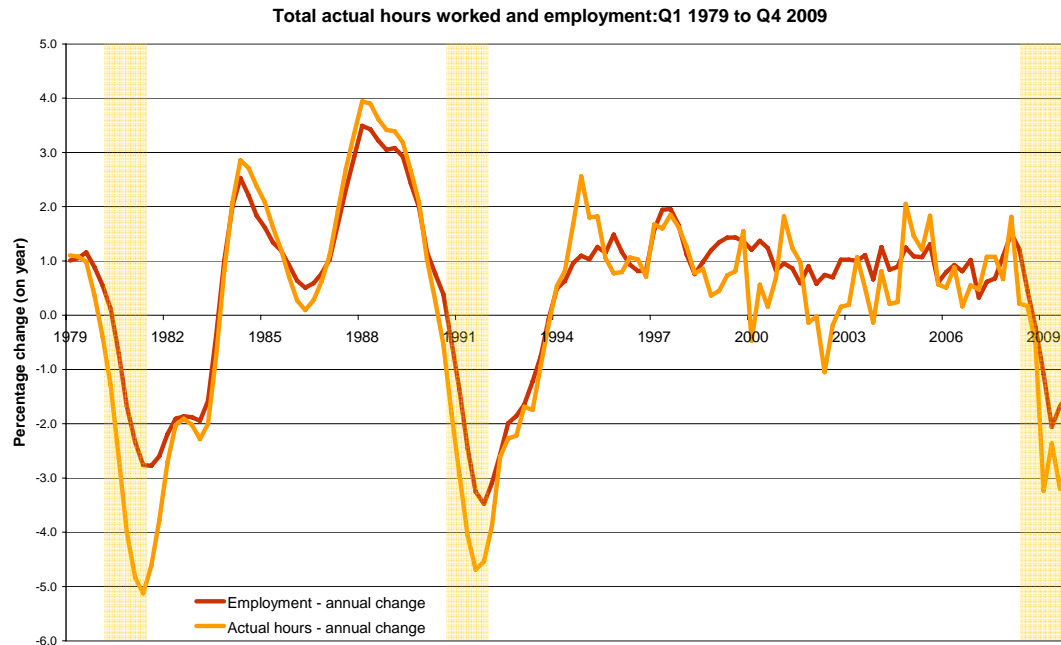


But it usually does during a recession
(as firms adopt short-time working or are reluctant to hire full-time)

Much of recent rise driven by students working part-time



Annual percentage change in employment and hours 1979-2009

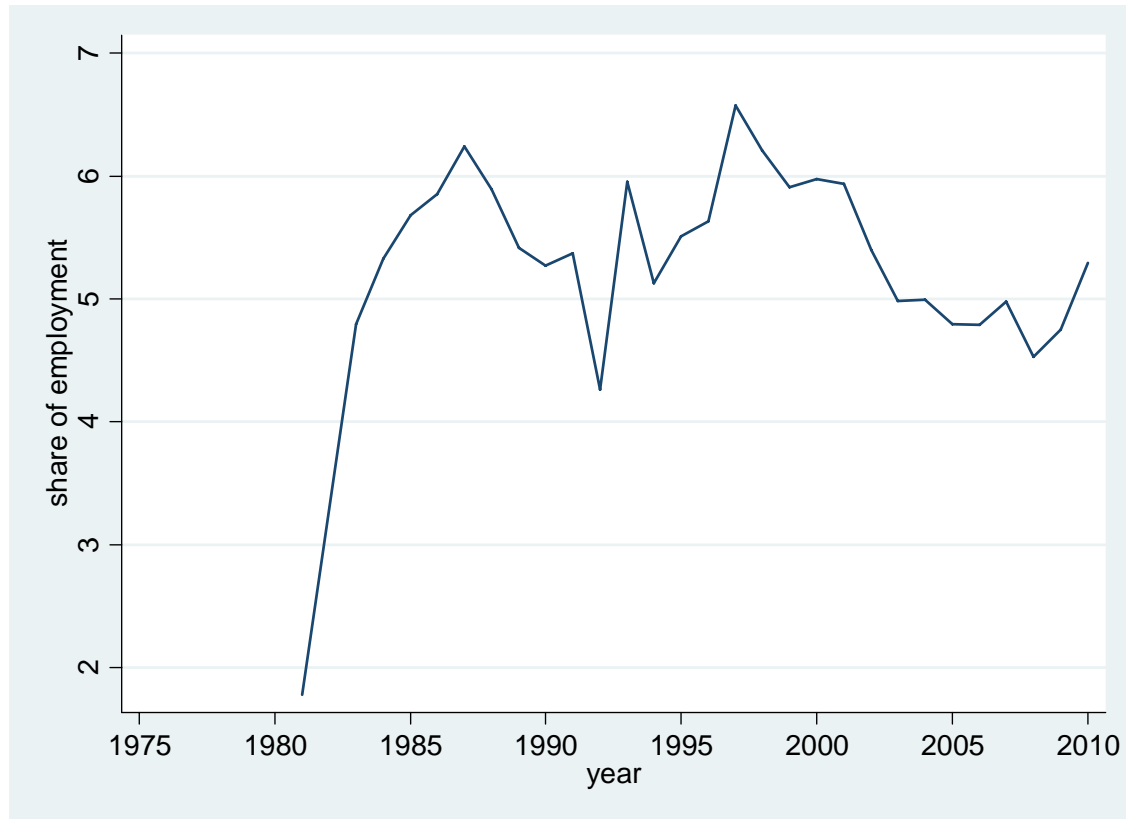


Source: LFS, ONS.

Hours did fall in this recession, by around 2%, but less so than in the last two recessions, especially during the 1980s when the government did subsidise short-time working in many major manufacturing plants and hours fell by around 4%.

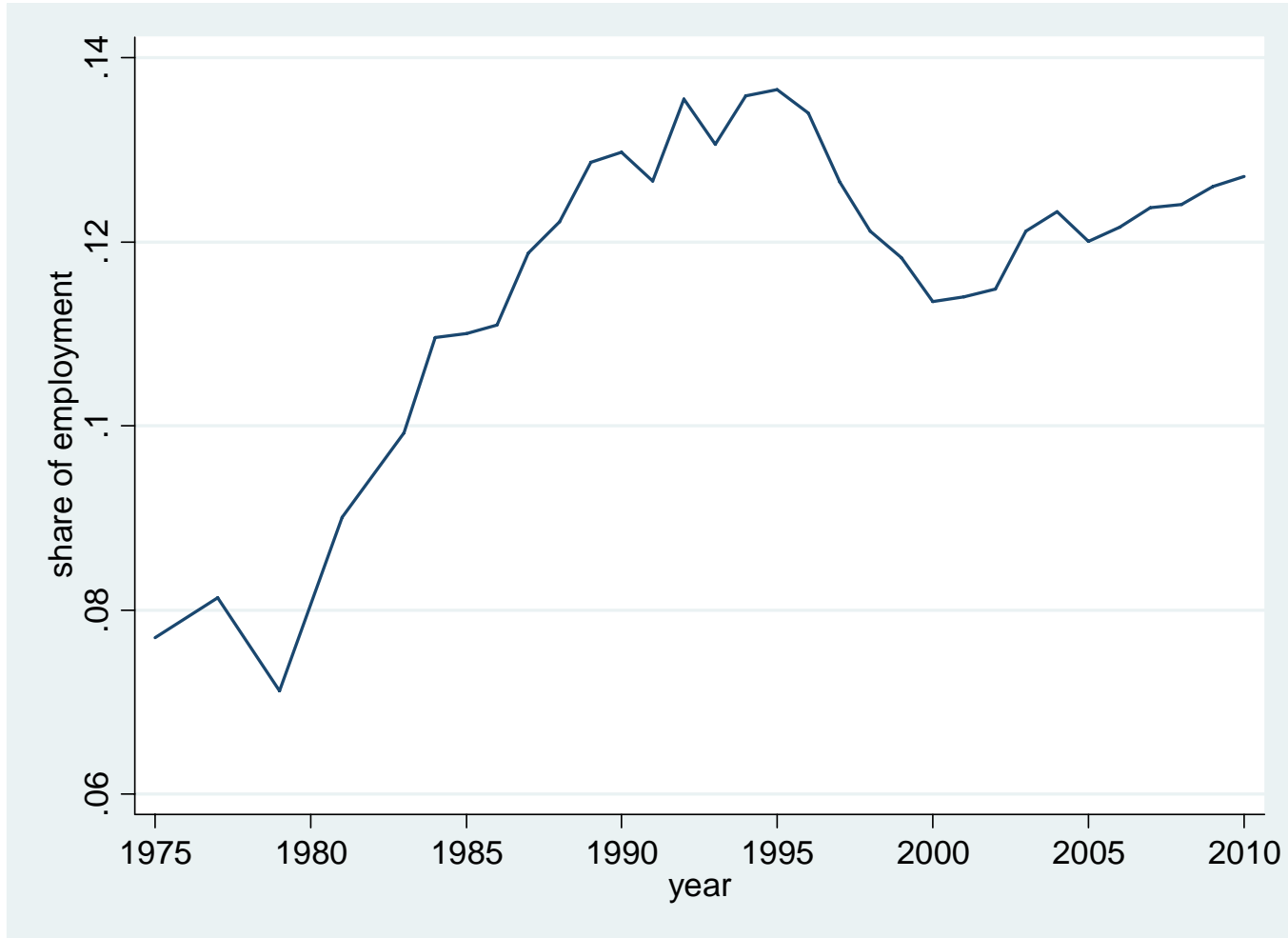
So hours not doing much to help explain

Little change in share of temporary jobs

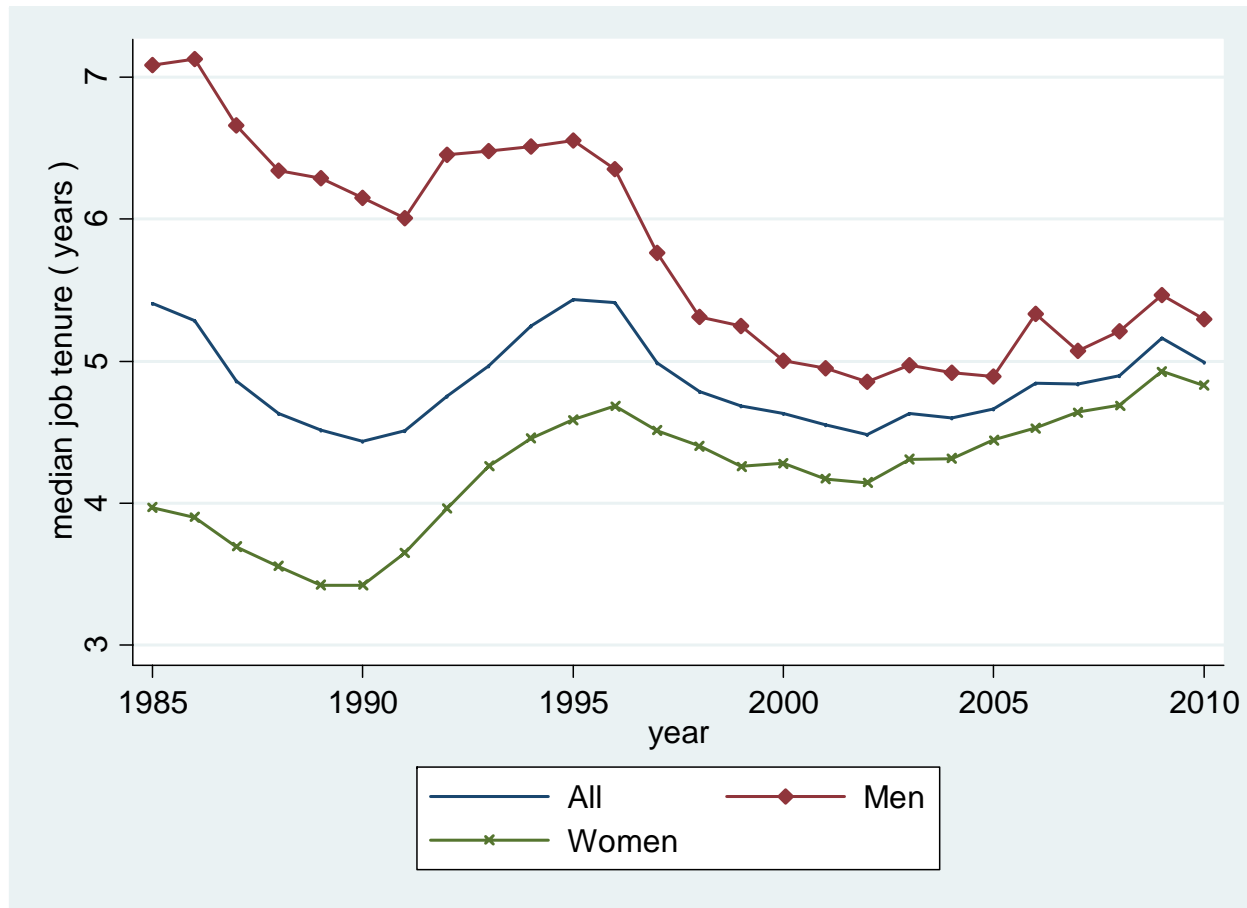


(again temporary working goes up at end of a recession)

Self-employment share rising over last 10 years – but not at 1990s peak



Job Stability

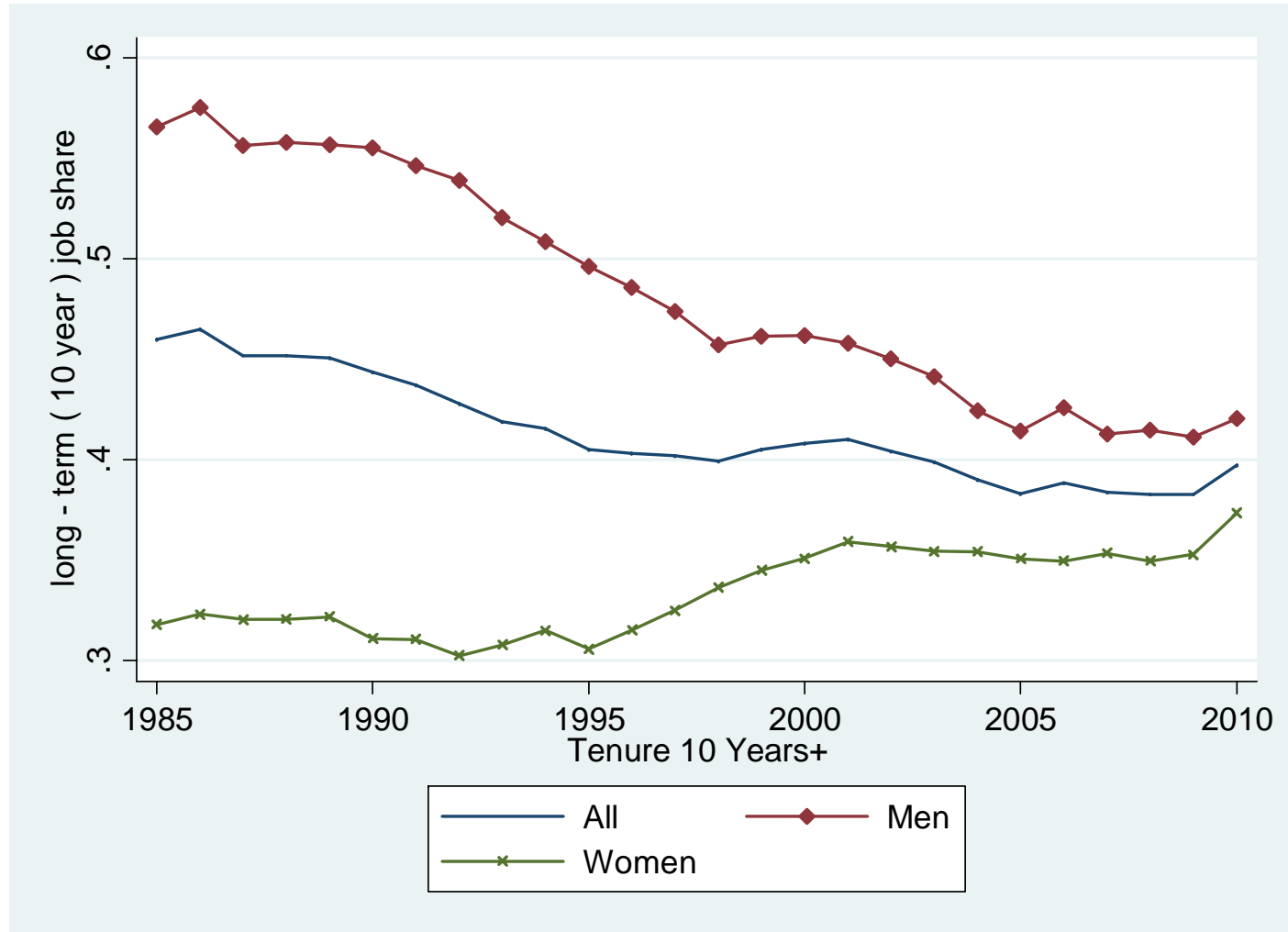


Average (median) job tenure is rather stable (subject to cycle – falls in good times),
but this obscures contrasting performance by gender

Share of short-term jobs (hiring) is low, but not unusual at this stage in cycle (also partly because women staying in jobs longer)

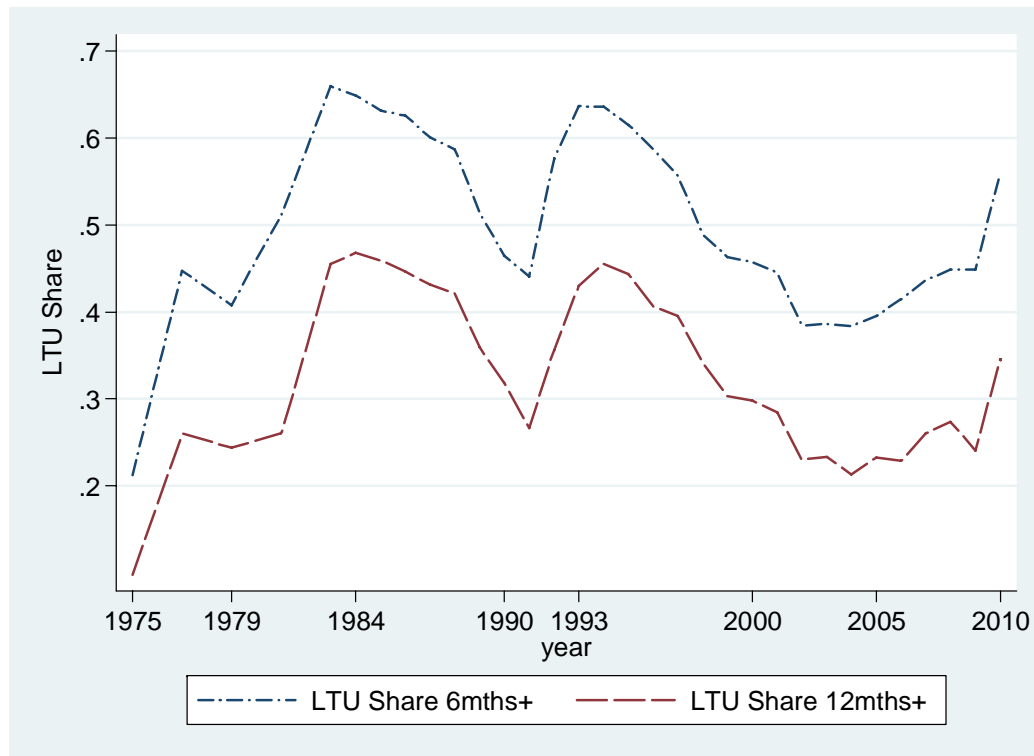


However long-term (10 year+) job share is falling, primarily among men, so this is driving job instability



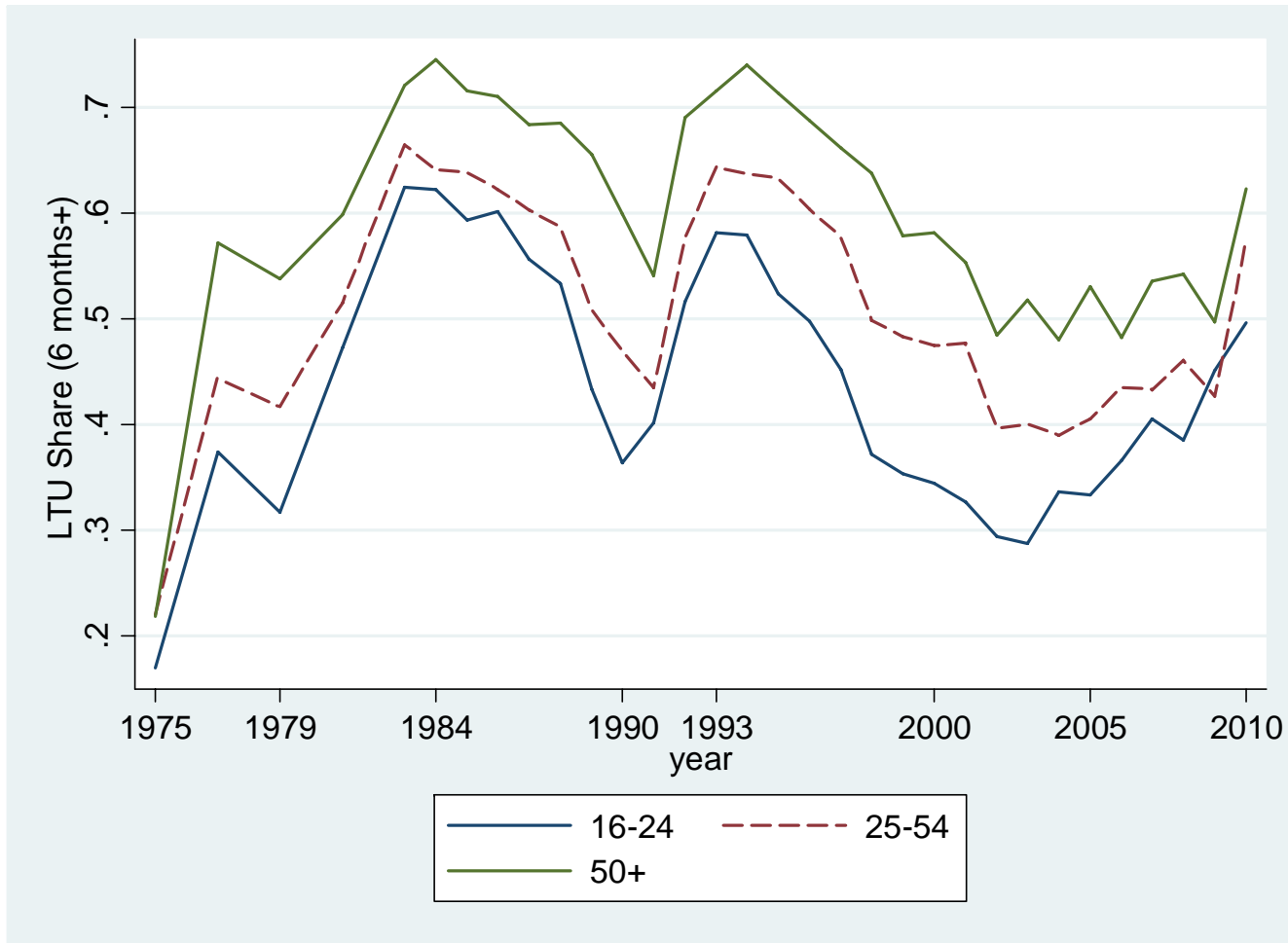
Long-Term Unemployment

Rising again (with a lag, as it does)
Still not back to previous highs



the real test of these policies is about to come, as long-term unemployment starts to build, (typically one year after the initial shock).

Worries about rising share of long-term unemployed among youth



But recent rise seems to be concentrated (one again) on older workers

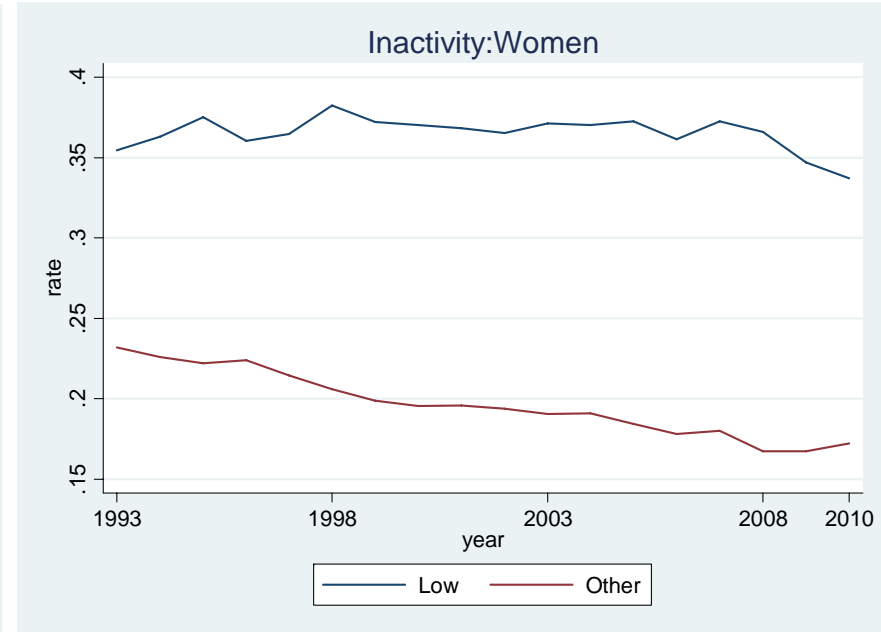
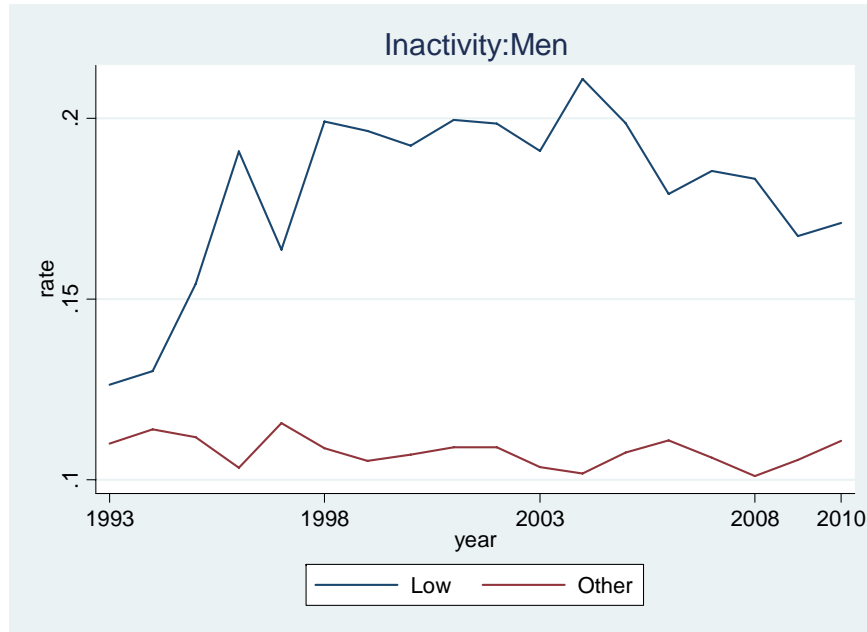
Skill

Longstanding differential performance by skill that has not diminished (much) over time and widened again in latest downturn



(Low = lowest 30% of workforce in each year)

Contrast in economic inactivity trends by skill is stark



Rise in male inactivity rate almost exclusive to less skilled (as was improvement prior to recession)

Fall in female inactivity rate (rising labour force participation) almost absent from low skilled

(Inactivity excludes students)

The composition of the (non-student) economically inactive has shifted markedly over time toward men.

The share of women in inactivity has fallen from 87% in 1979 to 61% in 2010.

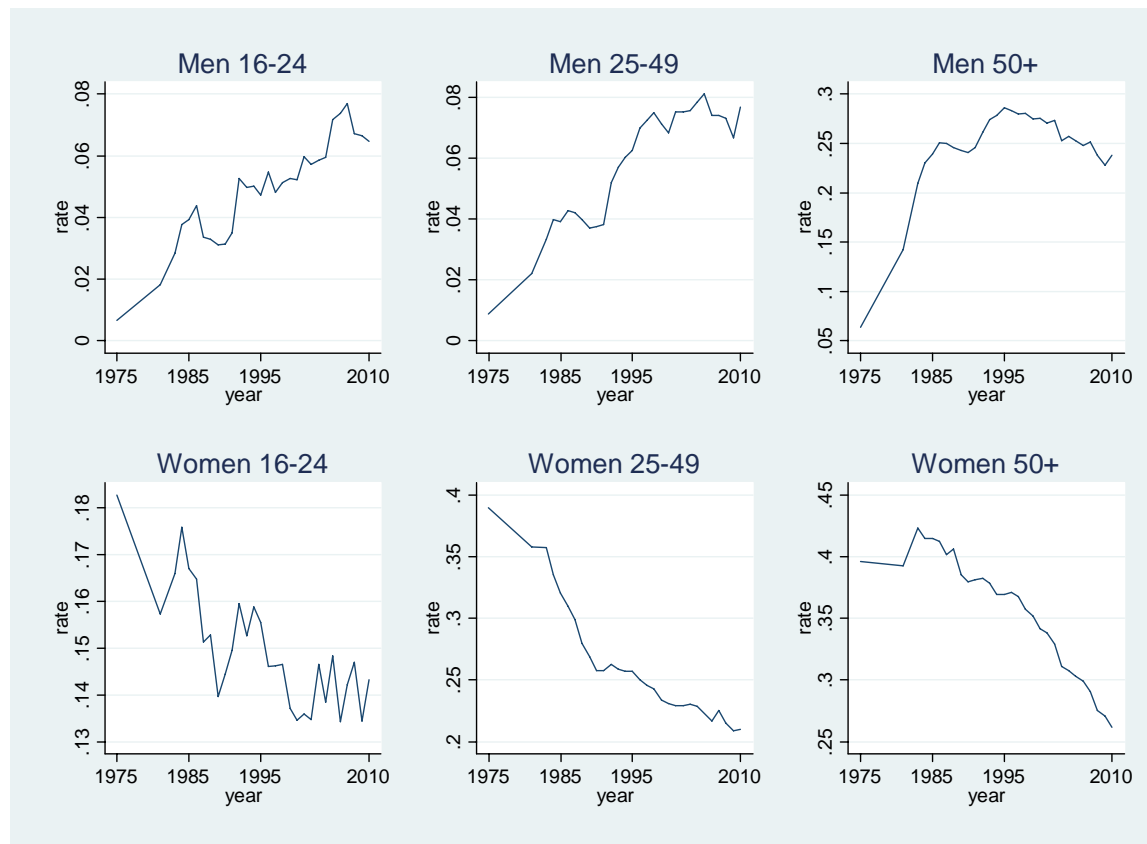
At around 2.4 million, there are still almost twice as many inactive men as unemployed men, (on the ILO/OECD definition), in the 3rd quarter of 2010.

Inactivity among men is, at best, static and remains 3 times higher than the rates observed in the 1970s.

More than half of the fall in the male unemployment rate from 1993 to 2008 can be accounted for by rising inactivity, (though much of that rise in inactivity took place in the 1990s)

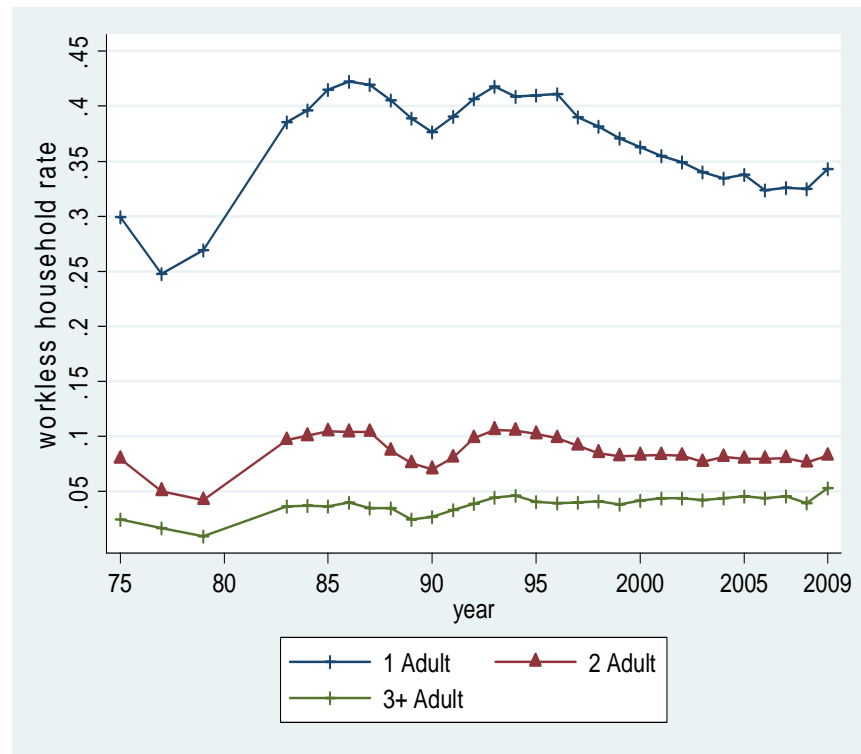
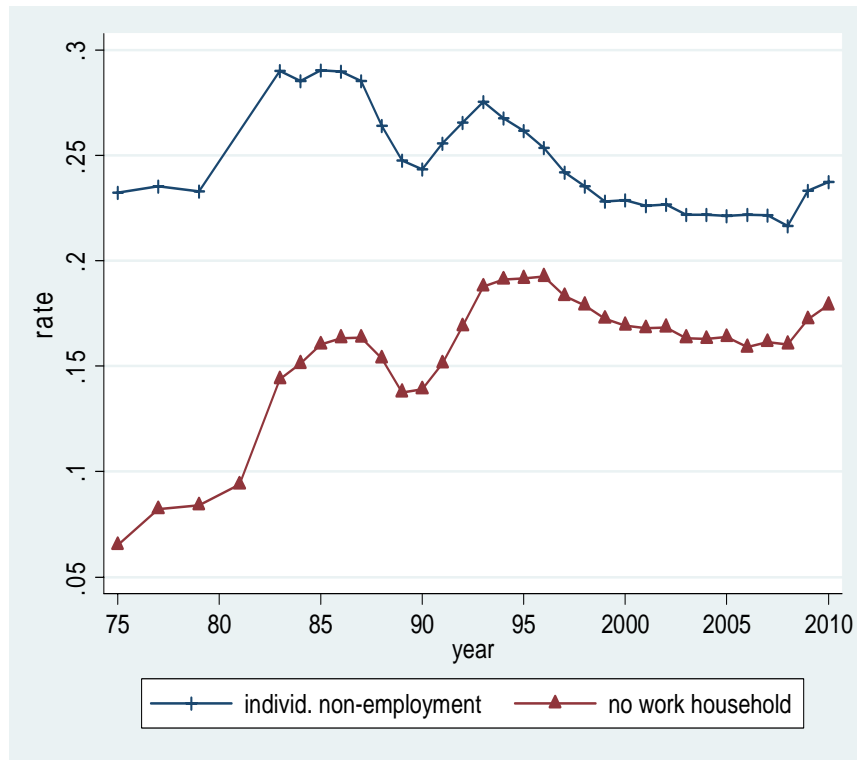
The Re-Emergence of Hysterisis?

Inactivity rates by age, gender and skill, for SOME (mainly men) have ratcheted up during past recessions and do not return to base levels in recovery

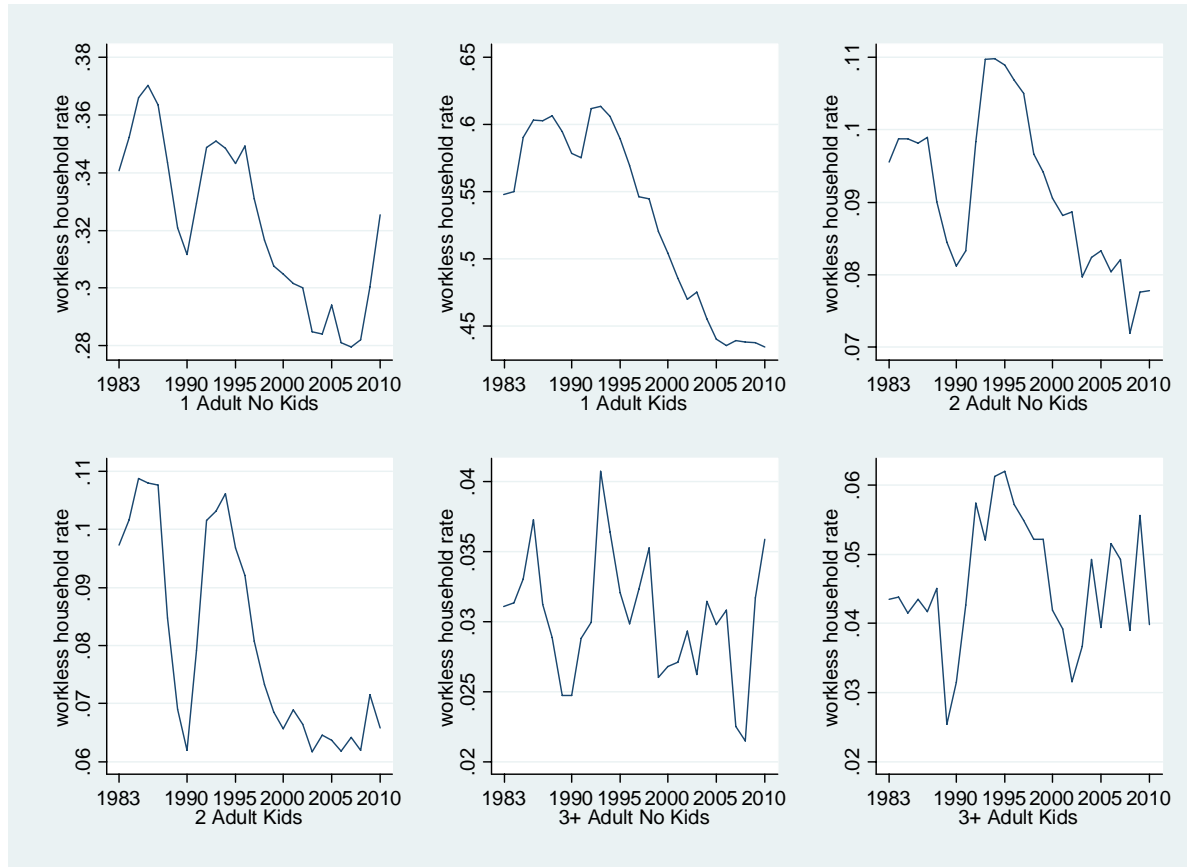


Workless Households

Progress not as good as it could have been (now gone into reverse)



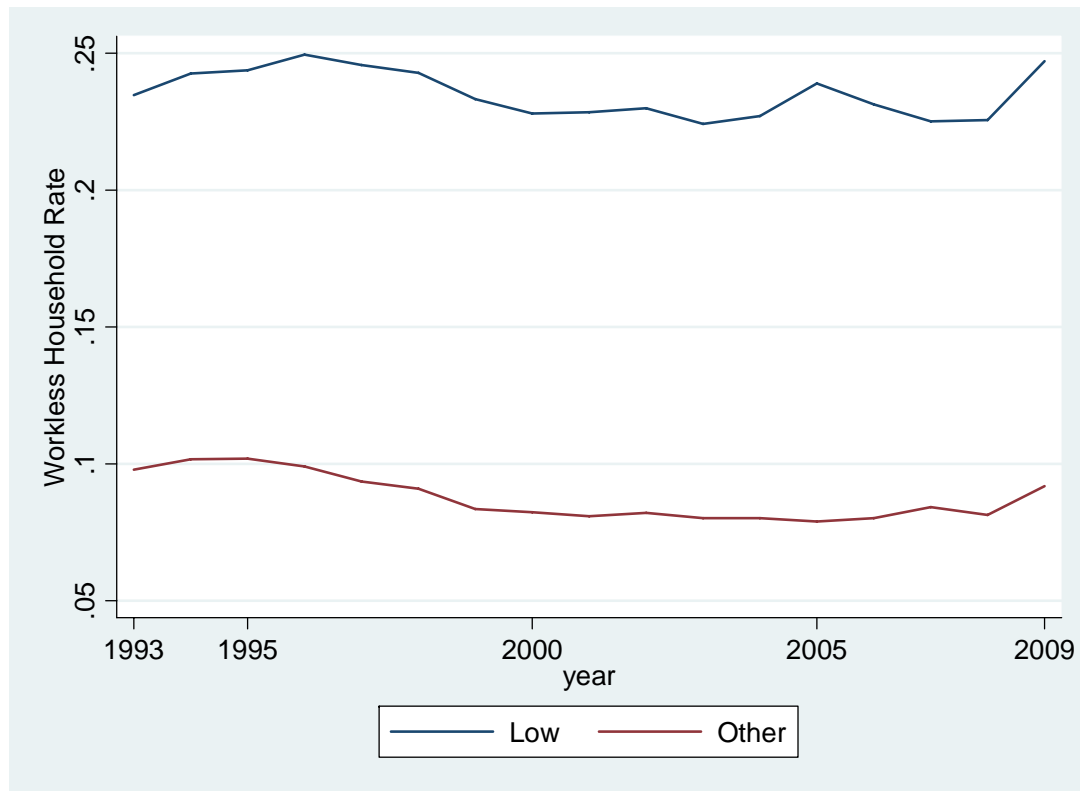
Workless Households by Household Type



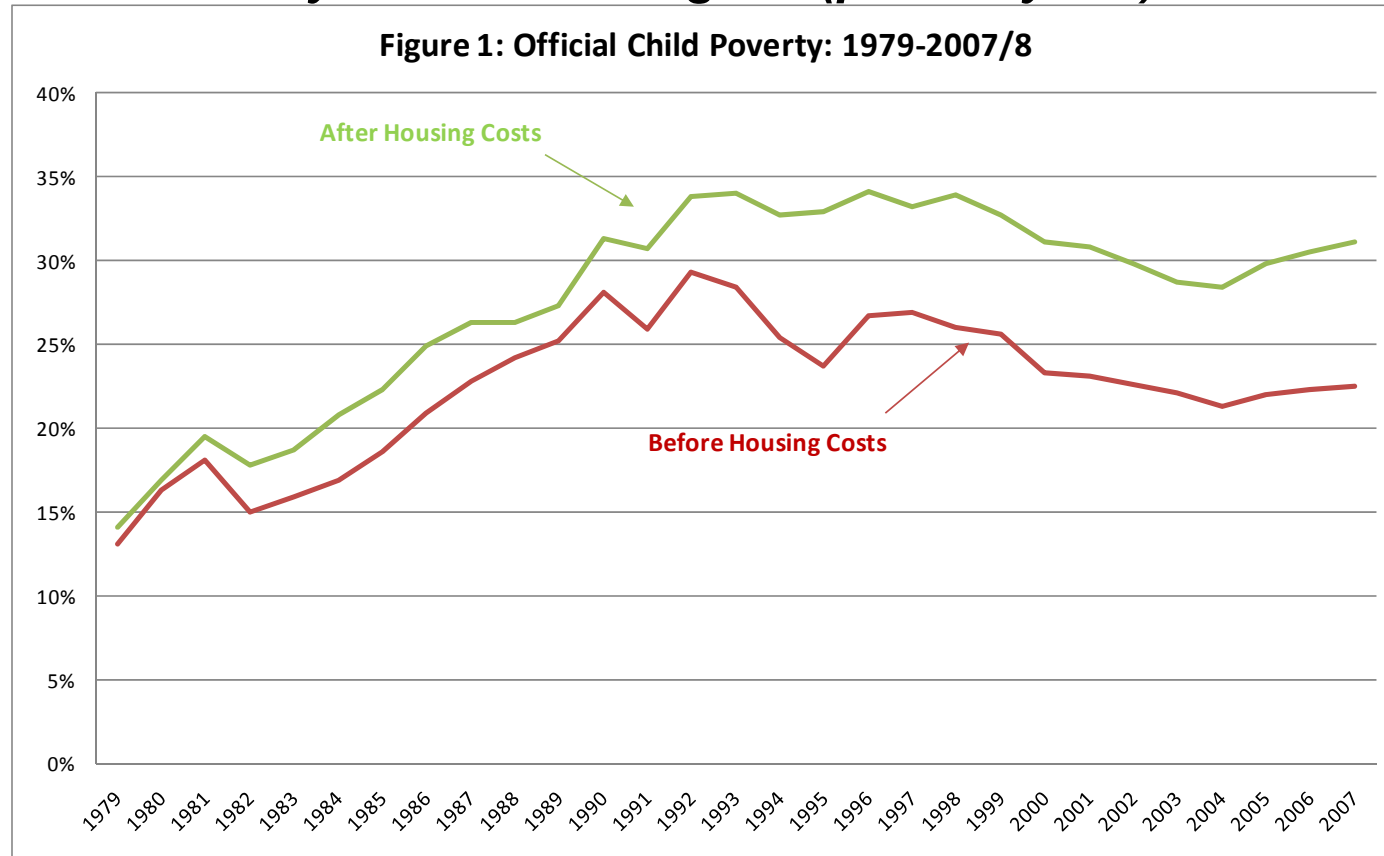
Though single parents something of a success

Single childless households less so

And a far larger share of less skilled individuals living in workless households



Child Poverty Reduction Target ? (probably not)



Source: Dickens SWoB (2010).

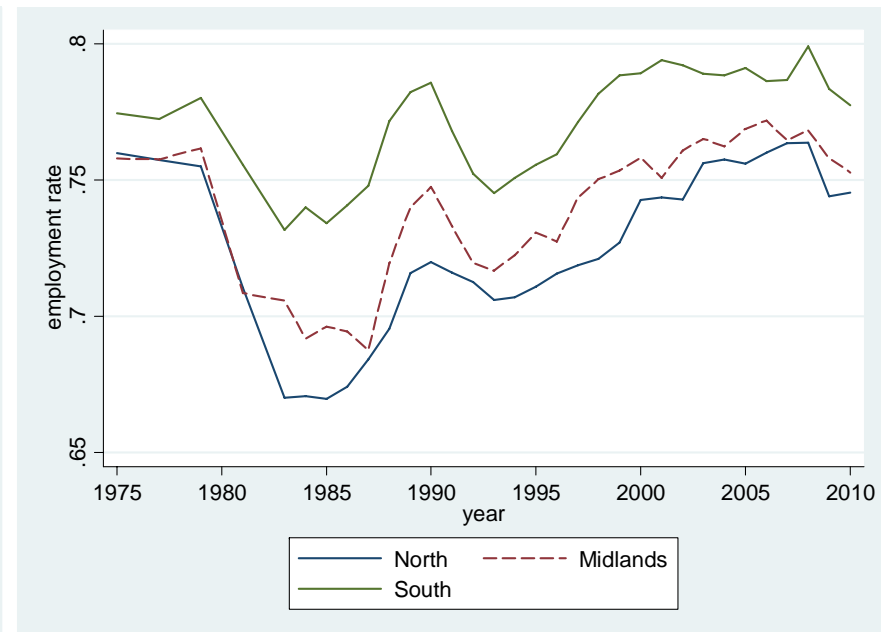
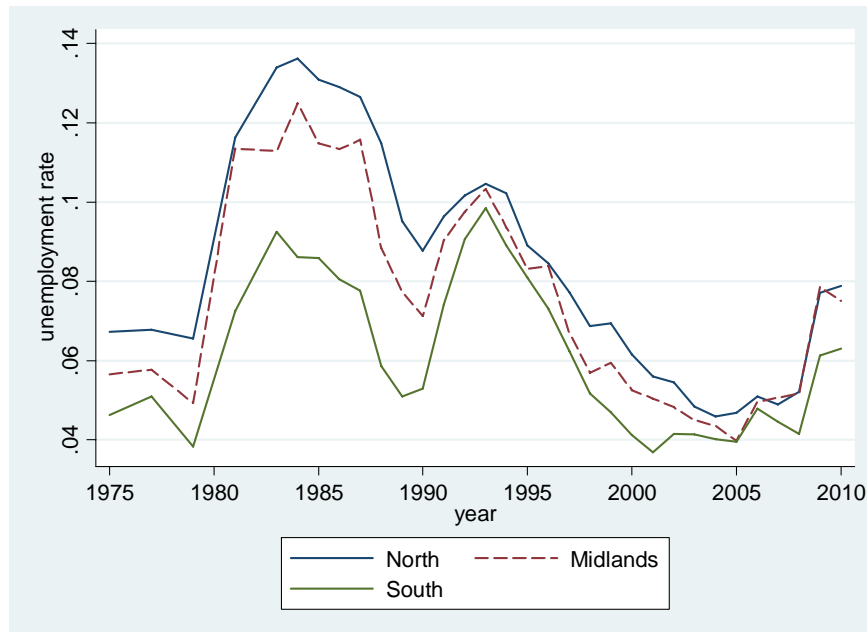
Welfare benefits underlie improvement

Regions

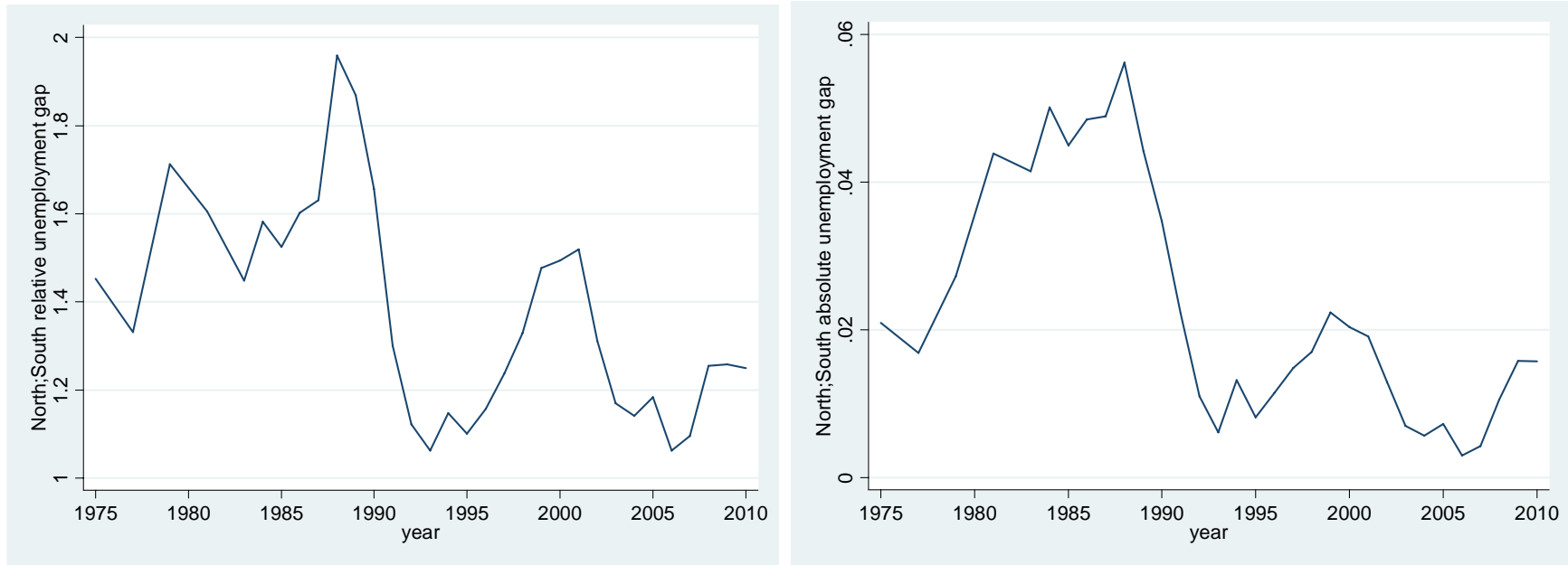
re-emergence of North-South unemployment divide in recession

- though not yet back to 1980s relativities
- but widening of broad regional differences is similar to 1980s, not 1990s (when gap narrowed)

(employment divide not changed much)



Relative & Absolute Unemployment gaps now moving together over time

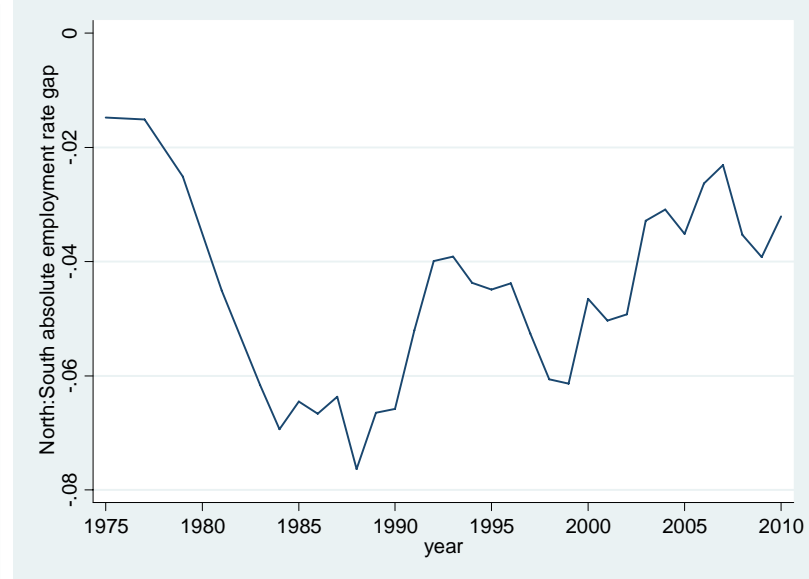
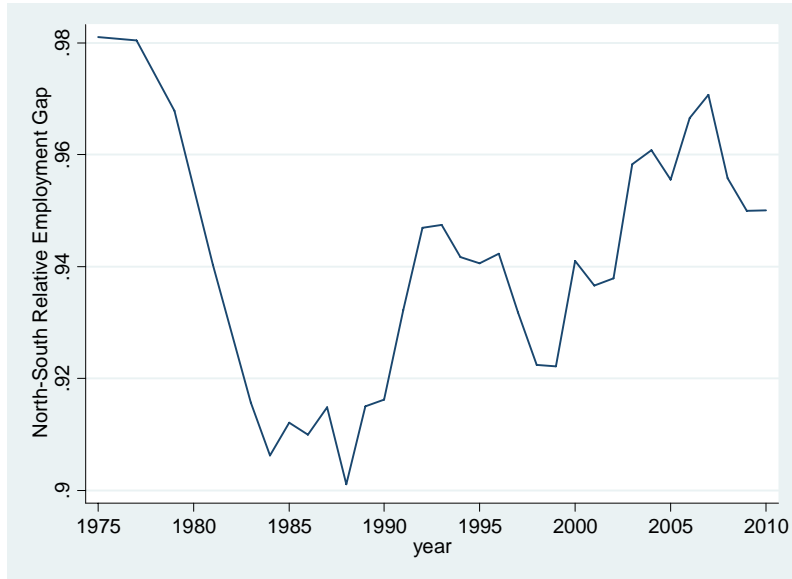


If shocks to *employment* were **evenly** distributed across regions, we would expect the absolute gap in unemployment rates to be broadly the same in bad times as in good times, (see Jackman and Savouri (1999). Eg 5% shock to employment rate ($N=80$ $S=90$ So $U_n=20$ $U_s=10$ gives $N=76$ $S=85.5$ so $U_n=24$ & $U_s=14.5$ & absolute gap remains at approx. 10 while relative gap narrows)

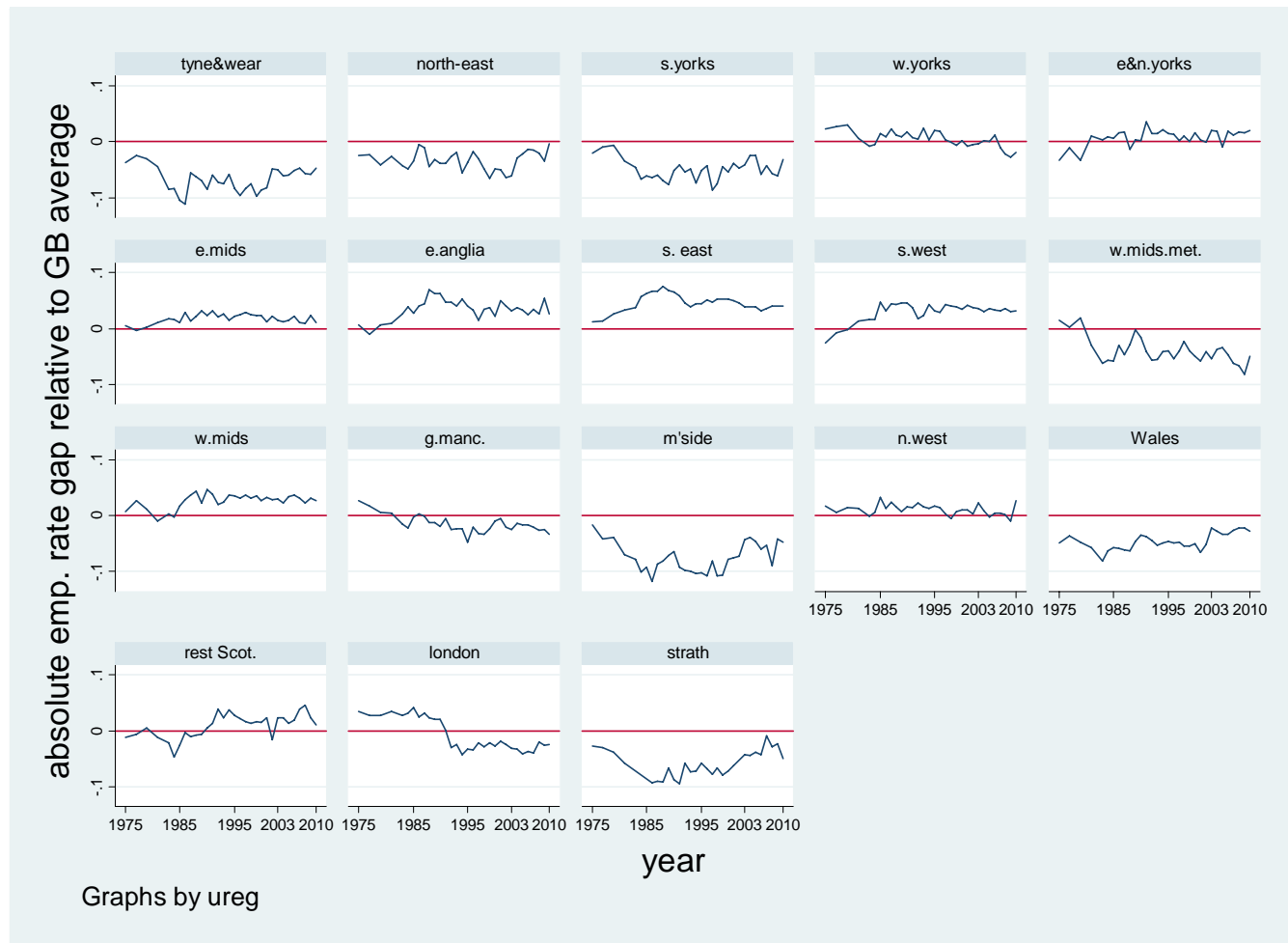
Fall in manufacturing means regional economies more balanced?

The fact that the percentage fall in the employment rate has been greater in the North and Midlands this time round (and the absolute unemployment gap risen more) indicates that the shock of the recession was again not neutral across regions – though again not as bad as 1980s

Employment gaps similar story (recessions widen broad regional gaps)

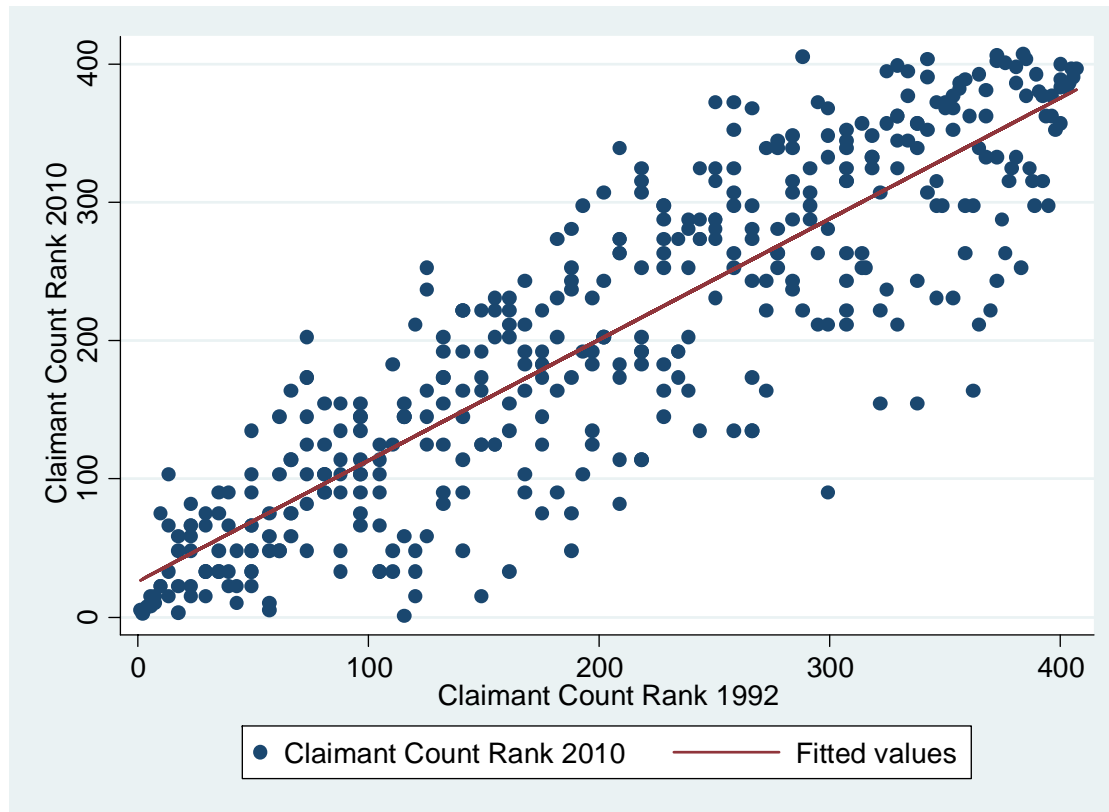


On a more disaggregated level



Not much change in regional performance rankings

So persistence in Local Area Performance is wearily familiar



$$\hat{Rank}_{2010} = 0.87 * \hat{Rank}_{1992}$$

$$R^2 = 0.76$$

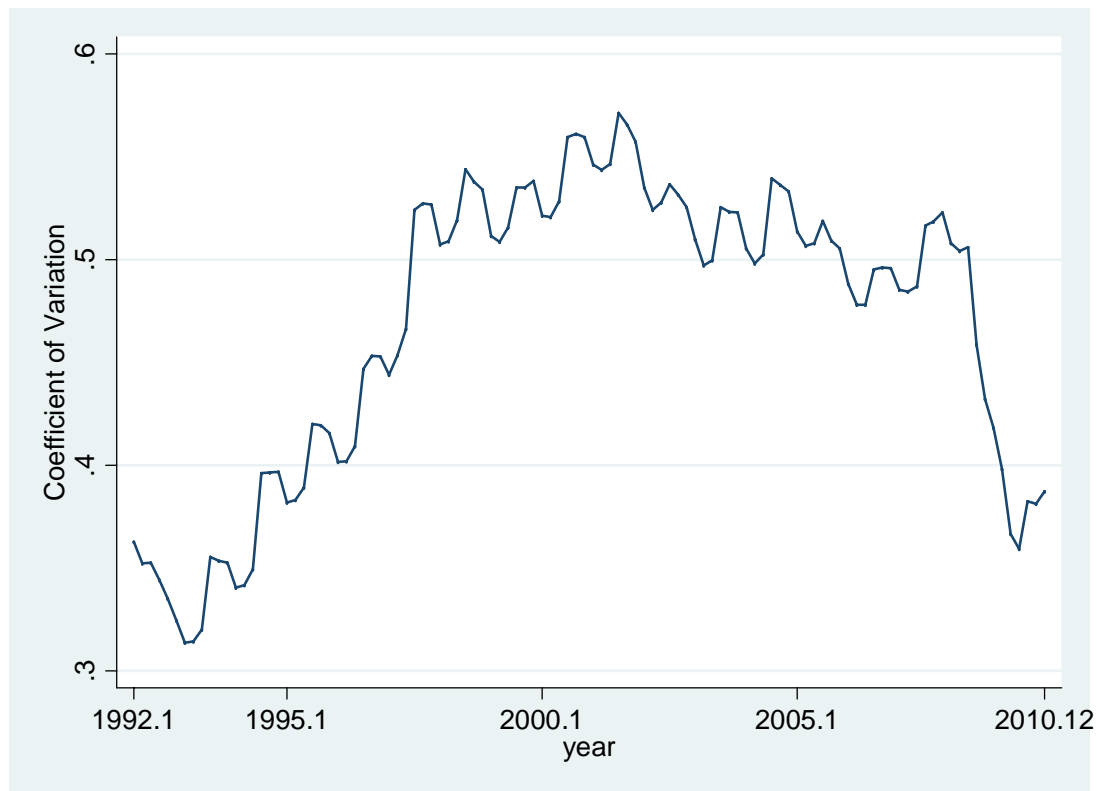
N=406

At local level dispersion of unemployment rate – at local authority level

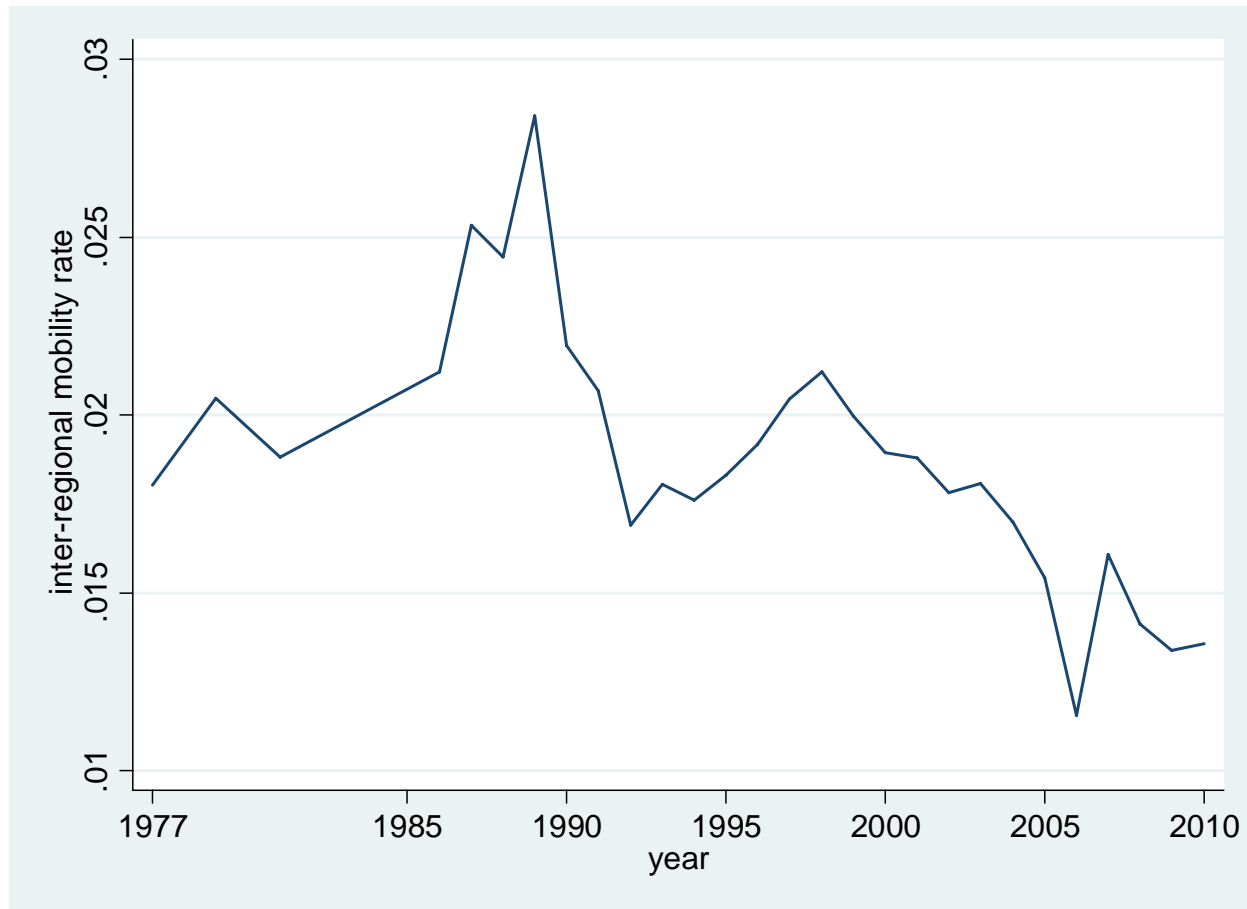
a) goes down at onset of recession

b) is higher in recovery period

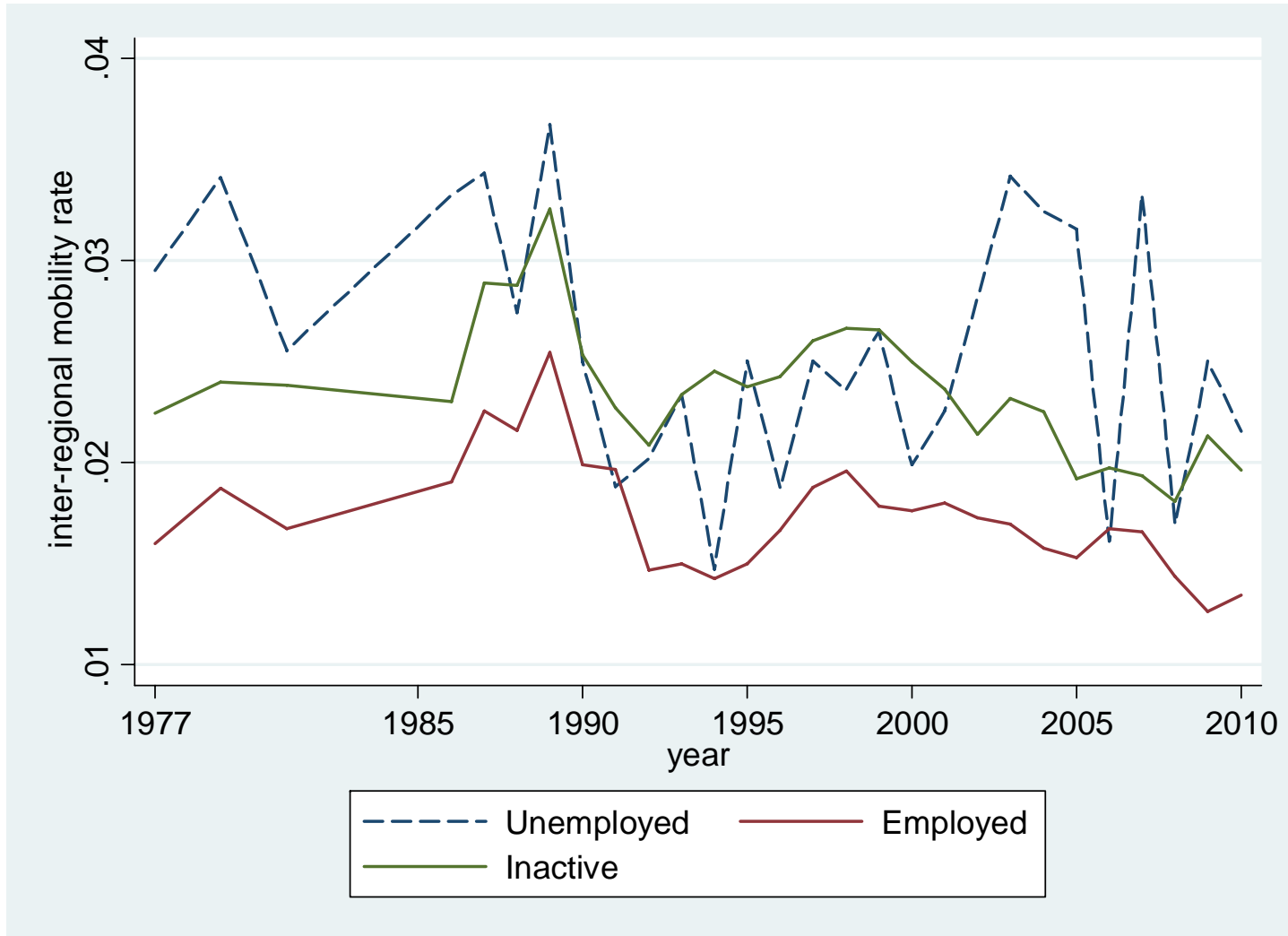
– again indicative of unbalanced growth



And not moving as much as we did



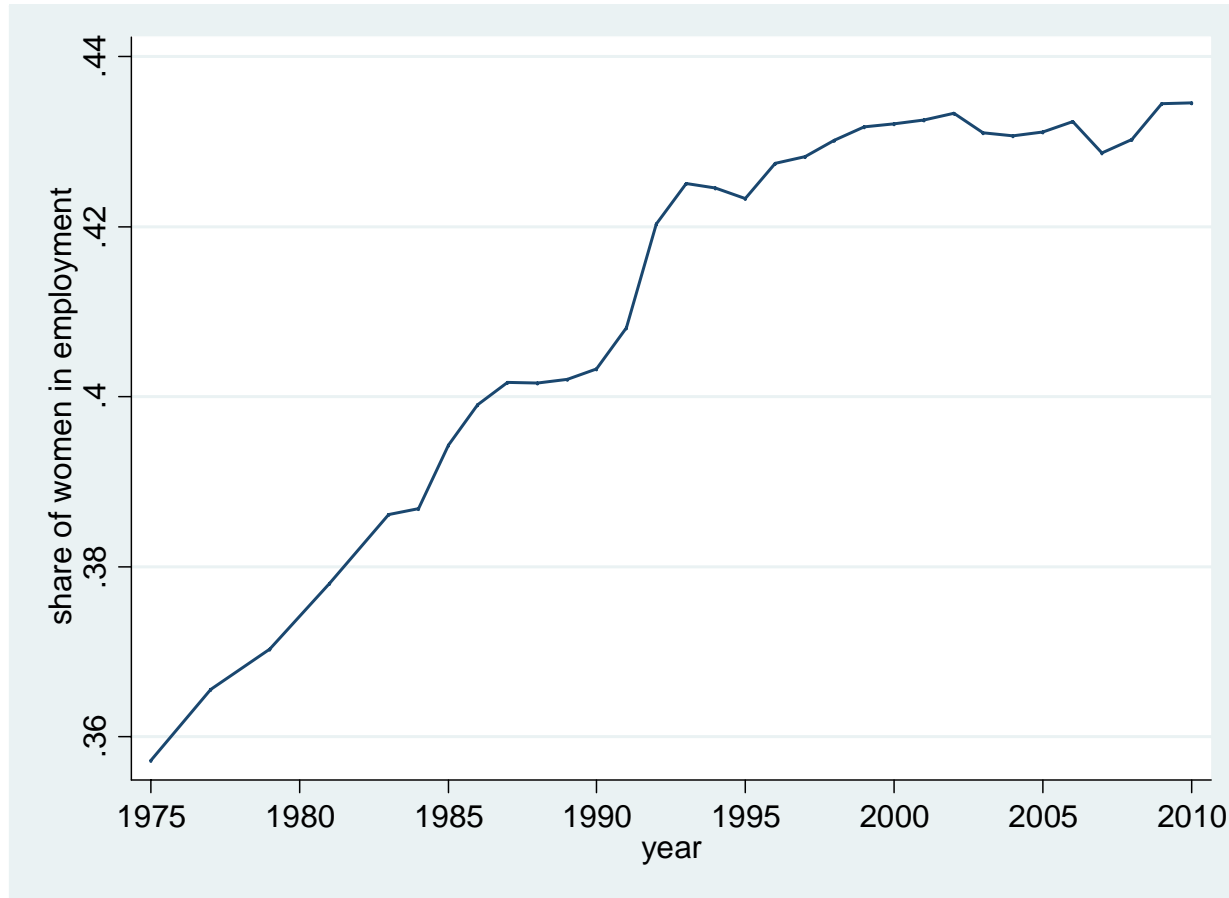
(Mobility across 18 broad regions, working age, status one year ago)



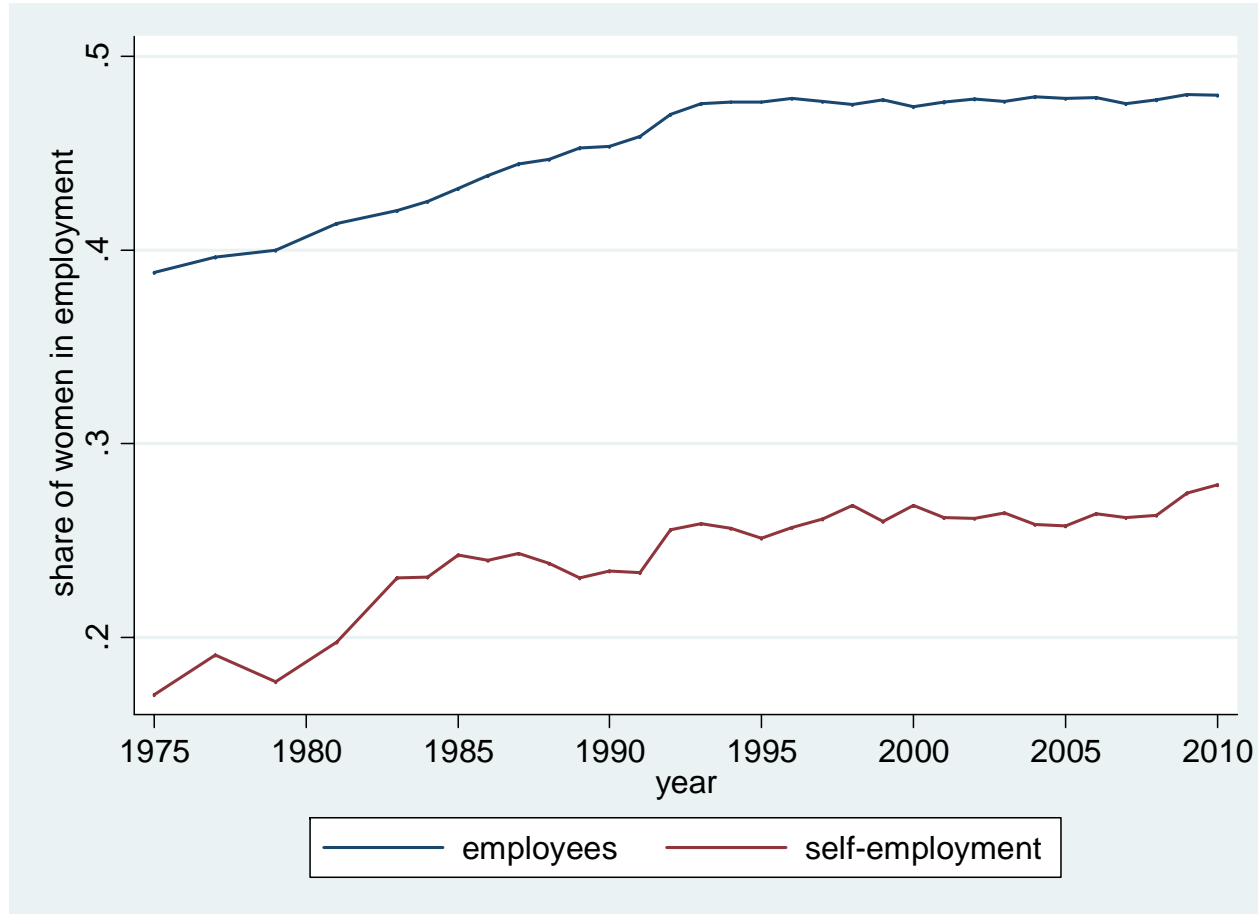
But unemployed still more likely to move than employed
(though employed drive aggregate patterns)

Gender

The world of work is increasingly feminine
(women fared better (less badly) in the last 3 recessions)



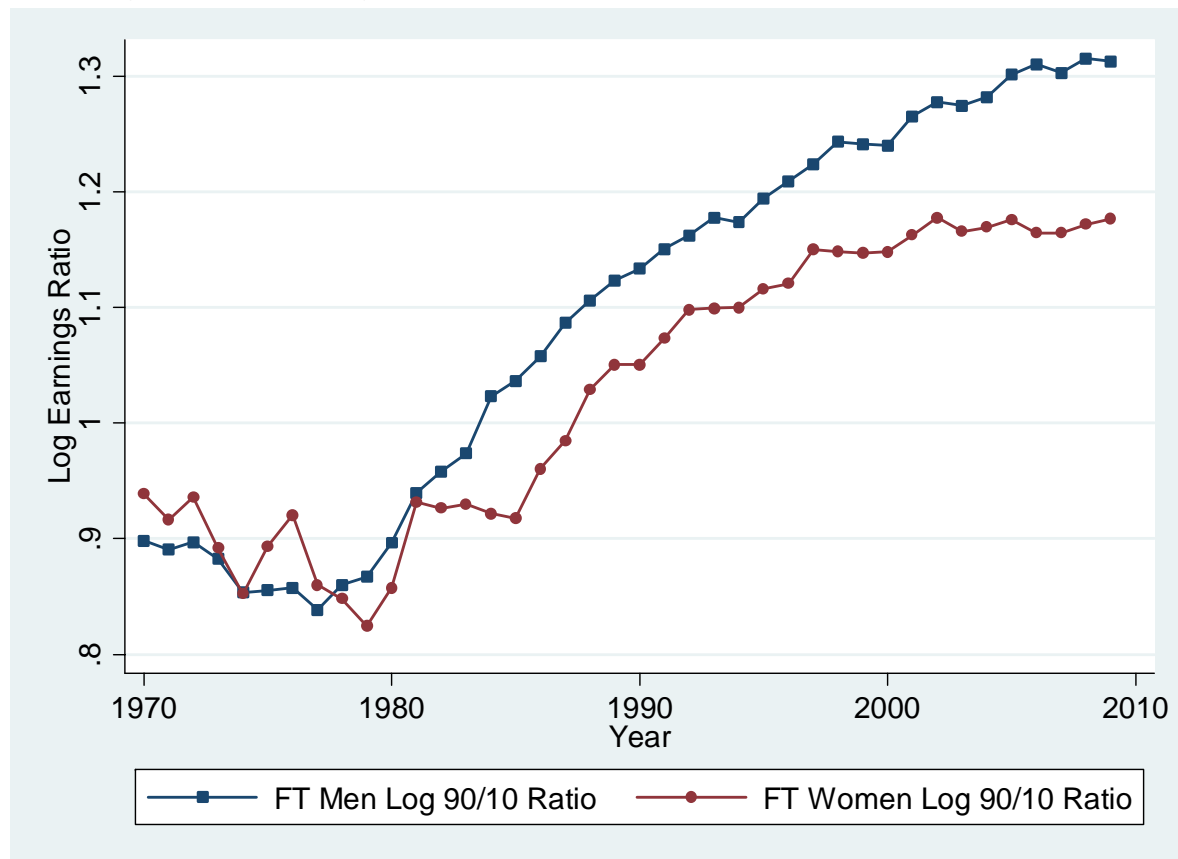
Long since reached near parity among employees, lag behind in self-employment



Inequality

Is still rising (at the top)

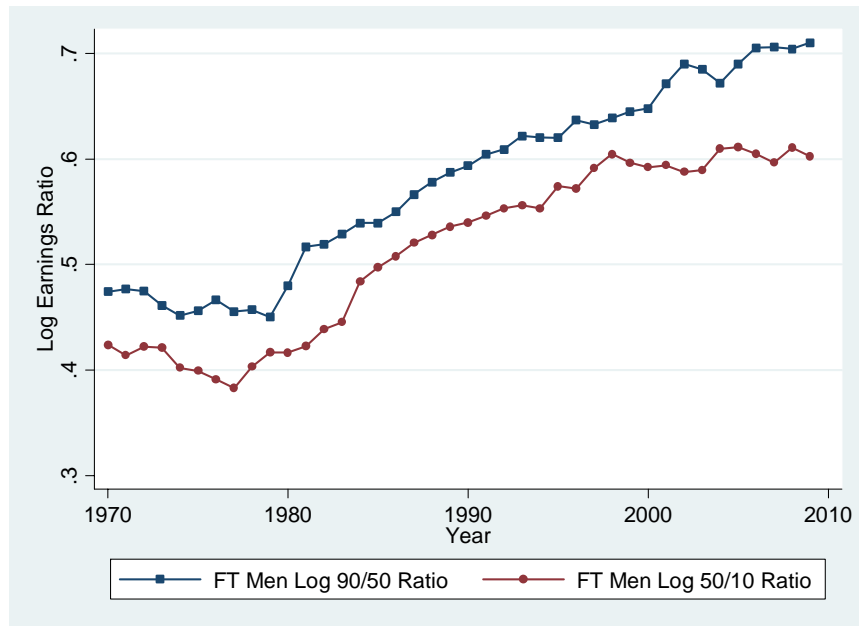
90-10 Log weekly earnings ratios, full-time employees, men and women, 1970-2009



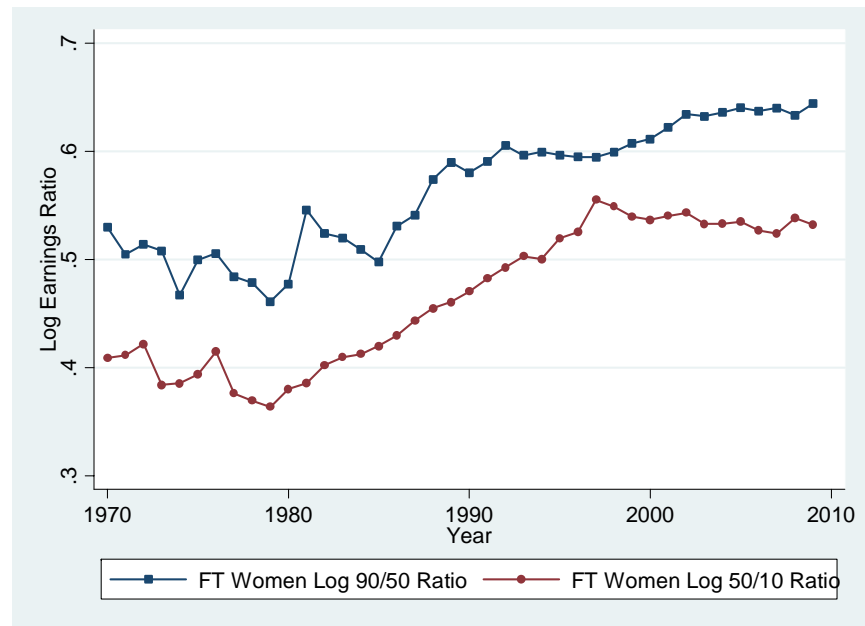
Source: S. Machin (SWOB 2011) 1968-1996 New Earnings Survey (NES) and 1997-2009 ASHE

Upper tail (90-50 log earnings ratio) and lower tail (50-10 log earnings ratio) inequality, full-time, 1970-2009

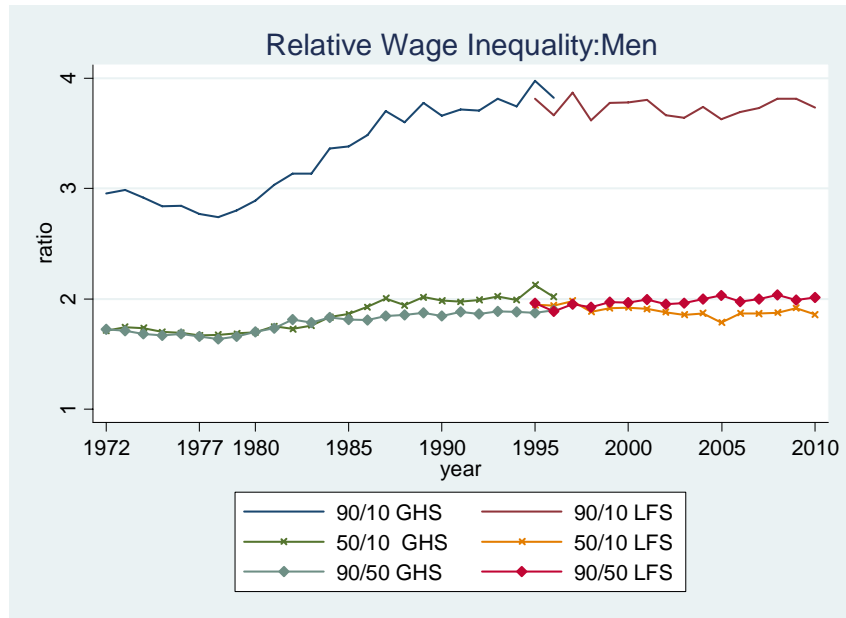
a) Men



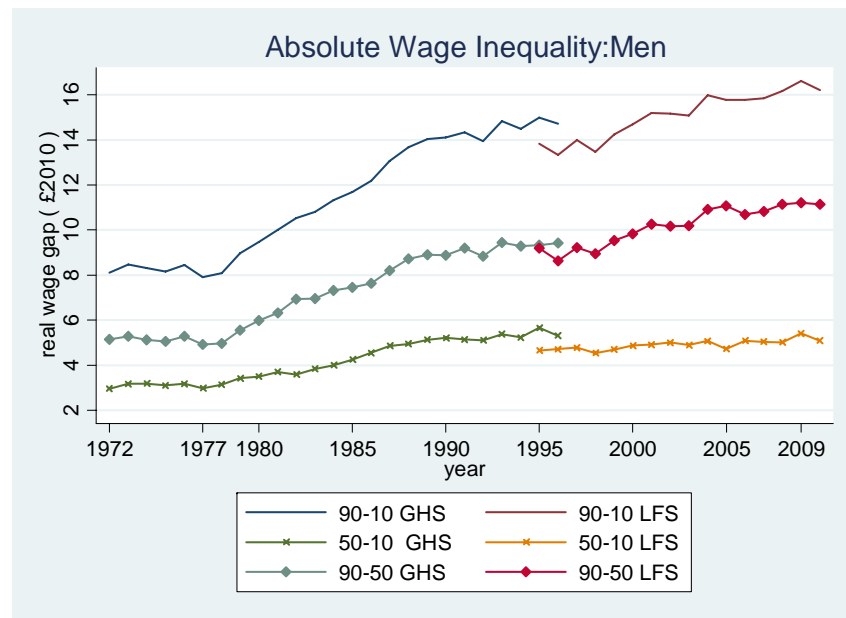
b) Women



a) Relative

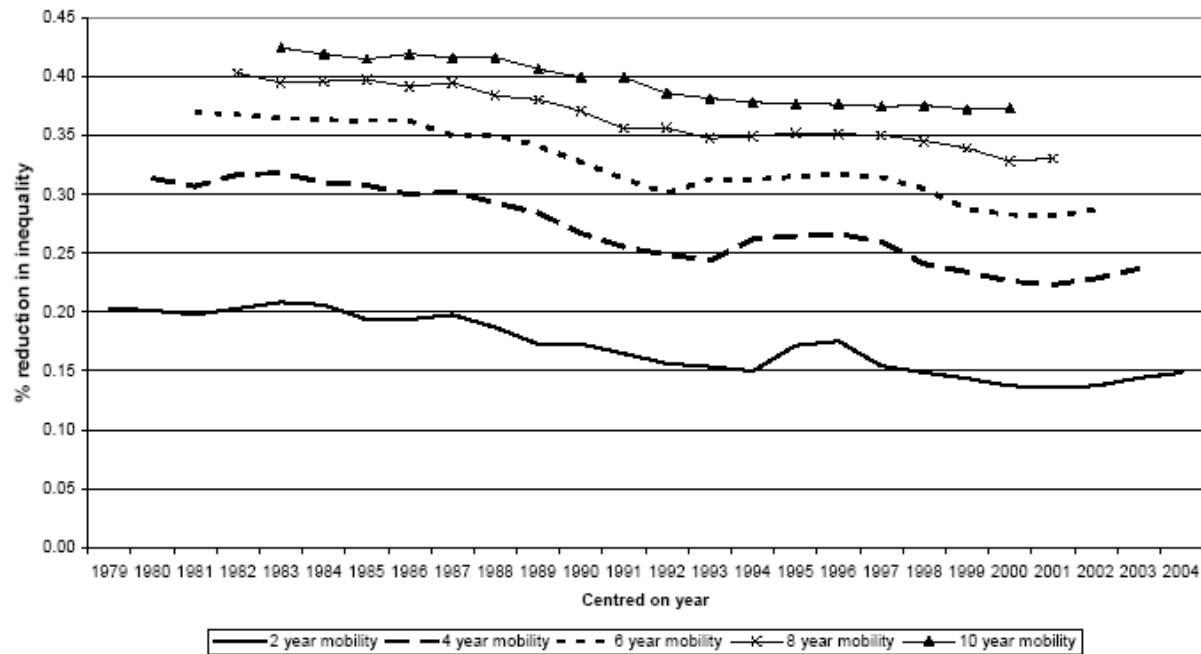


b) Absolute



And mobility across a wider distribution is much less now than before

Figure 8: Shorrocks Mobility - Theil GE(0) Index: Males Excluding Zeros



Conclusions

It seems that the explanation of how Britain got away with a smaller fall in employment in 2008-2009 consists of several elements.

Policy makers were better prepared this time round - 2 recessions well within memory. The understandings gained under these periods undoubtedly helped frame a policy response in the latest downturn (and before), allied with a greater willingness to intervene than in the past.

Policy makers did the right thing in saving the banks, cutting interest rates and inducing fiscal and monetary stimuli, that helped maintain demand and firm cashflow which continues to this day

Workers did the right thing in accepting lower nominal wage growth so reducing firm costs helping reduce need for mass layoffs

Real consumer wage growth was sustained by cuts in interest rates and VAT which helped sustain demand (no longer)

Employers entered the recession in good financial shape and this has helped avoid the level of job shedding that occurs when firms get into deep financial trouble.

But...

lower employment losses during the recession means that firms have under-used labour (low productivity) and this will allow them to grow without the need for extra jobs in the short to medium term.

If demand continues to be weak, then job shedding will resume.

This recession represents the first serious test of the active labour market policies that have been put in place since 1996.

Increased conditionality on welfare claimants to take active steps to secure work, increased package of support services for job search available to those claiming benefits and use of outside providers to deliver these services rather than Job Centres aimed at keeping individuals in the labour market and maintaining search effectiveness – seen in (relatively) buoyant outflows from unemployment

Reforms that increased the financial returns to working relative to not working, the National Minimum Wage and Working Tax Credit should also help continue to make work pay through a downturn when job prospects may not be as good as in recovery.

No major trends in the way we work, apart from jobs (for men) becoming significantly less stable

There are also serious jobless concentrations among more marginal groups (typified as ever by skill and region) that 15 years of sustained growth did little to remedy. As a result, for some groups, there has been a ratchet upward in joblessness from the 1980s onward

this will need to be addressed when the economy recovers (no hope unless growth exceeds 2%)

As the focus shifts to cuts in public spending and employers begin to assess their longer-term employment needs the prospects for the near future are less than clear.

Appendices

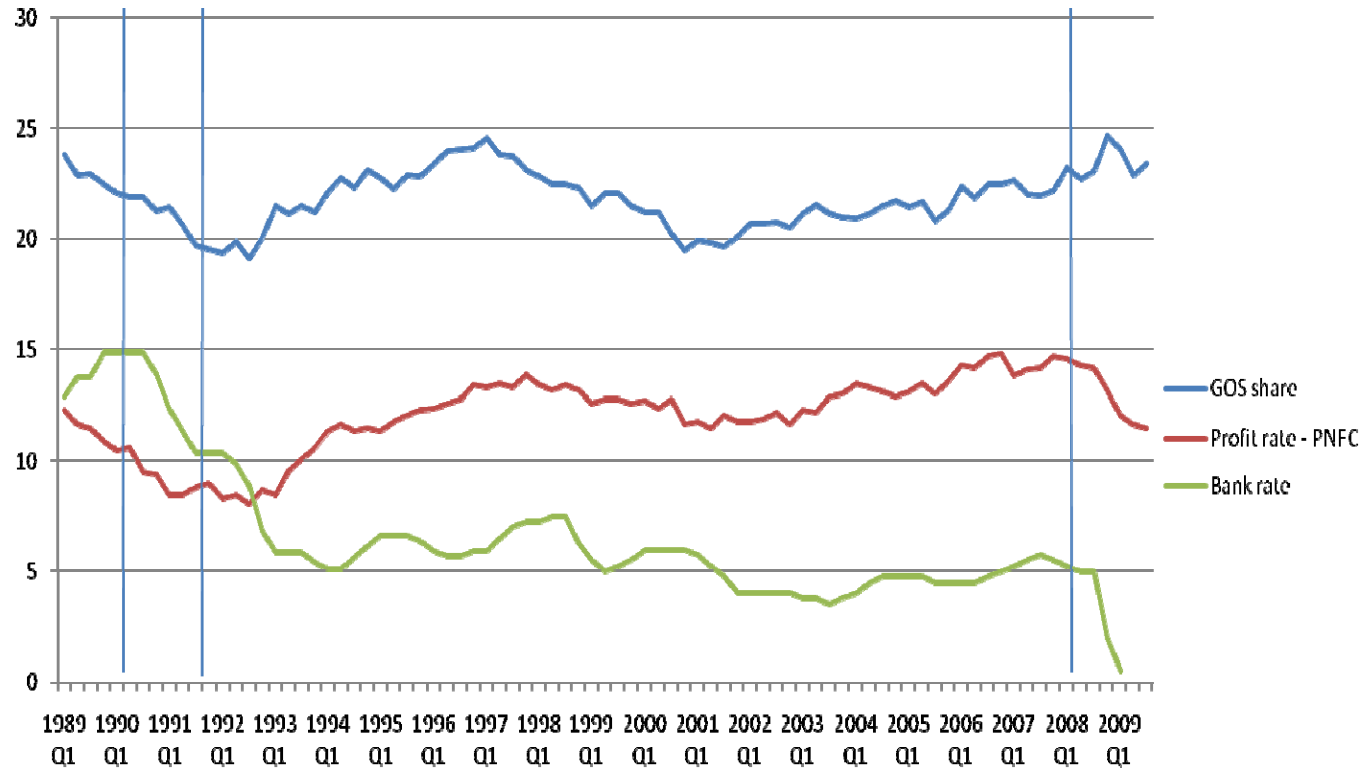
Profitability

Geroski and Gregg, (1997), show that firms will hold labour where possible through a recession, preferring instead to take short-term hits on profitability. However, if a firm is in deep financial trouble such longer-term planning is discounted and the firm will take emergency measures to cut costs and improve cash flow.

This means job cuts, as equivalent cost reductions made (large) wage cuts are difficult to implement.

So a large part of the story of employment through the recession is shaped by the extent to which firms are in a battle for survival rather than adjusting to, temporarily, lower demand.

Figure 6: Rate of return on capital (profit rate), profits as a share of GDP and Bank of England base interest rate 1989-2009



In the 1990s recession, profitability was already being squeezed ahead of the recession proper, (interest rates were set high to bear down on inflation).

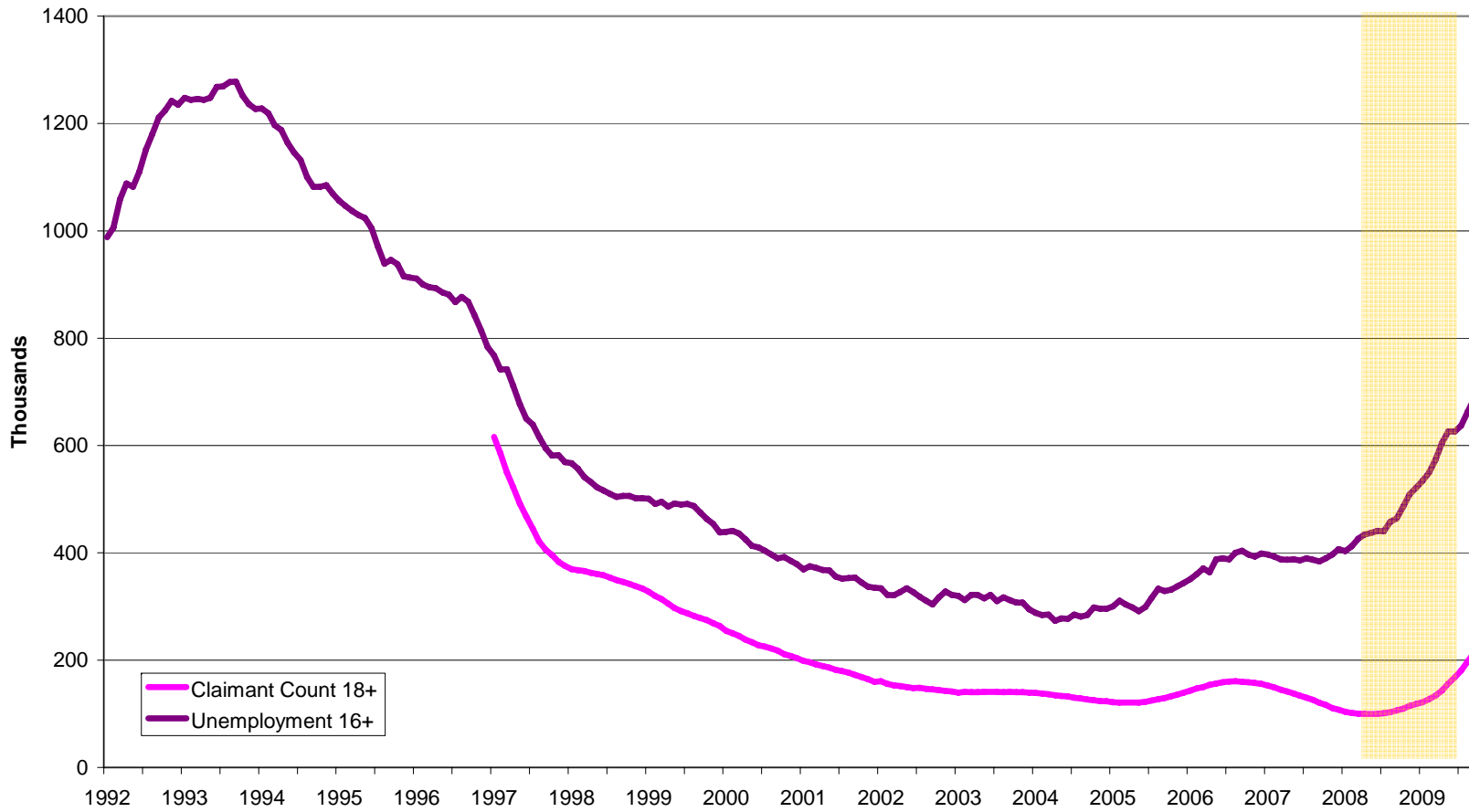
This time, profits were much higher immediately prior to the recession.

This means that the immediate pressure on firms to cut jobs in order to survive was reduced.

Since then, profitability held up over the recession and indeed rose as a share of GDP.

This is due to a) lower interest rates making financing debt easier; b) the fall in the exchange rate, unlike in the 1990s when membership of the ERM precluded devaluation; c) falls in wages and d) the maintenance of spending in the economy.

LTU (all over 12 months) Claimant Count (18+) v Unemployment (16+)
Seasonally adjusted



Welfare Receipt

In addition to the large cyclical fluctuations in unemployment benefit receipt over time there have been marked increases in claims for Income Support (IS) for lone parents and in sickness-related benefits.

Unlike unemployment related benefit, claims for these other benefits did not fall back after the recessions ended.

Inactivity benefit claims only started to fall around 2001 and then mainly for lone parents. Lone parents with children aged 7 and over are now being moved from IS to unemployment benefits (JSA) that require active job search and the new Work

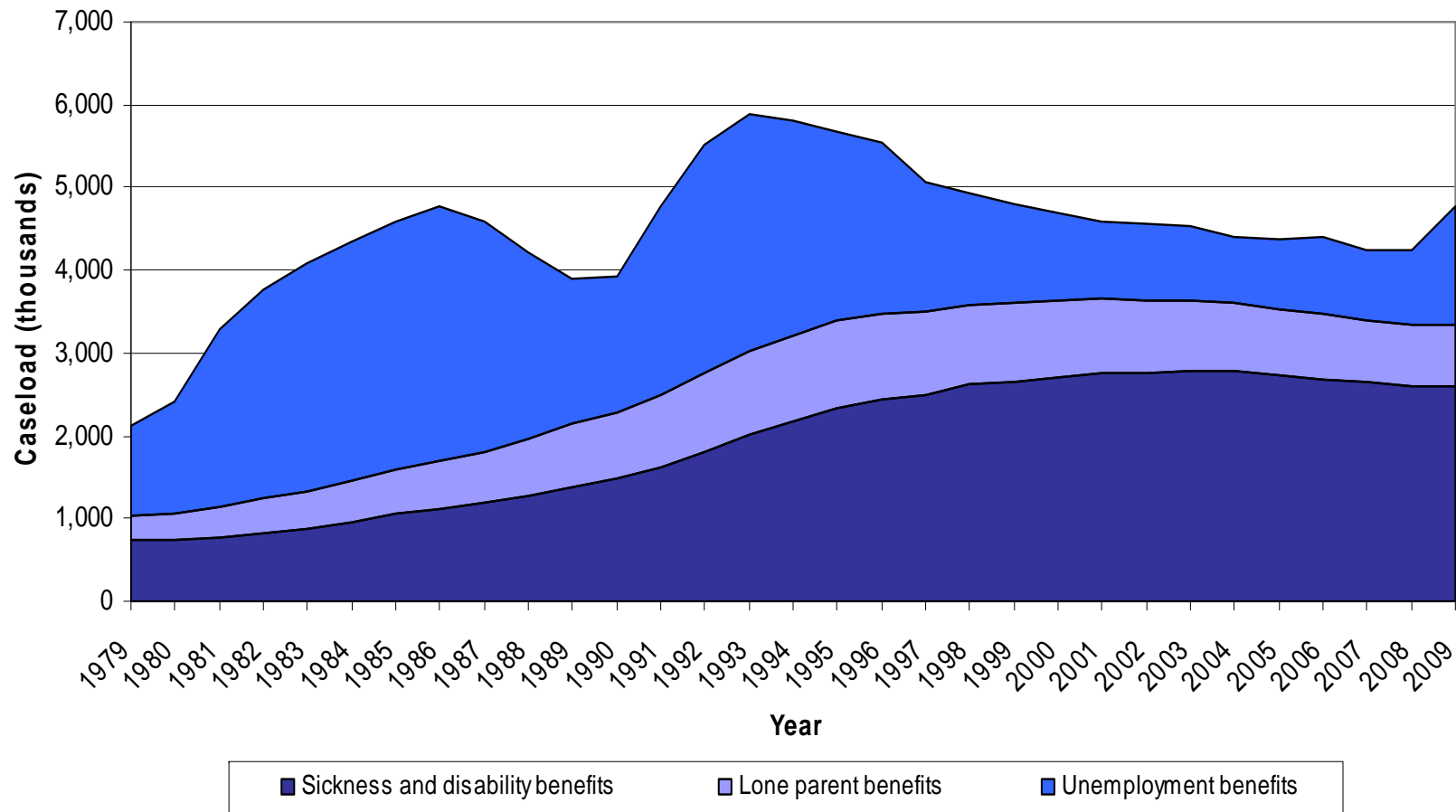
Capability Assessment tests are also making claiming disability benefits much harder.

These changes are pushing up the number of claims for JSA during the recession.

Claims for lone parent benefits did rise, once again during the latest recession.

The uncertainty arises around how far, compared to previous recessions, they will rise this time. The expectation is that they will not because of the extra support and job search schemes targeted at not just the unemployed but also the inactive.

Figure 12. Claims for Different Workless Benefits 1979 to 2008



Shares of Different Household Types

