

Sonderdruck aus:

Mitteilungen aus der Arbeitsmarkt- und Berufsforschung

Nigel Meager

British experiences in the
Reduction of Unemployment

Mitteilungen aus der Arbeitsmarkt- und Berufsforschung (MittAB)

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Das Manuskript ist in dreifacher Ausfertigung an die federführende Herausgeberin Frau Prof. Jutta Allmendinger, Ph. D. Institut für Arbeitsmarkt- und Berufsforschung 90478 Nürnberg, Regensburger Straße 104 zu senden.

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Herstellung

Satz und Druck: Tümmels Buchdruckerei und Verlag GmbH, Gundelfinger Straße 20, 90451 Nürnberg

Verlag

W. Kohlhammer GmbH, Postanschrift: 70549 Stuttgart; Lieferanschrift: Heßbrühlstraße 69, 70565 Stuttgart; Telefon 07 11/78 63-0; Telefax 07 11/78 63-84 30; E-Mail: waltraud.metzger@kohlhammer.de, Postscheckkonto Stuttgart 163 30. Girokonto Städtische Girokasse Stuttgart 2 022 309. ISSN 0340-3254

Bezugsbedingungen

Die „Mitteilungen aus der Arbeitsmarkt- und Berufsforschung“ erscheinen viermal jährlich. Bezugspreis: Jahresabonnement 52,- € inklusive Versandkosten: Einzelheft 14,- € zuzüglich Versandkosten. Für Studenten, Wehr- und Ersatzdienstleistende wird der Preis um 20 % ermäßigt. Bestellungen durch den Buchhandel oder direkt beim Verlag. Abbestellungen sind nur bis 3 Monate vor Jahresende möglich.

Zitierweise:

MittAB = „Mitteilungen aus der Arbeitsmarkt- und Berufsforschung“ (ab 1970)
Mitt(IAB) = „Mitteilungen“ (1968 und 1969)
In den Jahren 1968 und 1969 erschienen die „Mitteilungen aus der Arbeitsmarkt- und Berufsforschung“ unter dem Titel „Mitteilungen“, herausgegeben vom Institut für Arbeitsmarkt- und Berufsforschung der Bundesanstalt für Arbeit.

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British Experiences in the Reduction of Unemployment

Nigel Meager, Ph.D., Institute for Employment Studies, University of Sussex, Brighton

Good afternoon. I am very pleased to be here again in Berlin, especially as participant in such a special occasion, and in so prestigious a venue.

I have been asked to talk about UK experiences in the reduction of unemployment.

Given the short time available, my approach is going to be largely descriptive. I intend to cover three aspects in my presentation:

First, I will describe some important trends in British unemployment; and also some other key aspects of recent labour market developments. I will focus, in particular, on areas where the UK experience appears to be different or unusual in Europe, rather than those many areas where it is quite similar to the European experience.

Second I will describe some key aspects of the overall approach to labour market policy in the UK.

Third, I will try and draw some links between the two; and look at the evidence on how far the UK policy approach can be linked to overall labour market performance, and to developments in unemployment in particular.

Although I will draw on the results of scientific research, I will not talk about the specific contribution of economic and social research to policy-making and to reduction in unemployment. I am happy, however, to discuss this issue in the subsequent discussion.

What I will say is a personal view, but not an original or unusual one in the UK context.

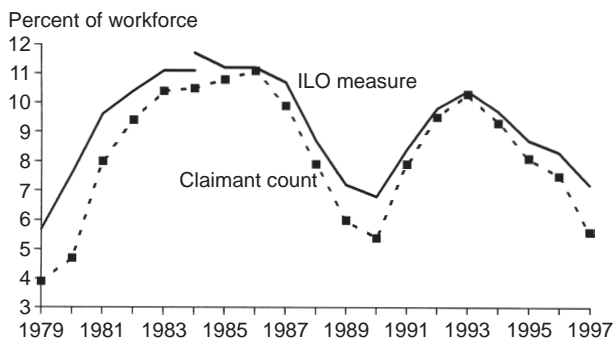
Inevitably, given the short time I have, most of what I say will consist of assertions, rather than detailed argument. Again, I am happy to try and provide more of the underlying arguments in the subsequent discussion.

The UK labour market trends

Before looking at UK labour market trends, it is worth asking the question why should we be interested in the UK at all? There is common view that the UK has followed a path of deregulation and flexible labour markets; and that this path, initiated by the Thatcher administration, is still being followed by the present Labour government. A key question, therefore, is to what extent has this supposed deregulation and flexibilisation contributed to improved labour market performance in the UK, and particularly to a reduction in unemployment. The existing evidence does not give a clear answer to this, but I will try to summarise what we know so far.

To provide some background information for the subsequent discussion, I start by presenting some summary 'stylised facts' about recent UK labour market developments. If we turn first to look at trends in aggregate unemployment (Figure 1), we can see that in the recession of the early 1980s, unemployment rose rapidly, and then fell dramatically in the late 1980s with macro-economic expansion, before being hit by a

Figure 1: Great Britain: unemployment rate 1979-97



Source: Labour Force Survey; Claimant Count

second recession in the early 1990s. Since 1993, unemployment has fallen fast again, and is now at its lowest level since 1980.

The Figure also shows, however, that the picture is less impressive when we use the ILO unemployment definition, than when we use the official definition based on the count of unemployment benefit claimants. Part of the recent fall in the official count is because people have been driven off the unemployment register, through recent administrative changes which reduce the duration of unemployment benefit, and make the eligibility conditions stricter.

Figure 2: Great Britain: unemployment by gender, 1984-97



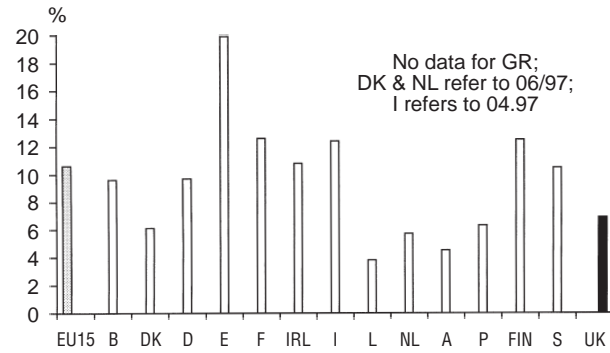
Source: Labour Force Survey

Figure 2 shows that male unemployment has been particularly affected in the most recent recession, partly because job losses have been concentrated in male-dominated sectors such as manufacturing and construction. The UK is unusual among European countries, in that female unemployment is now significantly lower than male unemployment.

Following the recent fall in unemployment, the UK is now in the position, for the first time in many years, using standardised definitions, of having an unemployment rate well below the EU average.

Also noteworthy is the speed with which unemployment has fallen in the most recent recovery; it would appear that un-

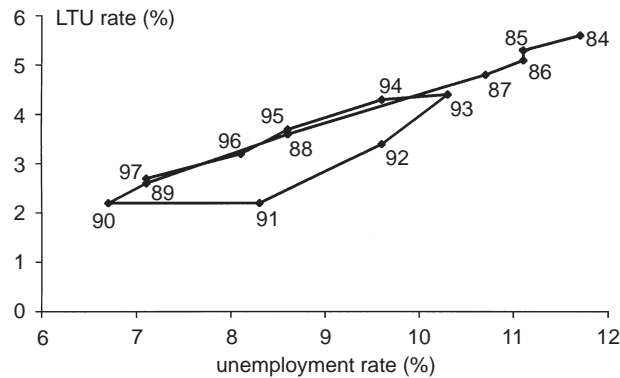
Figure 3: Unemployment rates in the European Union, July 1997



Source: Eurostat

employment now responds more quickly to growth in GDP, than has been the case during recovery periods from earlier recessions.

Figure 4: Great Britain: unemployment and long-term unemployment (1984-97)

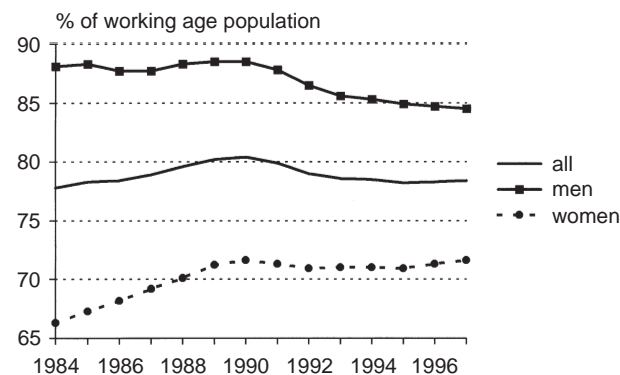


Source: Labour Force Survey

The share of long-term unemployment (12 months plus) in total unemployment (around 40 %) is also below the EU average. But as Figure 4 shows, long-term unemployment moves with a lag, very closely in line with overall unemployment. It does not seem, therefore, that the long-term unemployed are excluded from the benefits of an economic recovery.

Turning to look at some other important labour market trends, Figure 5 shows that labour force participation rates, and the

Figure 5: Great Britain: economic activity rates, 1984-97



Source: Labour Force Survey

labour force itself, grew in the 1980s. The growth in female activity rates was particularly strong. Labour force growth has, however, flattened off in the 1990s (there was even some decline over 1990-3).

Figure 6: Changing employment patterns



Source: Labour Force Survey; Robinson 1997

Figure 6 shows some aspects of the changing composition of unemployment, in particular the development of 'non-standard' or 'atypical' forms of work. As can be seen from the Figure, the share of employment accounted for by part-time work, temporary work and self-employment have all grown in the last two decades.

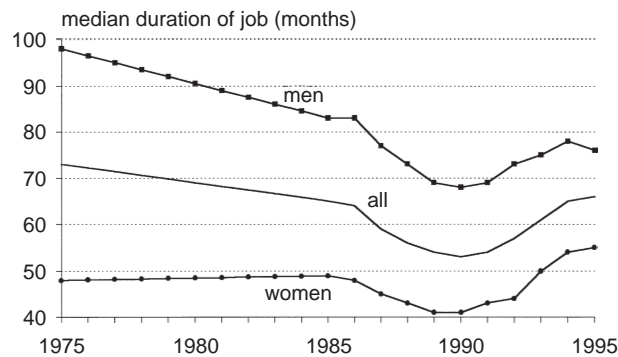
As far as the growth in part-time work is concerned, this is, for the most part, simply a reflection of a much longer-term trend. It mainly results from growing female labour force participation, and women's employment (although total female employment has increased significantly, the proportion of women who work part-time has grown very little, and most of such growth as there has been occurred in the early 1980s). In addition, however, male part-time employment, although still small in absolute size, has grown significantly (it has virtually doubled since the early 1980s). This has been largely due to a significant increase in the number of full-time students, working part-time in order to finance their studies. Demand side factors are also important in the growth in part-time work, especially the growth of the service sector, where levels of part-time work are traditionally high. There is, however, no real evidence that the expansion of part-time work is due in any significant respect to government policy to make the labour market more 'flexible' (as we have seen, most of the growth occurred, in any case, in the early 1980s, before the policy obsession with labour market flexibility really took root).

There has been some growth in temporary work, but this increase was relatively small, and it all occurred in the upturn in the early 1990s. The evidence suggests that it mainly reflects short-term cyclical factors, ie employers being careful in hiring in the early years of an upturn, in the face of uncertainty about the sustainability of the upturn in demand. In European terms, temporary work remains relatively unimportant in the UK (accounting, even after the recent growth, for only 7 % of all employment).

The only 'non-standard' form of employment which has grown significantly, is self-employment, which expanded massively from a relatively low base in the early 1980s. The research evidence suggests that this expansion was partly a response to growing unemployment, partly a reflection of changing industrial structure, and the tendency for large or-

organisations to 'outsource' their non-core activities, and partly a response to government policy of encouraging small business start-ups. There is, however, little evidence that this growth has been a source of net extra employment.

Figure 7: Job tenure: 1975-95



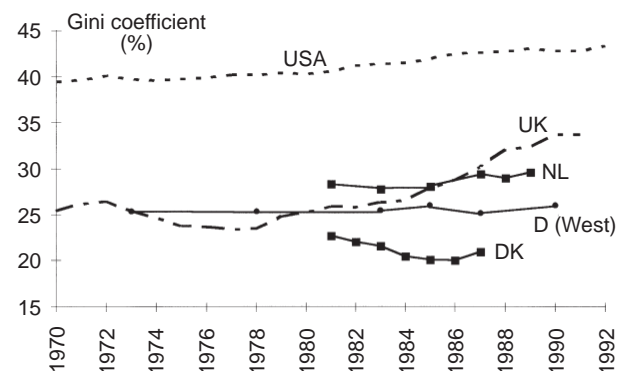
Source: Labour Force Survey, EPI 1997

Another possible indicator of growing labour market flexibility, is job tenure and security. When we look at the relevant data, however (Figure 7), there is no strong evidence of jobs getting shorter or more insecure over time. The data show that there was indeed some decline in the average duration of jobs in the late 1970s, but again this was before the policy emphasis on labour market flexibility took effect. Since the mid 1980s, moreover, average job duration has moved in a cyclical fashion, declining in the recession and lengthening in the upturn, and there is no evidence of a persistent trend towards greater job insecurity and flexibility in this sense.

Overall, despite the political rhetoric, the available evidence on the changing structure of employment does not suggest that the UK is significantly out of line with the experience of other European countries; in this respect any growth in so-called labour market 'flexibility' since the early 1980s, seems to have been modest at best.

The one important area, however, in which the UK is distinctive, and very different from the experience of most other European countries, relates to wages and incomes.

Figure 8: Trends in income inequality; UK and selected countries



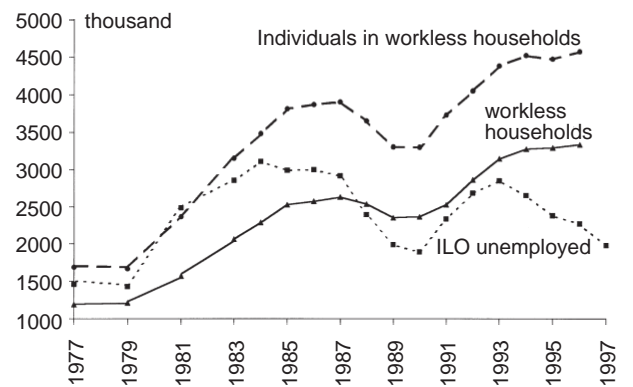
Source: Atkinson 1994

As Figure 8 shows, there has been a massive recent growth in income inequality in the UK. Inequality in the UK has always been relatively high, and it is one of the few OECD countries in which inequality has grown. The chart shows trends in in-

come inequality, in the five countries discussed at today's conference, measured by the Gini coefficient, a common way of summarising the degree of income inequality.

Research evidence shows that this growing inequality is due both to growing wage inequality, and to some changes in household structure, and reductions in social security and pension levels.

Figure 9: Unemployment and other measures of social exclusion



Source: Labour Force Survey; EPI 1997

Figure 9 shows some other indicators of social exclusion (the number of so-called 'workless household' - ie households in which no one has a job). Even during the 1990s, when unemployment was falling, the numbers of people in workless households, and the numbers of workless households themselves were increasing. It is clear that a high proportion of the new jobs created in recent years have gone to people living in households where there were already people with jobs; and the concentration of unemployment in deprived households has continued to increase.

Having set out some key recent labour market developments, I now turn to look at the labour market policy framework in the UK.

The late 1970s in the UK (as in many other countries) saw a major shift in the dominant economic explanation for mass unemployment, and a corresponding shift in the emphasis of policy. Keynesian demand-management was replaced by the concept of a 'natural rate of unemployment', determined by structural and institutional factors. The dominant view from this period on, has been that the key objective of macro-economic policy is to keep aggregate demand growth steady, so that unemployment falls to its natural rate. Micro-economic policy, on the other hand, should focus on tackling the structural barriers and institutional factors which were believed to be keeping the natural rate high.

The main areas of labour market policy

Within this overall perspective, we can identify four main areas of policy development affecting the labour market since the early 1980s.

The first of these is the emphasis on 'deregulation'. There is a common view that there has been massive labour market deregulation in the UK since the early 1980s. In practice, however, this is not the case: in comparison with most EU countries, the UK has *always* had a relatively deregulated labour market, and the recent changes have been relatively minor.

Thus individual employment rights have never been highly regulated (except in the areas of health and safety, and equal opportunities, where, if anything, the degree of regulation is higher in the UK than in many other countries). The only significant deregulation in the 1980s was the extension of the qualification period for redundancy payments and protection from unfair dismissal, from 6 months of employment to 2 years. The research suggests that this change had little impact on employer practices or on the functioning of the labour market, and as we have already seen, there is very little real evidence of growing labour market insecurity and flexible forms of work. In so far as the UK has a 'hire and fire' labour market, this was the case long before the changes introduced during the 1980s.

This is not to say that there were no important changes during this period. Indeed the most significant changes have been in the areas of collective industrial relations and pay determination; in which area there was a series of legislative changes aimed at reducing trade union influence. To some extent these changes can be seen as introducing a *greater* degree of regulation: through limiting unions' traditional legal immunities; reforming union internal organisation (to increase individual union members' rights); and undermining the role of collective wage-setting. The net effect of this legislative onslaught on the trade unions, is that union density fell from 53 per cent in 1980 to just over 30 per cent currently, and the coverage of collective pay-setting fell accordingly.

In addition, minimum wage legislation covering a range of sectors, through the so-called 'wages-councils', was abolished in the late 1980s¹ (the new Labour government will introduce a universal national minimum wage)

So what effect did the limited deregulation have? Research evidence suggests that on the one hand, UK productivity growth has clearly improved, especially in manufacturing; the industrial relations reforms appear to have contributed to this, but are not the only explanatory factor. Equally importantly, however, the decline in collective bargaining and the abolition of minimum wages have contributed in a major way to the growing wage inequality in the UK.

The second main area of policy change was in the area of active labour market policies. The 1980s saw a shift away from traditional demand side measures – employment subsidies and job-creation schemes towards: firstly, vocational training programmes for the unemployed (with major measures both for young people and for the adult long-term unemployed); and secondly, measures delivered through the Employment Service, concerned with improving motivation, job-search skills etc. among the unemployed (these were often combined with benefit checks for eligibility).

Evaluation evidence, suggests that the training measures have had a short-term impact on the unemployment register; but have had very little impact on participants' longer-term employment chances. There is also some evidence that the measures to improve job-matching; job-search training *etc.*, through the Employment Service, have contributed to a (small) reduction in frictional and structural unemployment. A further key evaluation finding is that mixed approaches may be the most effective. For example, training programmes which incorporate other elements such as job-search support,

or practical work placements with employers, are more effective than training alone. Under the new government, however, there is a shift back towards traditional demand-side measures, with a series of massive new initiatives, based on recruitment subsidies, and job-creation schemes.

The third important area of policy development is education and training. There has been a major expansion in education and training provision during the 1980s. The participation rate in full-time education has expanded massively. This has reduced the labour supply of young people, and contributed directly to relatively low levels of youth unemployment in the UK. For example, the participation rate of 18 year-olds in full-time education has more than doubled between 1986 and 1996, from under 20 % to nearly 40 % (however, this simply brings the UK more in line with other European countries). In addition, the mid-1980s saw the introduction of a new system of national vocational qualifications (NVQs); aimed at increasing the relevance of qualifications to employment, and introducing systems based on competence in the workplace, rather than theoretical knowledge. Evaluation evidence, however, does not suggest that NVQs have significantly added to the overall stock of skill levels in the UK; their main effect has been in lower skill, service sector occupations, and not in areas critical to international competitiveness. Levels of continuing training within firms have also increased strongly since the early 1980s; but there is no evidence that this was a response to government policy.

The fourth and final important area of policy development and change relates to the benefit and tax systems. There has been an ongoing reduction in benefit replacement rates (which were already low) in the UK. OECD data show that UK benefits, at less than 20 % of average earnings, are among the lowest in Europe. The econometric evidence, however, does not suggest that low replacement rates in themselves have made more than a marginal contribution to reducing unemployment (although the reduction in the benefit duration, and changes to the administration of benefits, have had a bigger effect). Falling replacement rates have, however, further contributed to the growth in poverty and income inequality in the UK.

There is a long-tradition of 'in-work benefits' for low paid workers in the UK; the range and coverage of these were extended in the 1980s; the evidence suggests, however, that their effect on the so-called unemployment trap is relatively small, and that they may simply replace an unemployment trap with a 'poverty trap' (ie the high effective marginal tax rates, associated with the clawback of such benefits, contribute to trapping people in low-paid jobs).

Let me try to sum up, by asking: why has the UK's recent unemployment performance been better than European average? There is no consensus among economists on this, but the prevailing evidence suggests that the supply side reforms, and active labour market policy have made a modest contribution. The main reason for the recent fall in unemployment, however, has been due to macro-economic and structural factors.

First, the recent unemployment trends partly simply reflect the timing of the economic cycle; the UK went into recession first and came out first.

Second; recovery from recession has been supported by a generally expansionary macro-economic policy. In particular, the initial recovery was driven by the massive devaluation of the currency in 1992, when the UK left the European Exchange Rate Mechanism.

¹ The new Labour Government, elected in May 1997 has, however, announced its intention to introduce a national minimum wage for the first time, covering all sectors.

Third; supply side reforms appear to have made employment more sensitive to economic growth. In the most recent recovery, employment grew earlier and faster than was the case in previous upturns.

Fourth; there are a range of other factors affecting recent trends in unemployment. These include the UK's clear success in attracting inward investment, especially from Japan and other non-EU countries; this is partly driven by lower wage and non-wage costs, partly by government incentives to inward investors, and partly by non-economic factors such as the English language. The UK has the lowest non-wage costs of any major OECD country (in 1995, non-wage costs were 12.6 % of total labour costs, according to the OECD). There is, however, an unresolved debate about how important non-wage costs have been in affecting employment and unemployment levels. Again, it is important to remember, that this picture is not recent; the UK has had relatively low non-wage costs for many years, and it is therefore difficult to explain the strong labour market performance of the last 2-3 years in terms of non-wage costs. The research evidence suggests, however, that in so far as non-wage costs are important, their effect is greatest on the unskilled. The progressive nature of UK payroll taxes is clearly relevant here; the share of payroll taxes paid by employers increases with earnings, and this is likely to have had beneficial effects on the employment of the least skilled members of the workforce.

Finally, we need to remember, that the apparent recent success in tackling unemployment is significantly less than the official figures suggest. Due to changes in the level, duration and eligibility conditions for unemployment-related benefits (most notably the introduction of the so-called Job Seekers' Allowance in late 1996), a significant share of the most recent fall in unemployment reflects people leaving the workforce, rather than people getting jobs.

To conclude, I would argue that there is little real evidence of the so-called flexible labour market having had a big effect. The actual extent of deregulation and change has been considerably overstated by commentators. The UK labour market has always been relatively deregulated and the recent changes were minor. The impact of a more flexible labour market has mainly affected the bottom end of the labour market, and new entrants to the labour market, who are subject to lower wages, and greater insecurity than previously.

The major side-effect of the reforms we have seen in the UK, has been a massive growth in wage inequality; and a growing concentration of unemployment and social exclusion. The major future issue for the UK in labour market policy terms remains the extent to which some improvement in labour market performance has been bought at the cost of growing levels of inequality, poverty and social exclusion.