The British Low-Wage Sector and the Employment Prospects of the Unemployed

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Introduction

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- Several studies confirm these concerns, e.g. Stewart & Swaffield 1999, Stewart 2007, Cappellari & Jenkins 2008, Clark & Kanellopoulos 2013.

**Question:** Does this negative picture of low-wages also hold for the subsample of initially unemployed?
What is new:

• Analyzing a subsample which contains initially unemployed.
• Medium-term time frame (up to six years after becoming unemployed).
• Differentiate the effect of a low-paid job according to individual and job characteristics (Knabe & Plum 2013).
• In the econometric model it is explicitly respected for correlated random effects between the three labor market states (high-paid, low-paid, unemployed).
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The theoretical perspective:

No clear answer:

• Positive effect on the level of human capital.

• Layard, Nickell & Jackman (1991, p. 249): 'While unemployment is a bad signal, being in a low-quality job may well be a worse one'.
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- Evidence for low-pay persistence is found (Stewart & Swaffield 1999, Stewart 2007, Clark & Kanellopoulos 2013).
- 'Negative duration dependence' in unemployment (e.g. Kroft, Lange & Notowidigdo 2013).

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- Hence: ‘the prospects of becoming high-paid might darken when working in the low wage sector but may even be worse when staying unemployed’.
Data preparation

• British Household Panel Survey (BHPS), years 1996 to 2008.
• Restricted to men.
• Dropping: self-employed, disabled and men attending school or working in the army.
• Age frame: 20-60 years.
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Labor market position
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- ILO definition to differentiate between unemployed and inactive.
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- OECD (1997): two third of the median gross hourly wage of both sexes (including paid overtime) as low-pay threshold (annual adjusted)
Identification of the labor market dynamics

**Figure**: Identification of labor market dynamics

Note: $t_0 =$ first time observed in the sample; $t_{em} =$ being employed; $t_{ue} =$ being observed for the first time unemployed after being employed; $t_T =$ up to six years after $t_{ue}$. The shadowed box indicates the analyzed time frame.
Table: Transition into High-Paid Employment

<table>
<thead>
<tr>
<th>$\Delta_t$ after unemployment$^1$</th>
<th>First time being high-paid employed (low-paid in at least one period before)</th>
<th>Total</th>
<th>Less than a college degree</th>
<th>At least a college degree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>95 (―)</td>
<td>59 (―)</td>
<td>36 (―)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>34 (17)</td>
<td>21 (12)</td>
<td>13 (5)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>14 (12)</td>
<td>12 (11)</td>
<td>2 (1)</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>12 (11)</td>
<td>8 (7)</td>
<td>4 (4)</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>2 (2)</td>
<td>― (―)</td>
<td>2 (2)</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>1 (1)</td>
<td>1 (1)</td>
<td>― (―)</td>
<td></td>
</tr>
<tr>
<td>$\sum$</td>
<td>158 (43)</td>
<td>101 (31)</td>
<td>57 (12)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>210</td>
<td>143</td>
<td>67</td>
<td></td>
</tr>
<tr>
<td>Share</td>
<td>75.23% (20.47%)</td>
<td>78.32% (21.67%)</td>
<td>85.07% (17.91%)</td>
<td></td>
</tr>
</tbody>
</table>

Source: BHPS waves 8-18, N = 796. $^1$ $\Delta_t$ after unemployment refers to the length $\Delta_t$, measured in years, when the initially unemployed man obtains for the first time a high-paid job. Note that the labor market position is observed at one time point in the respective year.
### Table: Control variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Young Dummy</td>
<td>Dummy: 1 if observation is 30 years or younger, 0 otherwise</td>
</tr>
<tr>
<td>Old Dummy</td>
<td>Dummy: 1 if observation is older than 54 years, 0 otherwise</td>
</tr>
<tr>
<td>Married Dummy</td>
<td>Dummy: 1 if observation is married, 0 otherwise</td>
</tr>
<tr>
<td>Health Dummy</td>
<td>Dummy: 1 if self-reported health status is excellent or good, 0 otherwise</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>State-level unemployment rate; annual averages; in percent</td>
</tr>
</tbody>
</table>

**Interaction with labor market position**

<table>
<thead>
<tr>
<th>College-educated Dummy</th>
<th>Dummy: 1 if observation obtained a college degree (ISCED 5 or 6), 0 otherwise&lt;sup&gt;1&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low social status Dummy</td>
<td>Dummy: 1 if present's job RGSC-value is 4 or above, 0 otherwise&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

**Robustness**

| Female Dummy           | Dummy: 1 if woman, 0 otherwise                                                              |

---

<sup>1</sup> *ISCED*: International Standard Classification of Education.  
<sup>2</sup> *RGSC*: Registrar General’s Social Classes is 1=Professional occ., 2=Managerial & technical occ., 3=Skilled non-manual, 4=Skilled manual, 5=Partly skilled occ., 6=Unskilled occ.  
<sup>3</sup> Only included in the robustness checks.
### Table: Descriptive Statistics\(^1\)

<table>
<thead>
<tr>
<th></th>
<th>Full Sample(_t)</th>
<th>high-paid(_t)</th>
<th>low-paid(_t)</th>
<th>unemployed(_t)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Young</td>
<td>0.274</td>
<td>0.199</td>
<td>0.378</td>
<td>0.340</td>
</tr>
<tr>
<td>Old</td>
<td>0.104</td>
<td>0.109</td>
<td>0.098</td>
<td>0.100</td>
</tr>
<tr>
<td>Married</td>
<td>0.665</td>
<td>0.744</td>
<td>0.594</td>
<td>0.490</td>
</tr>
<tr>
<td>Health</td>
<td>0.687</td>
<td>0.708</td>
<td>0.665</td>
<td>0.650</td>
</tr>
<tr>
<td>Unemployment-rate</td>
<td>5.198</td>
<td>5.190</td>
<td>5.247</td>
<td>5.111</td>
</tr>
<tr>
<td>College-educated</td>
<td>0.323</td>
<td>0.373</td>
<td>0.240</td>
<td>0.310</td>
</tr>
<tr>
<td>Low social class</td>
<td>0.539(^2)</td>
<td>0.457</td>
<td>0.681</td>
<td>–</td>
</tr>
<tr>
<td>Observations</td>
<td>796</td>
<td>442</td>
<td>254</td>
<td>100</td>
</tr>
</tbody>
</table>

*Source: BHPS waves 8-18, \(N = 796\). \(^1\) share of observations in the respective group, \(^2\) only including high-paid and low-paid in the full sample.*
Preliminary remarks

• Assuming a first order Markov process.
• Unobserved heterogeneity (Heckman 1981a)
• Initial conditions problem (Heckman 1981b)
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The two binary outcome variables are defined as:

\[ y_{1it} = \begin{cases} 
1 & \text{if the person is employed in a high-paid job,} \\
0 & \text{otherwise,} 
\end{cases} \]
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\[ y_{1it} = \begin{cases} 1 & \text{if the person is employed in a high-paid job,} \\ 0 & \text{otherwise,} \end{cases} \]

and if \( y_{1it} = 0 \),

\[ y_{2it} = \begin{cases} 1 & \text{if the person is unemployed,} \\ 0 & \text{otherwise,} \end{cases} \]
The observed binary outcome variable is defined as:

\[ y_{1it} = \begin{cases} \mathbb{1}(x'_{1it}\beta_1 + \gamma_{11}y_{1i(t-1)} + \gamma_{13}y_{3i(t-1)} + \pi_{11}y_{1i0} + \pi_{13}y_{3i0} + x'_{1i}\delta_1 + \kappa_{1i} + \epsilon_{1it} > 0), \\
0 \end{cases} \]
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\[ y_{1it} = \begin{cases} 
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0, \ 	ext{if } y_{1it} = 0,
\end{cases} \]
and if \( y_{1it} = 0 \),

\[ y_{2it} = \begin{cases} 
1(x'_{2it} \beta_2 + \gamma_{21} y_{1i(t-1)} + \gamma_{23} y_{3i(t-1)} + \pi_{21} y_{1i0} + \pi_{23} y_{3i0} + x'_{2i} \delta_2 + \kappa_{2i} + \epsilon_{2it} > 0), \\
0, \ 	ext{if } y_{1it} = 0.
\end{cases} \]
Correlation structure:

\[ \text{corr}(\nu_{1it}, \nu_{1is}) = \begin{cases} \sigma^2_{\kappa_1} & \text{if } t \neq s, \\ \sigma^2_{\kappa_1} + 1 & \text{if } t = s, \end{cases} \]
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\sigma_{\kappa_1}^2 + 1 & \text{if } t = s,
\end{cases}
\]

\[
\text{corr}(\nu_{2it}, \nu_{2is}) = \begin{cases} 
\sigma_{\kappa_2}^2 & \text{if } t \neq s, \\
\sigma_{\kappa_2}^2 + 1 & \text{if } t = s,
\end{cases}
\]
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\begin{align*}
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\end{cases} \\
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\sigma_{\kappa_2}^2 + 1 & \text{if } t = s,
\end{cases} \\
\text{corr}(\nu_{1it}, \nu_{2is}) &= \rho_{\kappa} \sigma_{\kappa_1} \sigma_{\kappa_2}
\end{align*}
\]
Deriving the log likelihood:

• Applying a correlated simulated multivariate random effects (CSM RE) probit model.

• Main feature: the complete variance-covariance matrix is estimated at once (Cappellarie & Jenkins 2006).

• Multivariate normal probability functions of orders higher than two must be simulated.

• For simulation, Halton draws are applied (Train 2003) due to high accuracy and stability (Plum 2013).
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Regression results

<table>
<thead>
<tr>
<th></th>
<th>RE Probit</th>
<th></th>
<th>CSM RE Probit</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>coeff.</td>
<td>std. err.</td>
<td>coeff.</td>
<td>std. err.</td>
</tr>
<tr>
<td><strong>dependent variable:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>employed in a high-paid job in $t$</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>high-paid$_{t-1}$</td>
<td>0.929</td>
<td>0.237</td>
<td>0.986</td>
<td>0.240</td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>0.428</td>
<td>0.255</td>
<td>0.434</td>
<td>0.258</td>
</tr>
<tr>
<td>$\times$ low social class$_{t-1}$</td>
<td>-0.201</td>
<td>0.220</td>
<td>-0.182</td>
<td>0.224</td>
</tr>
<tr>
<td>low-paid$_{t-1}$</td>
<td>0.369</td>
<td>0.275</td>
<td>0.566</td>
<td>0.289</td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>-0.038</td>
<td>0.308</td>
<td>0.037</td>
<td>0.313</td>
</tr>
<tr>
<td>$\times$ low social class$_{t-1}$</td>
<td>-0.257</td>
<td>0.262</td>
<td>-0.228</td>
<td>0.264</td>
</tr>
<tr>
<td>unemployed$_{t-1}$</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>0.486</td>
<td>0.223</td>
<td>0.474</td>
<td>0.228</td>
</tr>
<tr>
<td><strong>reference category</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>unemployed in $t$</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>high-paid$_{t-1}$</td>
<td>-1.412</td>
<td>0.550</td>
<td>-1.698</td>
<td>0.560</td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>0.882</td>
<td>0.584</td>
<td>1.132</td>
<td>0.594</td>
</tr>
<tr>
<td>$\times$ low social class$_{t-1}$</td>
<td>0.533</td>
<td>0.588</td>
<td>0.474</td>
<td>0.579</td>
</tr>
<tr>
<td>low-paid$_{t-1}$</td>
<td>-0.564</td>
<td>0.495</td>
<td>-0.497</td>
<td>0.484</td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>-0.334</td>
<td>0.554</td>
<td>-0.226</td>
<td>0.547</td>
</tr>
<tr>
<td>$\times$ low social class$_{t-1}$</td>
<td>-0.385</td>
<td>0.482</td>
<td>-0.531</td>
<td>0.480</td>
</tr>
<tr>
<td>unemployed$_{t-1}$</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$\times$ college-educated$_{t-1}$</td>
<td>0.065</td>
<td>0.356</td>
<td>0.117</td>
<td>0.358</td>
</tr>
<tr>
<td><strong>reference category</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$\sigma^2_{\kappa_1}$</td>
<td>0.454</td>
<td>0.205</td>
<td>0.533</td>
<td>0.218</td>
</tr>
<tr>
<td>$\sigma^2_{\kappa_2}$</td>
<td>0.827</td>
<td>0.584</td>
<td>0.944</td>
<td>0.578</td>
</tr>
<tr>
<td>$\rho_{\kappa}$</td>
<td>—</td>
<td>—</td>
<td>0.737</td>
<td>0.260</td>
</tr>
<tr>
<td>log likelihood</td>
<td>-579.379</td>
<td></td>
<td>-575.996</td>
<td></td>
</tr>
<tr>
<td>observations</td>
<td>796</td>
<td></td>
<td>796</td>
<td></td>
</tr>
</tbody>
</table>

Source: BHPS waves 8-18, own calculations. Coefficients displayed in bold are significant at least at the 10% level. Estimations include additional covariates as enlisted in Table 2 and year dummies.
Table: Average Partial Effects

<table>
<thead>
<tr>
<th></th>
<th>RE Probit</th>
<th>CSM RE Probit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>APE</td>
<td>p-value</td>
</tr>
<tr>
<td><strong>Partial effect to obtain a high-paid employment in t</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>high-paid(_t-1)</td>
<td>0.274</td>
<td>0.001</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>0.217</td>
<td>0.002</td>
</tr>
<tr>
<td>low-paid(_t-1)</td>
<td>0.111</td>
<td>0.177</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>0.033</td>
<td>0.580</td>
</tr>
<tr>
<td><strong>Partial effect to obtain a low-paid employment in t</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>high-paid(_t-1)</td>
<td>-0.067</td>
<td>0.287</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>-0.050</td>
<td>0.341</td>
</tr>
<tr>
<td>low-paid(_t-1)</td>
<td>0.003</td>
<td>0.907</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>0.106</td>
<td>0.111</td>
</tr>
<tr>
<td><strong>Partial effect to be unemployment in t</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>high-paid(_t-1)</td>
<td>-0.206</td>
<td>0.009</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>-0.167</td>
<td>0.009</td>
</tr>
<tr>
<td>low-paid(_t-1)</td>
<td>-0.114</td>
<td>0.111</td>
</tr>
<tr>
<td>× low social class(_t-1)</td>
<td>-0.139</td>
<td>0.029</td>
</tr>
<tr>
<td><strong>Observations</strong></td>
<td>143</td>
<td></td>
</tr>
</tbody>
</table>

Source: BHPS waves 8-18, own calculations. APE = Average Partial Effect.
Robustness:

1. Dropping observations with a relative wage change below $<10\%$.
2. Gender specific threshold.
3. Including women into the regression.
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3. Including women into the regression.
Conclusion:

1. Low-wages increase the probability to switch into a high-paid employment.
2. Low-wages reduce the risk of future unemployment.
3. Upward mobility is reduced when the job is associated with a low social class.
4. Men with at least a college degree profit less strongly from low-wages.
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Thank you for your attention!