

ELECTION ANALYSIS

Jobs and Youth Unemployment: It's bad but not as bad as you think

- The Great Recession of 2008-2010 has inflicted a larger cumulative loss of UK output than any of the other post-war recessions. Nevertheless, unemployment is much lower than we would have expected given past experience.
- Young people have fared badly during the recession, with larger increases in their unemployment rates than adults. But young people always do worse in downturns and there is no evidence that young people are doing relatively worse this time round than in previous recessions.
- The youth labour market deteriorated after 2004, *prior* to the onset of the recession. The reasons for this are not well understood - the weakening of the adult labour market can only account for some of the rise in youth unemployment. Increased immigration, minimum wages, skill demand changes and schooling are possible explanations, but there is little compelling evidence for any of these factors.
- Labour's welfare reforms – such as the New Deal for Young People introduced in 1998 – have had a positive impact on jobs. But after 2004 the Employment Service de-emphasised the young unemployed compared to other groups (e.g. lone parents and those on incapacity benefits) and this may be a factor in the post-2004 rise in youth unemployment.
- The trends for 18-24 year olds Not in Employment, Education or Training (NEET) follow the same pattern as youth unemployment. NEET rates for 16-17 year olds are very high (and rising) only if we include all part-time students. When these are removed teenage NEET rates are more like 10%.

Introduction

Unemployment is a perennial policy concern, and youth unemployment is a particular worry because of the ‘scarring effects’ of joblessness, which can persist for a long time in an individual’s life¹.

When Labour came to power in 1997, one of the party’s five pre-election pledges was to ‘get 250,000 under 25 year olds off benefit and into work’. Following on from the previous government’s efforts, policies such as the New Deal for Young People emphasised the importance of job search. But the new policies went beyond Jobseeker’s Allowance (JSA) by guaranteeing some activity (either subsidised employment, a government job or education/training), for all young people who were on JSA for more than six months.

Despite this policy activism, youth joblessness remains a problem - on some measures youth unemployed is higher today than in 1997.² Youth joblessness has indeed risen dramatically since the recession began in 2008, but we argue that this is to be expected as ‘marginal’ groups almost always fare worse during recessions.

The more surprising fact is that the youth labour market worsened between 2004 and 2007 *before* to the start of the current downturn. This is harder to explain – it is partly linked to the sluggishness of the whole labour market, but it may also be linked to changes in the priorities of the Employment Service.

The trends for 18-24 year olds Not in Employment, Education or Training (NEET) follow the same pattern as youth unemployment. The NEET rates for 16-17 year olds are extremely high (1 in 5 and rising) *only* if we include all part-time students. When these are removed teenage NEET rates are more like 10%.

The Great Recession of the late 2000s

GDP and aggregate unemployment in the last three recessions

Figure 1 plots GDP growth and the unemployment rate since 1975 – we use the ILO (International Labour Organisation) definition of unemployment from the Labour Force Survey (LFS) unless otherwise stated. The shaded areas denote the timing of the last three recessions the latest one, the last one (‘1990s’) and the earliest (‘1980s’).

Unemployment rose sharply in all recessions, peaking at over 11% in 1983 and 10% in 1992. After the 1990s recession, unemployment fell steadily, levelling off at historically low rates of around 5%

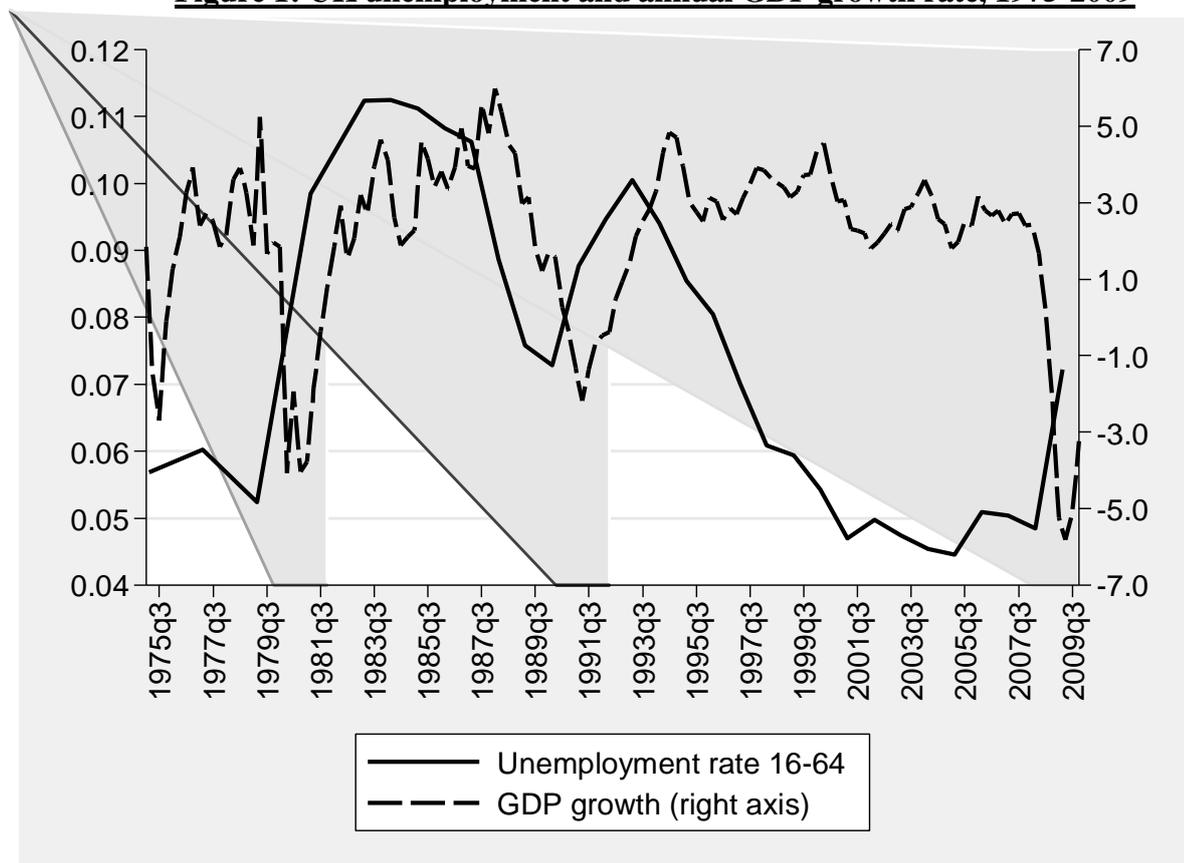
¹ von Wachter et al (2009) and Gregg and Tominey (2001).

²<http://www.guardian.co.uk/politics/2009/nov/11/cameron-brown-pmq-s-youth-unemployment>

in the mid-1990s. When the latest recession hit in 2008 and 2009, unemployment climbed to 7.6% by the third quarter of 2009.

Figure 2 plots the cumulative loss of GDP since the start of each of the last three recessions. The 1980s recession was worse than the 1990s recession. But despite getting off to a slightly slower start, the latest downturn has seen a larger cumulative fall of output than even the Thatcher recession – a 6% or more fall in GDP.

Figure 1: UK unemployment and annual GDP growth rate, 1975-2009



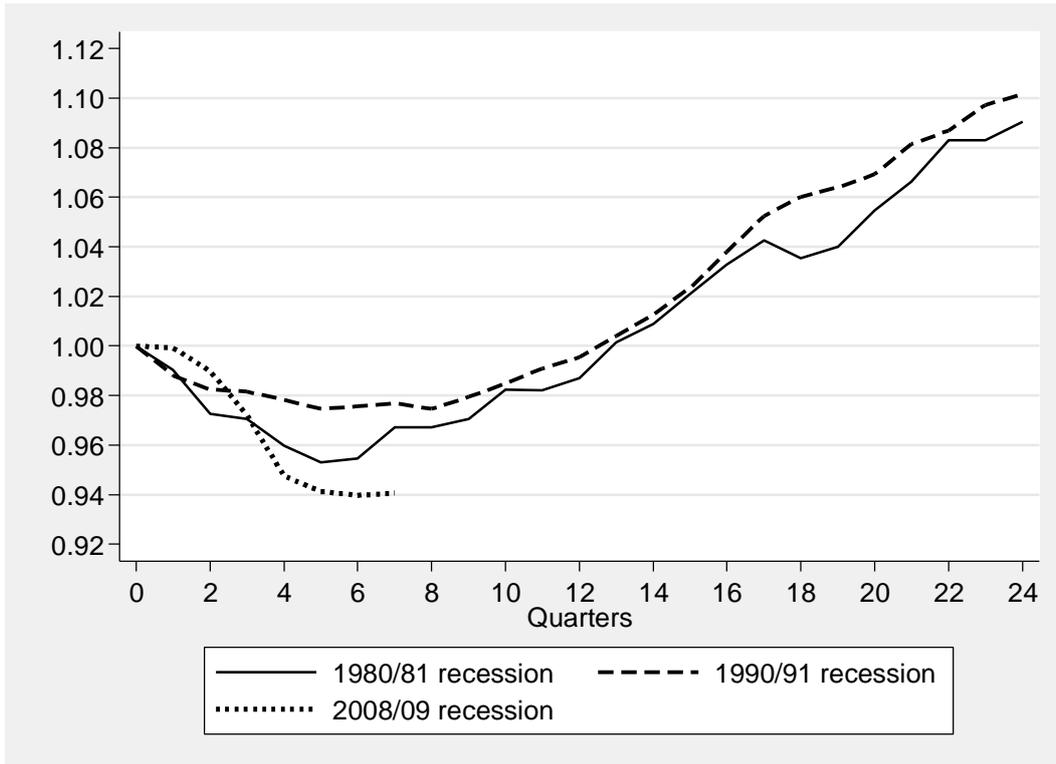
Source: Annual LFS 1975-1991 and calendar quarters 1992q2 to 2009q3. ONS GDP from 1975q1 to 2009q4 <http://www.statistics.gov.uk/statbase/>. Annual GDP growth. Unemployment rate (ILO) is measured yearly in March/April/May and linearly interpolated.

Unemployment by age group

Figure 3 plots the unemployment rates for the population of working age (16-64) and for three subgroups – prime age (25-49), young (18-24) and teenagers (16-17). The prime age group follows the general pattern of the aggregate labour market, but it is clear that the young are much more sensitive to the state of the business cycle. The unemployment rate is higher for the younger groups, and the magnitude of this disadvantage widens during a recession.

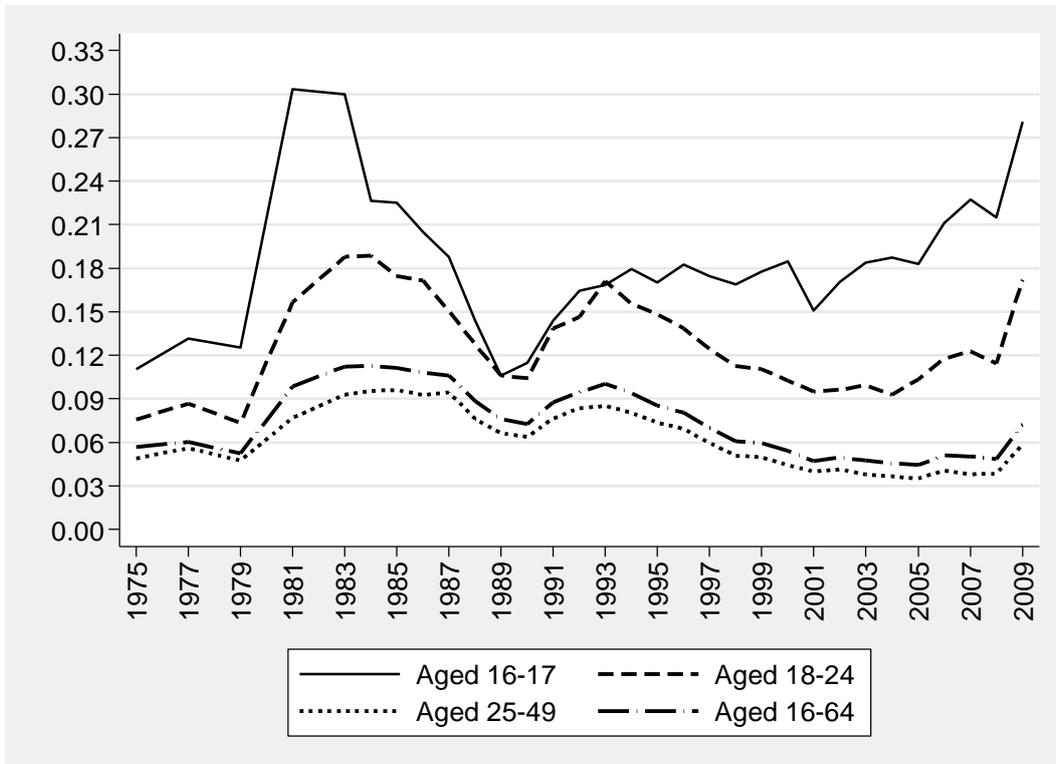
This outcome is unsurprising as employers will be reluctant to lose more experienced workers who have firm-specific skills (and also greater redundancy costs), so the burden of adjustment typically falls on low wage workers, such as young people. (Minorities and the less educated also tend to fare worse during downturns.)

Figure 2: Cumulative growth of GDP in the last three recessions



Source: ONS GDP from 1975q1 to 2009q4. We normalise to 1 the quarter before the start of each recession (dates as first GDP decrease) 1979q4, 1990q2 and 2008q1.

Figure 3: Unemployment rates by age group, 1975-2009

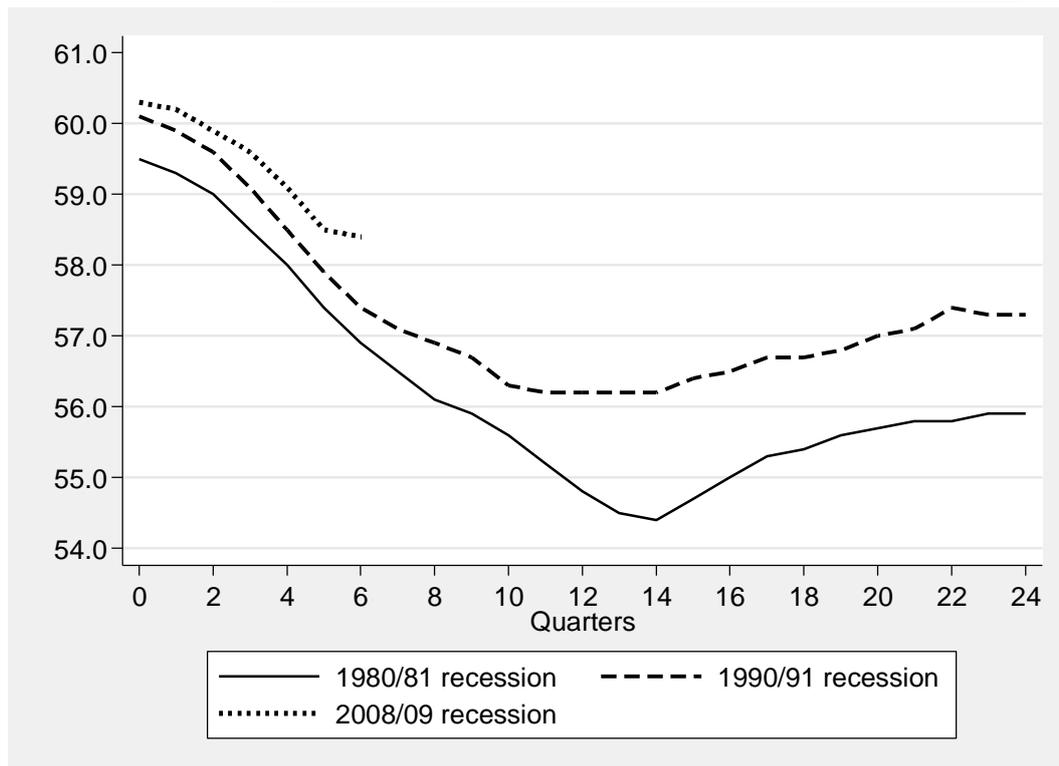


Source: Annual LFS 1975-1991 and calendar quarters 1992q2 to 2009q3. Unemployment rate (ILO) is measured yearly in March/April/May and linearly interpolated.

The teenagers do not appear to have experienced the same falls in unemployment after the 1990s recession as older groups. But this trend conceals important selection effects, as increasing numbers of non-employed teenagers are staying in education, and we discuss them in more detail below.

Figure 4 plots the employment rate for each of the three recessions. The employment rate was at historically high rates in 2007 prior to the Brown recession, yet despite the much larger fall in output shown in Figure 2, the employment rate has fallen by less than in the previous two recessions. This is the sense in which the labour market appears to be performing better than in the past.

Figure 4: Employment rates in the last three recessions



Source: LFS employment rate from 1971q1 to 2009q3. UK, all individuals aged 16 and over, seasonally adjusted (MGSR). <http://www.statistics.gov.uk/statbase/> Reference quarters 1979q4, 1990q2 and 2008q1 (first quarter before GDP decrease).

There are a number of possible explanations for this, including:

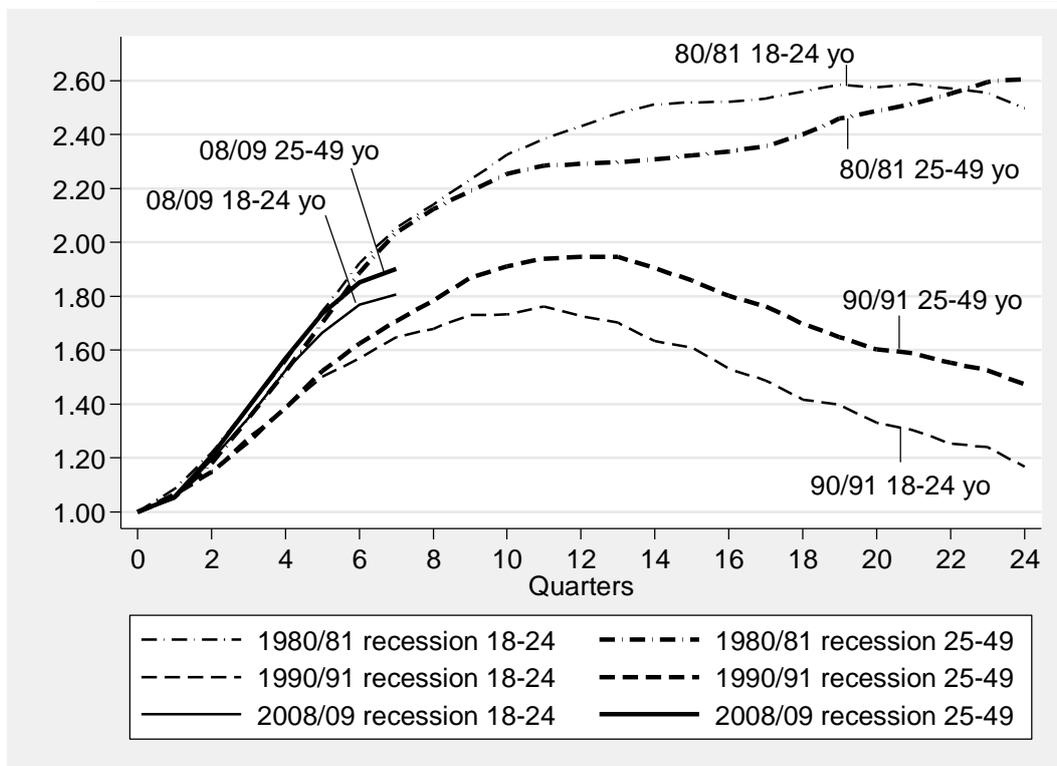
- A genuine improvement in the way job ‘matches’ are made through a more effective Employment Service. This is the ‘optimistic’ story that the cumulative reforms made since 1997 – such the New Deal and Job Centre Plus – have helped to improve matching in the labour market. For example, the ability (and incentive) to switch from JSA to incapacity benefit has been much reduced, which is a positive move as exit rates from disability benefits are much lower than from JSA (in part due to less emphasis on helping people look for jobs).
- Greater wage moderation (‘wage flexibility’) reducing the need for employers to shed jobs.

- The industrial composition of the shock has been in sectors that have high capital-labour ratios (for example, finance and manufacturing), so the GDP fall has been disproportionately greater than the jobs fall.
- Higher unemployment is still to come (for example, when public sector employment starts to fall with planned spending cuts).

But has the recent recession hit young people much worse than in the past? Figure 3 shows that the unemployment rate for the young has increased by more than the unemployment rate for older groups since the onset of the 2000s recession.

Furthermore, hourly wages appear to be falling for the younger groups more than the older groups; and even for those who are employed, average hours worked fell by more for the younger groups than the older groups. This all seems to indicate that young people have been bearing the brunt of the adjustment.

Figure 5: Proportionate growth in claimant count by age in last three recessions



Source: ONS claimant count current data up to 2009q4 (1985-2009), historical data (1983-1985) and registrants (1979-1982) by age band (February 2010). Reference quarters 1979q4, 1990q2 and 2008q1 (1st quarter before GDP decrease). Historical data are for a given calendar month, a monthly time series has been created by linear interpolation, leading to the quarterly data, which were seasonally adjusted.

But it could be said that this has been the general pattern in all recessions ('twas always thus'). The unemployment rate for young people is about the same as its 1990s highpoint and better than the 1980s peak, despite the fall in GDP being deeper. (The higher absolute number of young unemployed is due to the larger labour force and so is not really a relevant comparison.)

Figure 5 examines this more formally, breaking down the claimant count by age group in each recession³. The growth of youth unemployment (relative to the old) in this recession looks no worse than previous recessions – if anything slightly better.

We conclude that the available information does not suggest that there is a special problem of youth unemployment in this recession compared with past experience. The fact that young people suffer more during downturns is quite consistent with what has happened in previous recessions in the UK and elsewhere. A bigger problem is what was happening before the recession. We now turn to this issue.

Why did youth unemployment rise before the Great Recession?

Prime-age unemployment in the UK has been falling dramatically since the early 1990s – from nearly 9% in 1993 to 3% in 2005, after which it broadly stabilised and then rose again in 2008. But for the 18-24 age group, unemployment started rising in 2004, several years in advance of the recession. Thus there seems to be a component of the adult-youth unemployment differential that does not seem to be purely explained by the stronger impact of cyclical downturns on young people.

Despite several forces that may be in theory related to the poor performance of the youth labour market in recent years, the bulk of the rise in youth unemployment between 2004 and 2008 remains largely unexplained. We examine several factors: immigration, unemployment benefit reform, the minimum wage and skill demand.

Rising immigration

As the rise in youth unemployment dates back to 2004, the year of European Union enlargement to take in eight countries of Central and Eastern Europe (plus Cyprus and Malta), it would be natural to think that the increase in youth unemployment is related to stronger competition from immigrant labour.

The UK has experienced a record increase in immigration in the past few years. The proportion of foreign-born population was below 6% in the early 1990s, but is currently about 10%. In London, this proportion rose from 28% to the current level of around 40%. If immigration has an effect on the labour market prospects of natives, it may hurt youths more strongly than adults. Immigrants who are less skilled than natives will be closer substitutes for inexperienced youths.

Although youth unemployment is positively correlated with the share of immigrants in the regional labour market, this result is driven solely by the contrast between London and the rest of the UK (as London experienced particularly high rates of immigration and a relatively higher increase in unemployment). This raises the suspicion that other factors may explain this correlation. Overall, there is no compelling evidence of a causal impact of higher migration on youth unemployment (Card, 2009).

Unemployment benefits

The poor showing of the youth labour market is particularly worrying given the considerable policy reform to the Employment Service (especially for young people) in the last two decades.

³ The LFS was only annual prior to 1992, so we cannot do ILO quarterly unemployment rates for earlier recessions.

Jobseeker's Allowance (JSA) was introduced in 1996 as the main form of unemployment benefit and greatly increased the job search requirements for receiving benefits. It did appear to reduce the claimant count, but few of those leaving seemed to find sustainable jobs. JSA did not seem to improve the overall employment rate significantly (Manning, 2009) and may even have reduced it for the young (Petrongolo, 2009).

While the claimant count and LFS unemployment have been very close until October 1996 for the population over 18 years old, LFS unemployment remained well above the claimant count in the post-JSA period.⁴ Thus there is evidence of increasing numbers of workers who left the unemployment register but did not find jobs. About half of the 18-24 LFS unemployed do not claim JSA (compared with a third for 25-49 year olds). When dropping out of the welfare system, individuals may become more detached from the labour market and spend less effort on job search than while on unemployment benefits.

The New Deal for Young People was introduced in 1998 with the aim of improving the incentives and prospects for young workers to find jobs. All 18-24 year olds on JSA for six months now receive help with job search from a dedicated personal adviser. So there is some 'carrot' of job search assistance as well as a tougher 'stick' of stricter monitoring.

Rigorous evaluations show that job finding rates increased by about 20% as a result of the policy (Blundell et al, 2004, di Giorgi, 2005). These evaluations exploit the fact that there was a large difference in treatment between 24 years olds who were in the programme (the 'experimental group') and 25 year olds who were not (the 'control group'). Blundell et al (2004) also use the fact that the New Deal was piloted early in areas first and showed very similar programme effects.

Around 2004, the Employment Service was incentivised to focus less on young people on JSA and relatively more on other groups such as lone parents and those on incapacity benefits (through a system of 'job points'). This was because the problem of long-term youth unemployment was thought to have been broadly solved. Although there is no rigorous evaluation of this change, the timing does make one suspect that this may have been a cause.

A further problem is that the increasing numbers of LFS unemployed who are not claiming JSA (shown in Figure 8) separate them from any direct effect of the New Deal and the Employment Service in general.

Minimum wage

The National Minimum Wage was introduced in the UK in April 1999, but 16-17 year olds were exempt. In October 2004, the minimum wage was extended to cover workers aged 16-17 who are not apprentices, and this coincides with a strong increase in their unemployment rate.

Research in the UK has generally found few jobs effects of the wage floor.⁵ For example, Dickens and Draca (2005) find that the 2003 increase in the minimum wage had insignificant employment

⁴ One possible reading of these series is that the JSA removed from the register those who were not really looking for work or claiming fraudulently. Another interpretation is that the non-claimant unemployed simply have a level of search effort above the ILO/LFS threshold, but below the JSA threshold.

⁵ Machin et al (2003) detect a mild reduction in employment in the care homes sector after the introduction of the minimum wage. As the care homes sector is particularly vulnerable to the introduction of the minimum wage given the low starting level of wages, their estimates may be interpreted as an upper bound for the aggregate employment effects

effects for all demographic groups including youths. Furthermore, if minimum wages were to blame, we would expect a positive jobs impact on teenage apprentices, who were exempt from the 2004 legislation. In fact the proportion of apprentices in the 16-17 year old population *fell* from 4.1% in the first quarter of 2003 to 3.1% in the first quarter of 2007,⁶ casting doubt on the minimum wage explanation.

Falling demand for low skilled workers

There has been a large increase in wage inequality over the last three decades in the UK. The wage premium for being educated has risen despite a huge increase in the supply of college-educated workers, which implies that there has been an increase in the demand for skills. This is probably due to new 'skill-biased' technologies, but trade with less developed countries like China and India and falls in union power may also play some role. There are similar rises in the demand for skills in the United States and other countries (see, for example, Machin and Van Reenen, 2008).

A rise in demand for human capital may disproportionately hurt the young because they have less experience. This secular explanation is not so persuasive as youth unemployment was falling from 1992 to 2004 (and for parts of the 1980s) in the face of this rising demand for skill, so skill biases in labour demand are unlikely to be the explanation.

One possibility is that the quality of education for the type of young people likely to be unemployed may have declined. Although standards as a whole appear to be rising, it is possible that targets have led schools to neglect some of the 'hard to reach' that may up as non-employed.

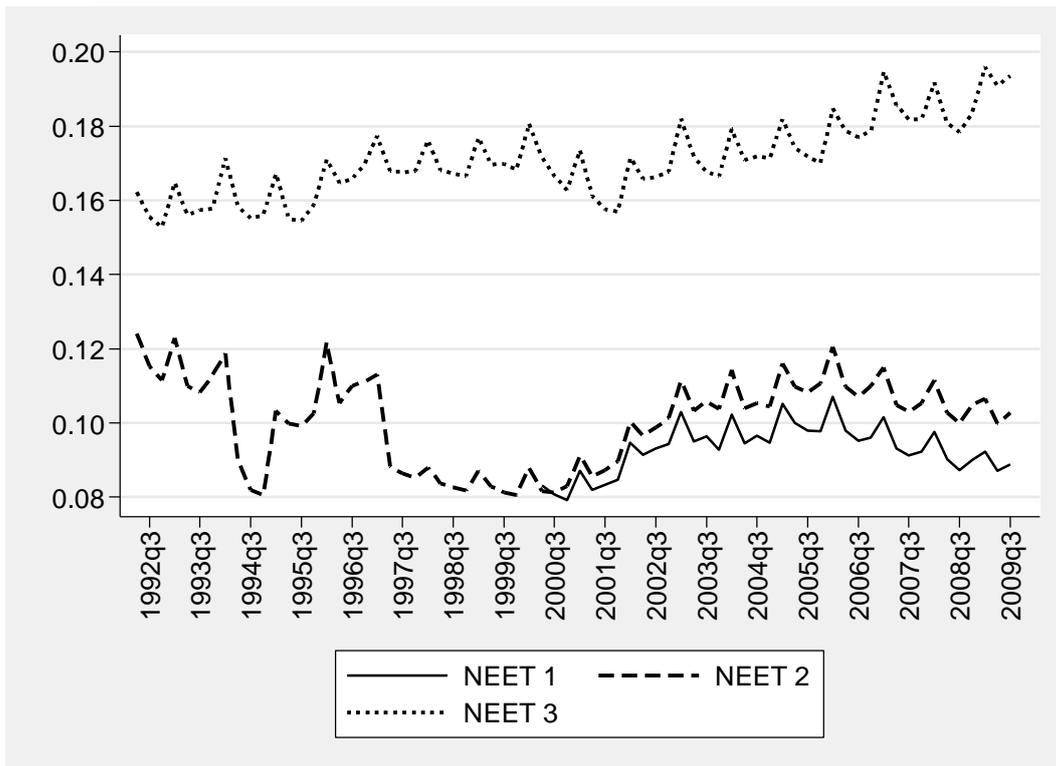
Idle youth? What about the young NEETS?

Unemployment rates may give a misleading impression of the labour market because of the large increase in the fraction of young people staying in full-time education. An alternative indicator is the proportion of the age group who are NEETs – 'not in employment, education and training'. Reducing the number of young NEETS has been a priority of the Department for Children, Schools and Families.

of the minimum wage. Stewart (2004a, 2004b) finds neither the introduction of the minimum wage nor the 2000 and 2001 upratings had significant employment effects for adults (aged 22+) or youths (18-21).

⁶ The data source is the LFS individual record files.

Figure 6: NEET rates 1992-2009 (aged 16-17), seasonally adjusted



Source: LFS calendar quarters 1992q2 to 2009q3. NEET1 defines as NEET (not in employment, education or training) all those who are not working, are not enrolled in either education or training, and declare that they are not working or studying towards a qualification. This latter information is only available since 2000. NEET2 defines as NEET those who are not working or enrolled in either education or training. NEET3 defines as NEET those whose main economic activity is not education, training or work.

Although the *levels* of NEET differ for 18-24 year olds they all show the same trends as the youth unemployment rates discussed above – a steady fall from the 1990s recession and then a rise starting in 2004 and accelerating in 2008.

Even prior to the most recent recession, several media reports have expressed worries that large proportions of 16-17 year olds were ‘doing nothing’ (that is, they were NEETS). But measuring the number of NEETS precisely is not straightforward because of the ambiguity of whether someone is ‘really’ in education or training (for example, they might say they are at school but never turn up).

The ‘narrow’ definition (defined like the official rate) excludes those who are in any type of education or training from NEET. According to this definition, at the end of 2009, about 9% of all 16 and 17 years olds were NEET (see Figure 6, series ‘NEET1’). But if we include in the NEET count all those who say they are in education or training but would accept a job offer, this number leaps to 19% (series ‘NEET3’).

The difference is mainly in the fact that there are a lot of students looking for part-time jobs – and thus it is incorrect to classify them all as NEET or ‘doing nothing’. But at the same time, it may be plausible that some of those who declare themselves to be receiving some kind of education and looking for jobs have essentially dropped out of the education system – thus the ‘narrow’ 9% figure underestimates the NEET rate.

Figure 6 shows the evolution in alternative NEET measures over time. The ‘narrow’ definition (‘NEET1’) is only available since 2000, as it is based on a question about whether an individual is ‘working or studying towards a qualification’. To obtain a longer time series, one can use information available since 1992 on school attendance and enrolment in training programmes (‘NEET2’). For the time span when both measures are available, NEET2 is not more than a percentage point above NEET1 and the trends move in an identical way.

The true trends of teenage NEETs are hard to gauge, partially because there is a lot of seasonal variation. On the broad definition, the numbers have stayed high since the 1990s recession. The narrow series is only available for a shorter period of time, but here there does seem to be some improvement in the post-2005 period with little effect in the recession.

This suggests that many more teenagers are choosing to stay at school rather than face a hostile labour market. The planned extension of compulsory schooling will cement these trends.

Conclusions

The UK labour market has held up surprisingly well so far given the depth of the current recession. Young people, however, have fared much worse than other groups with larger increases in their unemployment and bigger falls in hours and wages.

We argue that, unfortunately, this is to be expected as young people always suffer worst during downturns, and it does not seem that (relatively) they are doing particularly badly in the latest recession compared with the Thatcher and Major recessions.

More worrying, however, is that the fact that youth unemployment and NEET rates were bad going into the recession having been rising since 2004. The existing evidence does not allow us to give a firm answer as to why after over a decade of steady improvement, youth unemployment started rising in the mid-2000s.

We think that part of it was due to some softening of the overall labour market, and part of it was due to changes in the Employment Service, which targeted other ‘at risk’ groups with greater vigour. The other suspects – immigrants, the minimum wage and skill demand – do not seem to blame.

Finally, the refrain of ‘idle youth’ is overstated as the young NEET numbers typically include a large number of students who are seeking part-time jobs.

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For further information

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