

The Impact of Rising Unemployment on Income Distribution in the OECD

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David Blanchflower

Dartmouth, Stirling, NBER, IZA,
The New Statesman and Bloomberg

Symptoms of Recession

- In this recession the labour market has been a lead indicator in some countries and contemporaneous with output in most others.
- The NBER dated the US recession as starting in 2007Q4 based on the decline in non-farm payrolls *before* output fell in 2008Q2.
- In the UK and the Euro area the recession started around 2008Q2.
- The scale of declines in output and increases in unemployment vary considerably by country.

Peak to trough falls in output and latest unemployment rates

	GDP fall	Unemployment rate	<25 Unemployment rate
EA16	-5.2	10.0	20.9
EU27	-5.3	9.6	21.2
Austria	-4.9	5.4	12.0
Belgium	-4.1	8.2	21.8
Denmark	-7.2	7.4	12.4
Estonia	-22.5	15.2	44.5
Finland	-9.3	8.8	22.9
France	-3.5	10.0	25.3
Germany	-6.4	7.5	10.2
Greece	-1.7	9.7	25.3
Hungary	-7.5	10.7	28.8
Ireland	-10.9	13.3	29.0
Italy	-6.7	8.5	26.2
Japan	-8.9	5.2	
Latvia	-26.8	22.8	43.8
Lithuania	-21.0	14.6	33.7
Netherlands	-5.2	4.0	7.6
Portugal	-4.2	10.4	18.6
Spain	-4.7	19.5	43.6
Sweden	-6.3	8.9	26.7
United Kingdom	-6.2	7.8	19.8
United States	-3.7	10.0	18.9

Explanations for the Growth in Unemployment

- Countries that have had big increases in unemployment have;
 - * been exposed to **world trade** (Germany, Japan and Sweden),
 - * had large increases in **house prices** (Spain, Ireland and the UK).
 - * had large **financial sectors** (UK and the USA),
 - * been unable to depreciate their currencies (Spain, Ireland, Greece).
- So there will be sectoral impacts on the income distribution – incomes in construction.
- The impact of this recession has hit the *young* especially hard. Not least because this is a large cohort.

Size of the 10 year old youth cohort in 2008 (20 year olds =100)

- Bulgaria 57.4
- Denmark 111.6
- Estonia 55.2
- Germany 83.1
- Latvia 48.6
- Poland 70.2
- Portugal 88.4
- Romania 62.2
- Russia 49.9
- Spain 81.6
- Sweden 82.4
- United Kingdom 89.4
- USA 94.2

Effects on the Income Distribution - 1

- It is too early to tell what has happened to the income distribution as data are scant to this point.
- Bankers bonuses are a particular issue in some countries but especially the UK and the USA, impacting the top-end.
- The self-employed have likely seen their earnings fall most – especially true in construction for plumbers, carpenters etc.!
- Non-labour incomes have fallen for savers because of low interest rates.
- Based on **wage curve** estimates incomes of the young, minorities and the least educated will likely fall the most.

Disaggregated wage curves – wage unemployment elasticities

All	-.13
Women	-.11
Men	-.14
Primary education	-.19
Secondary education	-.14
Tertiary	-.06
Age 15-29	-.31
Age 30-44	-.09
Age 45-64	-.11
Public sector	-.05
Private sector	-.17

Effects on the Income Distribution - 2

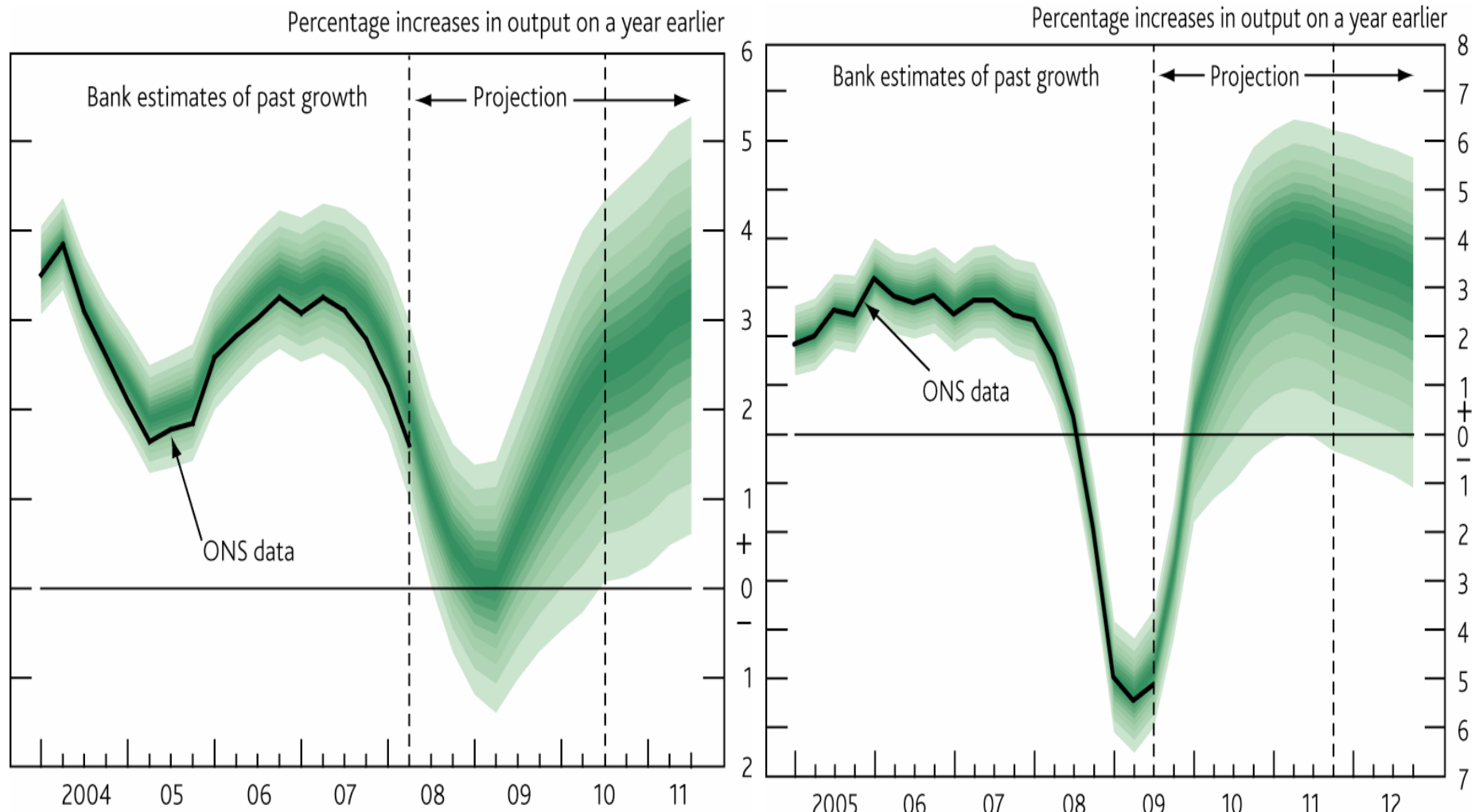
- This recession is clearly not over yet. The possibility exists of a double-dip recession once stimulus is removed as in the US in 1937.
- Reinhardt and Rogoff show that financial crises have “deep and lasting effects on asset prices and employment”
- The unemployment rate increases, an average of 7 percentage points over the down phase of the cycle, which lasts, on average over four years.
- Output falls (from peak to trough) an average of over 9 percent, although the duration of the downturn, averaging roughly two years, is considerably shorter than for unemployment.

A case study – the UK

- The UK experienced six quarters of negative growth with output dropping 6.2% from peak to trough.
- Unemployment has not increased as much as I had feared – now 2.5 million unemployed (7.8%).
- Wages and hours especially have been very flexible.
- Now the stimulus is being removed.
- The assumption made by the Bank of England is that there will be a V-shape recovery.
- This will impact incomes and employment.

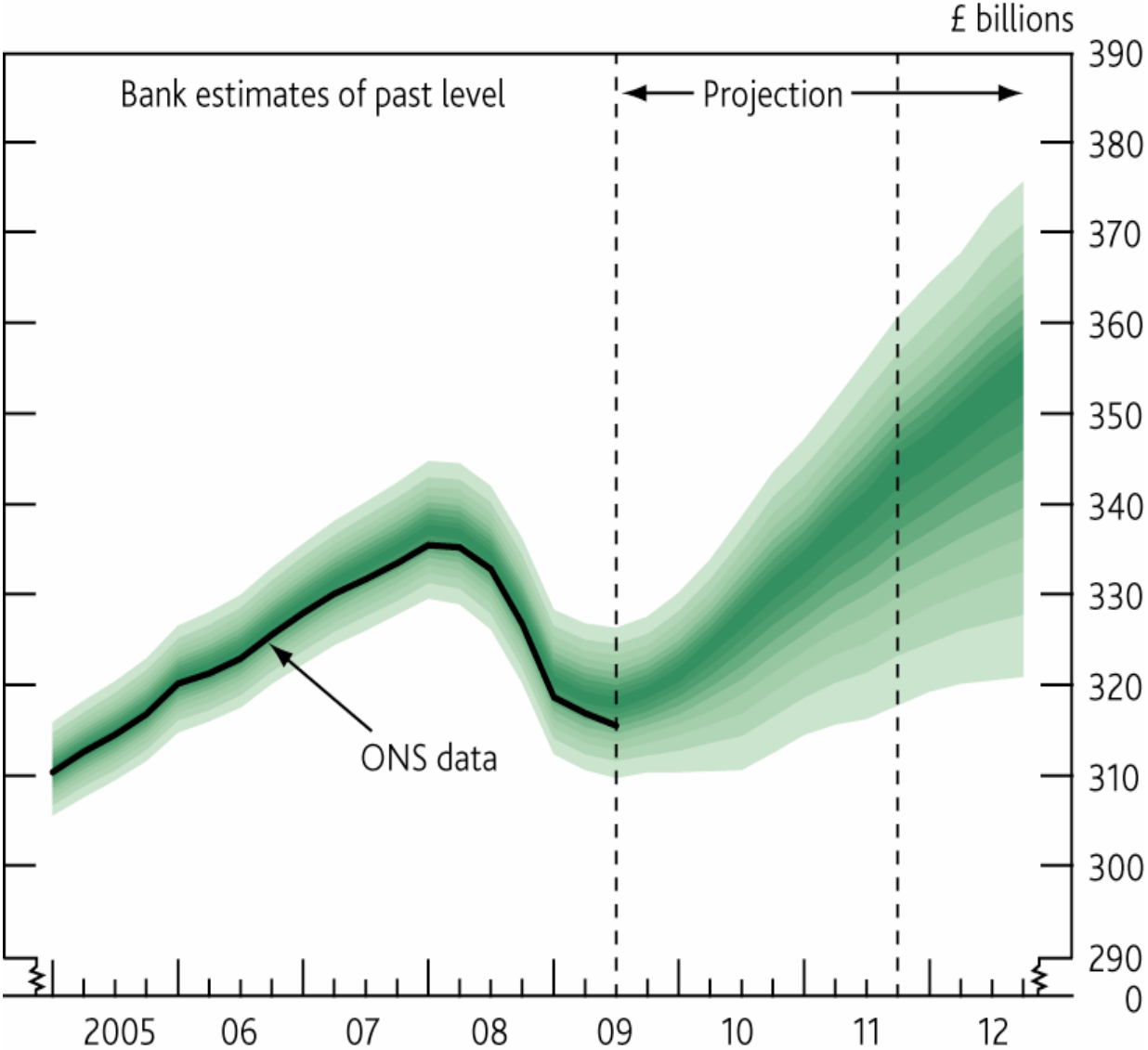
August 2008 MPC forecast

November 2009 forecast



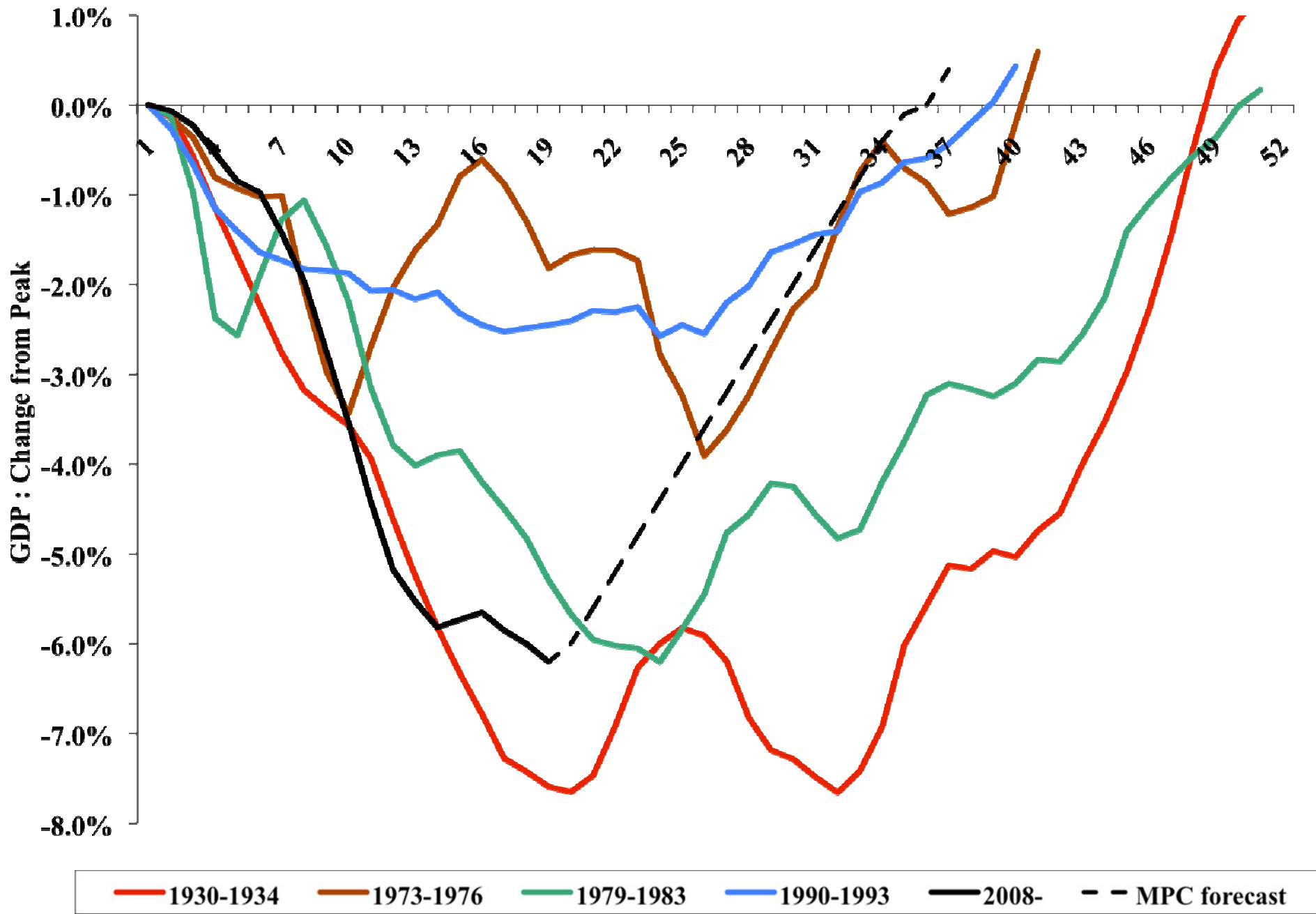
Wishful thinking!

Chart 2 Projection of the level of GDP based on market interest rate expectations and £200 billion asset purchases



Chained-volume measure. See the footnote to **Chart 1** for details of the assumptions underlying the projection for GDP growth. The width of this fan over the past has been calibrated to be consistent with the four-quarter growth fan chart, under the assumption that revisions to quarterly growth are independent of the revisions to previous quarters. Over the forecast, the mean and modal paths for the level of GDP are consistent with **Chart 1**. So the skews for the level fan chart have been constructed from the skews in the four-quarter growth fan chart at the one, two and three-year horizons. This calibration also takes account of the likely path dependency of the economy, where, for example, it is judged that shocks to GDP growth in one quarter will continue to have some effect on GDP growth in successive quarters. This assumption of path dependency serves to widen the fan chart.

Chart. UK GDP % cumulative changes



UK labour market developments - 1

- **ILO unemployment** increased by 850,000 (7.8%) from the peak in April 2008 (5.1%) to October 2009
- **Claimant count** increased by 781,000 between April 2008 and October 2009 (16-17 year olds ineligible).
- **Employment** has fallen by 642,000 between April 2008 and October 2009.
- **FT employment** over the last year fell by 594,000 but **PT employment** has *risen* by 143,000.

Latest labour market developments - 2

- Total actual **hours** worked has fallen by 4% compared with a 2.2% fall in employment from the peak
- The number of **temporary workers** who could not find a permanent job is 486,000, up 124,000 on the year.
- The number of **part-time workers** who can't find a full-time job is 1,028,000 up 280,000 on the year.
- There are 2,308,000 people who are **inactive because they could not find a job**, up 108,000 in latest quarter

Latest labour market developments - 3

- **Wages** have been more flexible downwards than in the US?
- **Self-employment earnings** are likely down a lot more.
- According to the latest BCC Monthly Business Survey 63% of firms are planning a **wage freeze** or pay cuts in 2010.
- The latest 3mth average growth rate of Average Weekly Earnings (AWE) for the private sector including bonuses was -0.2%
- Earnings in the UK seem to have been especially flexible in part due to existence of commuters from the Accession countries

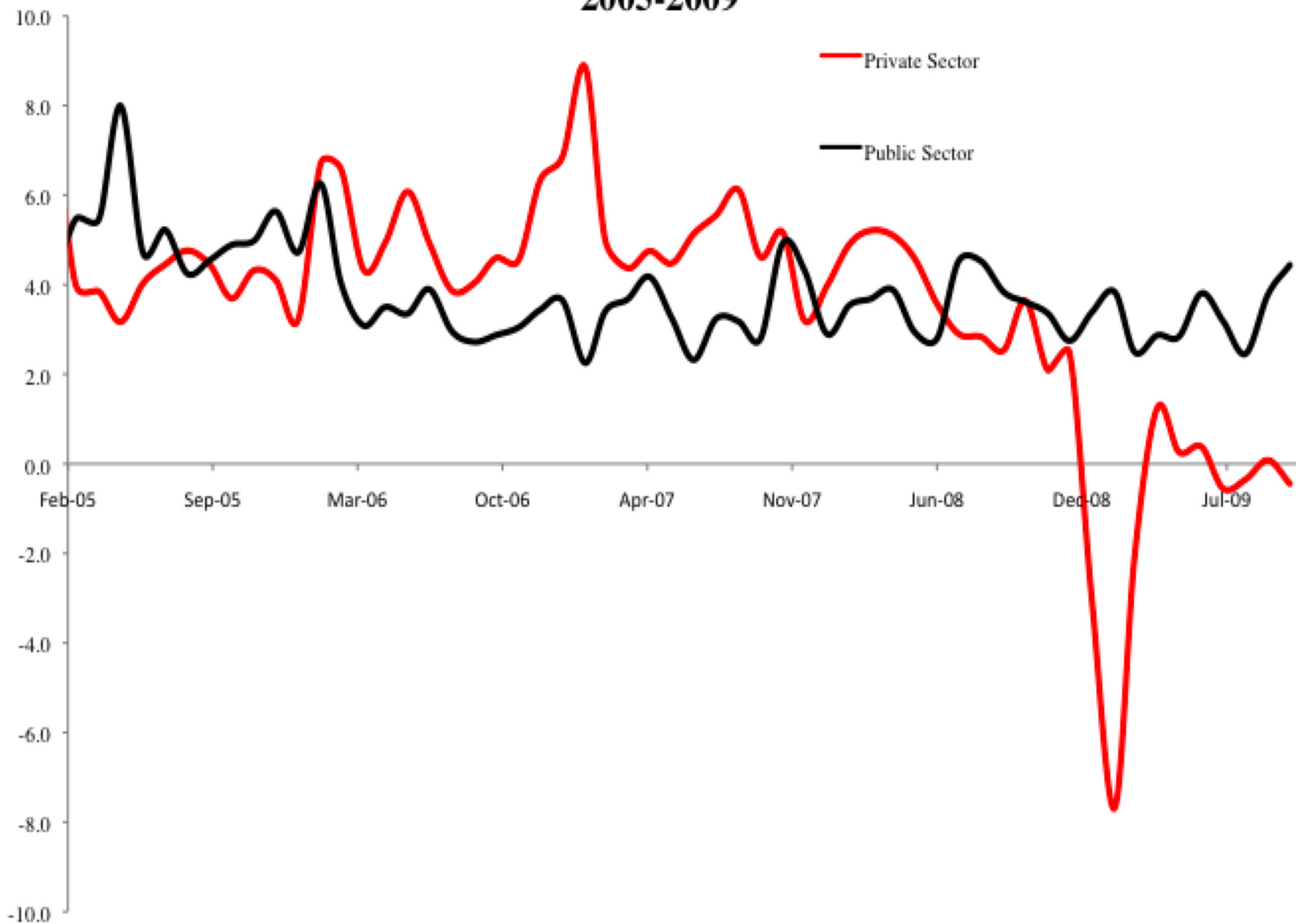
UK Construction

	Employment	Output (2005=100)
2006 Q1	2,150,000	100.2
2006 Q4	2,221,000	102.2
2007 Q1	2,219,000	102.6
2007 Q4	2,237,000	104.8
2008 Q1	2,251,000	105.9
2008 Q4	2,278,000	98.1
2009 Q1	2,231,000	91.0
2009 Q2	2,162,000	91.5
2009 Q3	2,095,000	93.2
2009 Q4		93.2

A8 Accession Country Commuters ('000s)

	WRS registrations	Nat Ins # registrations
Czech Rep.	25,490	37,770
Estonia	4,140	6,250
Hungary	32,670	45,430
Latvia	32,615	37,000
Lithuania	52,915	72,690
Poland	457,290	635,060
Slovakia	68,560	93,140
Slovenia	670	1,800
Total	674,350	929,140

3mth annual growth rates in Average Weekly Earnings (AWE) 2005-2009



UK weekly earnings of full time workers

	<i># workers</i>	<i>Mean</i>	<i>Median</i>	<i>1st decile</i>	<i>1st quartile</i>	<i>9th decile</i>
2008Q3	19,082	£513	£436	£231	£301	£865
2008Q4	18,891	£520	£442	£234	£308	£865
2009Q1	18,562	£520	£438	£231	£300	£877
2009Q2	18,354	£530	£450	£231	£308	£900
2009Q3	18,440	£524	£444	£231	£308	£904

Source: Labour Force Survey

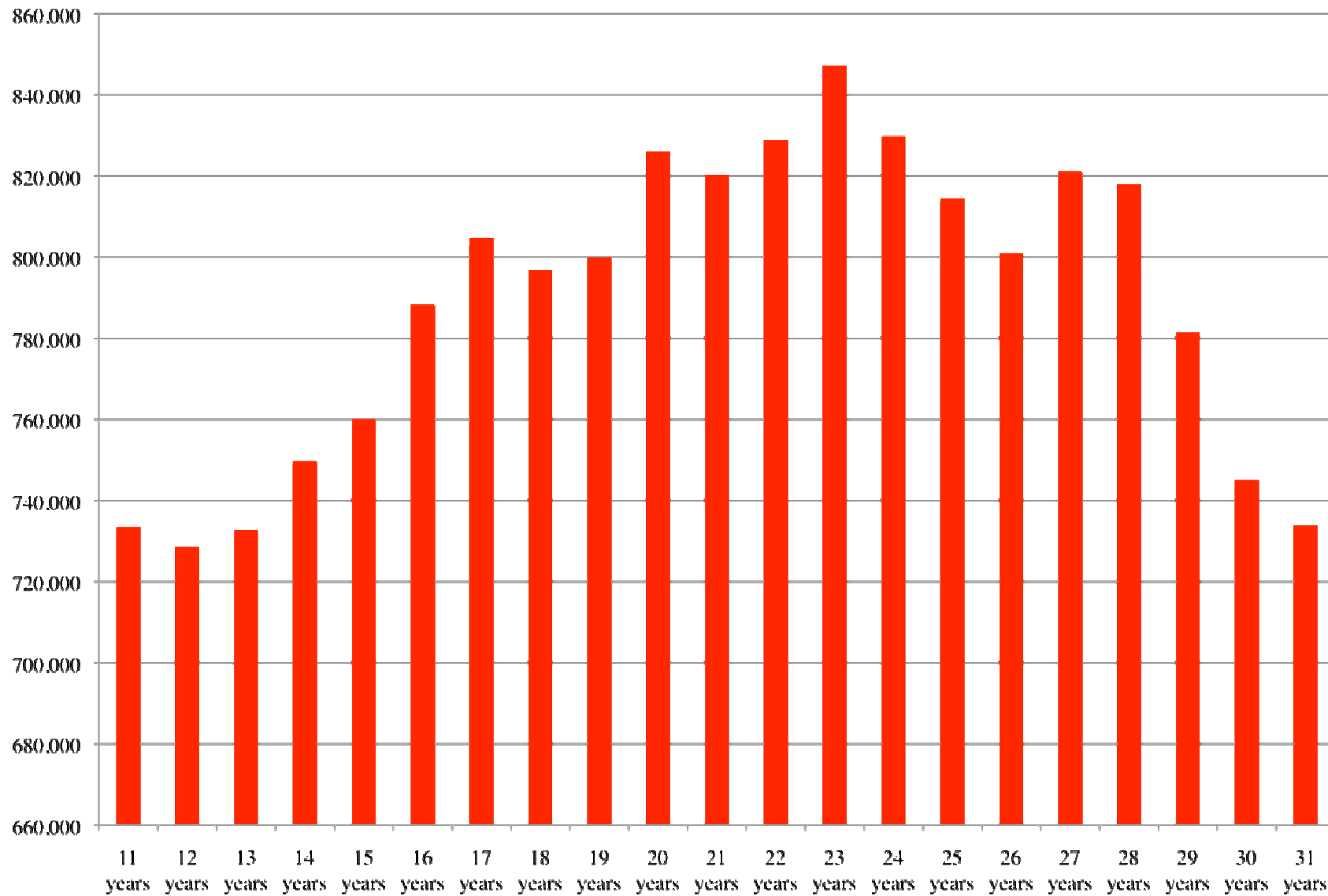
US Median usual weekly earnings of full time, wage and salary workers

<i>Year</i>	<i>Qtr1</i>	<i>Qtr2</i>	<i>Qtr3</i>	<i>Qtr4</i>
2007	\$693	\$690	\$695	\$700
2008	\$719	\$719	\$720	\$728
2009	\$738	\$734	\$738	\$748

The young

- The number of unemployed youngsters under the age of twenty five increased from 680,000 in April 2008 to 927,000 in October 2009.
- The number of employed youngsters under the age of twenty five decreased from 4,244,000 in April 2008 to 3,779,000 in October 2009.
- Over the last year employment of those aged 16+ fell by 451,000 whereas employment of those aged 16-24 fell by 340,000 or 75% of the total.

Size of youth cohort, UK 2008



The Consequences of Youth Unemployment - 1

- In a recent paper, David Bell of the University of Stirling and I, found that youth unemployment creates permanent scars
- We used data from the UK 1958 (3rd -9th March) birth cohort the National Child Development Study (NCDS).
- Youth unemployment raises unemployment, lowers wages, worsens health and lowers job satisfaction *twenty five years later*
- No such effects could be found for spells of unemployment when the respondents were in their thirties
- This is consistent with earlier work in the US by David Ellwood

The Consequences of Youth Unemployment - 2

- The Prince's Trust, along with YouGov, conducted a survey in the UK between 8 and 16 December last year of 2,088 young people aged between 16 and 25.
- But one group is strikingly different from the rest. Young people who are not in education, employment or training (Neets).
- In comparison to other young people, Neets are significantly more likely to feel **ashamed, rejected, lost, anxious, insecure, down and depressed, isolated and unloved**. Neets were disproportionately more likely to say that they had turned to drugs and to say that their life had no direction.
- There are 1,082,000 Neets currently aged between 16 and 24.

4-step Life Satisfaction Score of the Young

	2009	2007
Austria	3.07	3.20
Belgium	3.25	3.35
Denmark	3.60	3.68
East Germany	2.84	2.81
Finland	3.30	3.32
France	3.10	3.27
Great Britain	3.33	3.32
Greece	2.64	2.89
Ireland	3.09	3.27
Italy	2.78	2.86
Netherlands	3.56	3.61
Portugal	2.60	2.87
Sweden	3.46	3.34
West Germany	3.08	3.14

Happiness of the young – USA (%)

	very happy	quite happy	not too happy
1996	27	62	11
1998	26	59	15
2000	28	63	9
2002	29	56	15
2004	32	55	13
2006	27	60	13
2008	24	58	18
Average	28	59	12

Source: General Social Survey

The Consequences of Youth Unemployment - 3

- Lisa Kahn* has recently shown that the labour market consequences of graduating from college in a bad economy have large, negative and persistent effects on wages. Lifetime earnings are substantially lower than they would have been if the graduate had entered the labour market in good times.
- Cohorts who graduate in worse national economies tend to end up in lower-level occupations.
- Recent work by Giuliano and Spilimbergo** suggests that the period of early adulthood (between 18 and 25) is when people are more sensitive to macroeconomic conditions. Being exposed to a recession before the age of 17 or after age 25 they found has no impact on beliefs. They find that youngsters growing up during recessions tend to believe that success in life depends more on luck than on effort.
- Recessions seem to have a long-lasting effect on youngsters' beliefs.

*Lisa B. Kahn (2010), 'The long-term labor market consequences of graduating from college in a bad economy', forthcoming in Labour Economics.

**Paola Giuliano and Antonio Spilimbergo, 'Growing up in a recession: beliefs and the macroeconomy', NBER Working Paper No. 15321, September 2009

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Keynes

“The duration of the slump may be much more prolonged than most people are expecting and ... much will be changed both in our ideas and in our methods before we emerge. Not, of course the duration of the acute phase of the slump, but that of the **long, dragging conditions of semi-slump**, or at least sub-normal prosperity, which may be expected to succeed the acute phase.”

J.M. Keynes (1931)

Skidelsky

“In short, the object of macro-policy should be to keep the economy in ‘quasi-boom’ till the economic problem was solved and people could live ‘wisely, and agreeably, and well’.”

Robert Skidelsky (2009).

IMF

“The best indicator (for the exit timing) is private demand and employment ... In most countries, growth is still supported by government policies. For as long as you do not have private demand strong enough to offset the need of public policy, you shouldn't exit,”

Dominique Strauss-Kahn, head of IMF, January 18th 2010.

Conclusions

- We are still in the dragging conditions of **semi-slump** and are certainly not in **quasi-boom**.
- Unemployment lowers happiness much more than inflation does. Misery index is approx 2.
- There is a major concern of a double-dip in many countries if the stimulus is removed before recovery is established.
- I have a major concern that wage growth remains benign and with non-labour incomes low, spending is cut, which increases the number of redundancies and so on....
- We must continue to avoid what Bernanke called the **death spiral**.

End

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Thank you