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The Welsh Labour Market Following the Great Recession

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Abstract

Not only can recessions affect a range of aggregate outcomes but they can also have negative consequences for individuals, some of which can be long-lasting. It is therefore very important to take appropriate measures to try and mitigate the impact of a recession. The UK government was initially fairly pro-active in introducing and co-ordinating policy actions in an attempt to limit the impact of the recession. Combined with other factors, this resulted in a smaller reduction in UK employment than might have been expected, especially in comparison to the decline observed in GDP or in relation to the employment falls seen in other recent recessions in the UK. However, the coalition government's plans to reduce the budget deficit could have negative effects for towns and cities which are heavily reliant on public sector employment. Many areas within Wales fit into this category so after reviewing a range of statistical evidence, this policy brief reviews some of the policy measures that the Welsh Assembly Government has already taken and the areas where future policy could be directed. The discussion particularly focuses on the important role that skills can play.

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Background

It is important to be aware of what changes are taking place within the labour market during a recession. This is because of the implications that these changes have at both the aggregate and individual level. Not only do higher levels of unemployment have an impact on a range of social and economic outcomes (e.g. it is often thought to produce higher crime rates and lower levels of demand within affected areas and worsening public finances through lower tax receipts and higher benefit payments) but there are also major impacts on the people who lose their jobs. In particular, there is considerable evidence to suggest that unemployment causes higher levels of depression and poorer health outcomes more generally as well as often producing a scarring effect, whereby a person's future labour market prospects are harmed by a (prolonged) spell of unemployment. Such scarring effects are particularly damaging if the individual becomes unemployed at an early age (Gregg, 2001). Older workers losing their jobs can also find it very difficult to regain employment and often withdraw from the labour market after becoming discouraged with job search, which has contributed to the large number of people claiming incapacity benefit. Appropriate policy responses are therefore crucial in mitigating some of the negative impacts of a recession.

Gregg and Wadsworth (2010a,b) and Jenkins (2010) provide recent evidence on the impact of the recession on the UK labour market, by focusing on changes in employment, unemployment, inactivity, hours of work and earnings. Their findings provide a useful overview to some of the issues affecting the national level that are also relevant when discussing the Welsh labour market. This policy briefing also provides an update on the analysis and discussion contained in Blackaby and Murphy (2009), in which they consider the early impact of the recession on Wales and discuss the policy measures that were initially introduced, both by the Welsh and UK governments, in order to try and limit the impact of the downturn. This policy briefing also considers issues connected to the likely impact of the upcoming public sector cuts, following the recent Comprehensive Spending Review, since these are likely to have a major impact on Wales given the importance of public sector employment to many parts of the country.

The UK and Welsh Labour Markets During the Recession

The employment rate provides one of the main indicators for the health of the labour market since it expresses the number of people who are in work as a percentage of the working age population. Figure 1 shows how the employment rate has evolved in Wales and the UK since the second quarter of 1992.¹ It shows that the employment rate in Wales has been

¹ This is the earliest quarterly data available for UK regions, following the introduction of the Quarterly Labour Force Survey. Quarterly employment rates have been chosen (rather than monthly) as monthly rates are more likely to be subject to sampling variation.

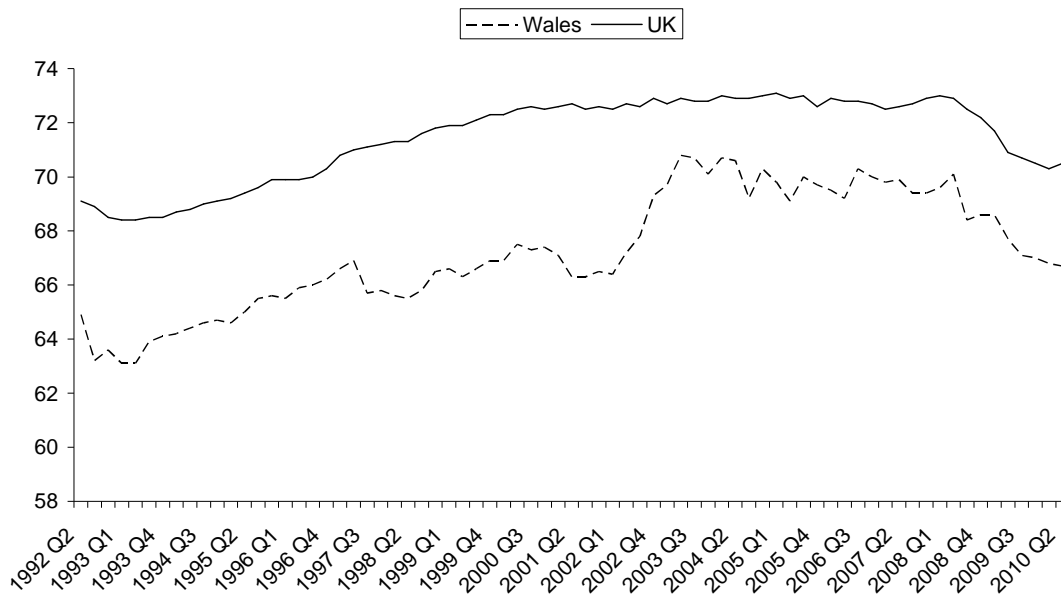
consistently below that in the rest of the UK over the whole of the period but the deficit narrowed to a couple of percentage points in the mid-2000s. The rise in the Welsh employment rate was particularly strong between the first quarters of 2002 and 2004, increasing by more than 4 percentage points, compared to half a percentage point in the UK as a whole. However, the gap between Wales and the UK has widened again in recent quarters.

Thus the Welsh labour market appears to have been affected slightly more by the recession than the rest of the UK. Figure 1 also reveals that Wales experienced relatively large falls in its employment rate during the first third quarter of 2008 and second and third quarters of 2009. In contrast, the decline in the UK rate between mid-2008 and early 2010 was fairly constant and the rate even showed a slight rise in the second quarter of 2010. Moreover, Gregg and Wadsworth (2010a) argue that the contraction seen in UK employment during the Great Recession was small in relation to the decline in GDP. They report that the fall in GDP of around 6% was not matched in terms of the decline in employment, which fell by only around 2 percentage points. In contrast, the declines in employment and GDP had been fairly similar in the two previous recessions.² Gregg and Wadsworth (2010a) suggest three reasons for this apparent discrepancy in the UK economy during the most recent recession. These were that employers were in reasonable financial shape at the time of the recession, the actions taken by the UK government and that wage settlements moderated at the start of the recession. Elsby and Smith (2010) also contrast the discrepancy between job inflow and outflow rates seen in the UK during the recent recession in comparison to what has occurred in the US and in past recessions in the UK. In particular, they report that whereas job loss has been fairly high recently in the UK, job finding rates have not fallen by much in comparative terms, which has limited the effect of the recession on the overall level of unemployment. However, unemployment can continue to increase after a recession has ended since it is a lagging indicator and cuts in the public sector, partly to pay for the fiscal stimuli to limit the early impact of the recession, as well as the recent rise in Value Added Tax (VAT) may still have a detrimental effect on overall levels of employment.

² The international experience has also been mixed with some countries also experiencing small increases in unemployment relative to the decline GDP such as Sweden, Italy, Germany, the Netherlands and Japan, whereas the rise in unemployment has been relatively large in others including the US, Spain and Ireland. Some countries such as Germany introduced policies designed to encourage shorter working in order to try and minimise employment loss.

Figure 1

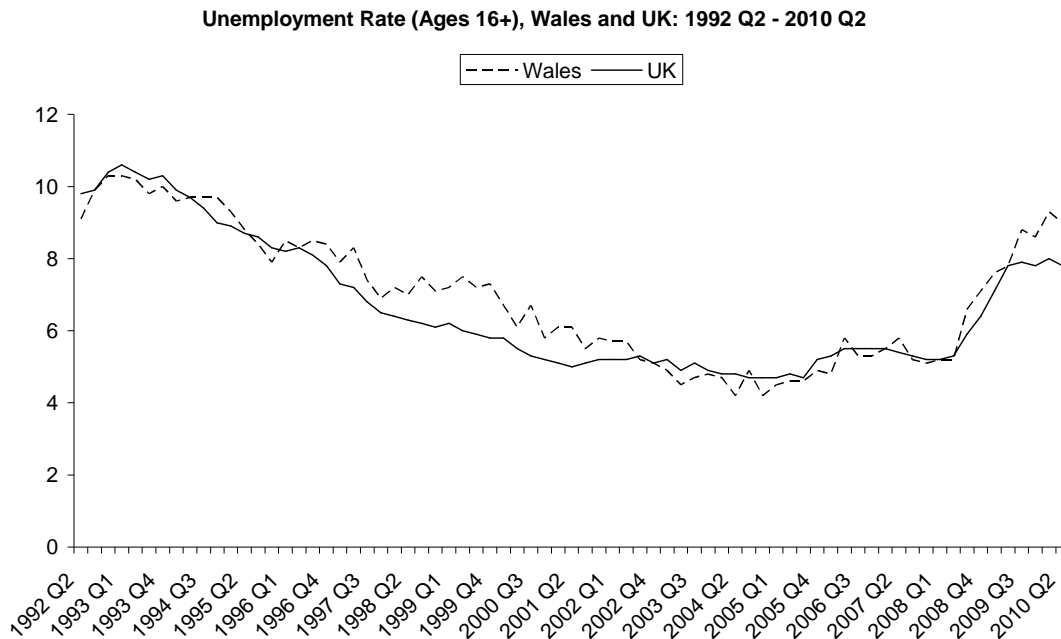
Employment Rate (16-64 year olds) Wales and UK: 1992 Q2 - 2010 Q2



Source: Office for National Statistics

Figure 2 presents changes in the unemployment rate over the same period. This figure reveals a different picture to Figure 1 since the International Labour Organisation (ILO) definition of the unemployment rate for Wales and the rest of the UK have been very similar over the period, with the Welsh rate sometimes falling below that of the UK. This was particularly the case during the mid-2000s, when as noted earlier, employment growth in Wales had been relatively strong. The similarity between Welsh and UK unemployment rates over most of the period can partly be explained by the relatively high rates of economic inactivity in Wales (Fothergill, 2001) since the economically inactive do not feature in the formula to calculate unemployment rates but appear in the denominator for employment rates. However, since the start of the recession the unemployment rate in Wales has been at least one percentage point above the UK rate, mirroring the position seen in the late 1990s and early 2000s, although this was in the context of an improving labour market. Interestingly, inactivity rates have remained fairly stable since the start of the recession. There has been a slight increase in male inactivity rates in the UK, increasing by over a percentage point between mid-2008 and mid-2010, whereas the inactivity rate for Welsh males has stayed more or less constant around 20%. However, a gap of around 3 percentage points remains for males. There has been more fluctuation in the inactivity rates in females in Wales both in comparison to males and to females in the UK as a whole. After an initial decline in inactivity rates in the early part of the recession, the rate has increased by around 2 percentage points since the end of 2009.

Figure 2



Source: Office for National Statistics

In order to examine whether the loss of jobs has been evenly distributed across different sectors of the economy, Table 1 reports how the industrial structure has changed in Wales and the UK between March 2008 and June 2010.³ The figures point to a further decline in manufacturing employment in both Wales and the UK of around two percentage points since the start of the recession, with this sector now accounting for just over a tenth of the workforce. The table also highlights the high, and increasing, proportion of workers in Wales employed in Public Administration, Education and Health. This sector currently accounts more than 35% of Welsh employment, compared to just over 30% in the UK as a whole. In contrast, the percentage employed in Banking, Insurance and Finance in Wales has traditionally been far lower than in the rest of the UK. For example, despite the relatively large increase in the percentage employed in this sector since March 2008, employment in this sector in Wales was still 5 percentage points lower than that in the UK.

³ ONS (2009) suggest that the recession in the labour market started in the second quarter of 2008 since both the claimant count measure of unemployment and redundancy levels started to increase in this quarter. This means that March 2008 should mark around the high point in the UK labour market.

Table 1**Industrial Distribution of Employment, Wales and the UK**

| | United Kingdom | | Wales | |
|--------------------------------------|----------------|---------|---------|---------|
| | Mar. 08 | Jun. 10 | Mar. 08 | Jun. 10 |
| Agriculture and fishing | 1.0 | 1.0 | 1.5 | 1.7 |
| Energy and water | 1.6 | 1.7 | 1.9 | 2.4 |
| Manufacturing | 12.1 | 9.9 | 12.6 | 10.4 |
| Construction | 8.8 | 7.8 | 9.6 | 8.4 |
| Distribution, hotels and restaurants | 18.7 | 18.7 | 19.1 | 18.9 |
| Transport and communications | 9.4 | 8.5 | 6.9 | 6.1 |
| Banking, finance and insurance | 14.8 | 16.1 | 9.9 | 11.6 |
| Public admin., education and health | 28.3 | 30.7 | 33.6 | 35.4 |
| Other services | 5.3 | 5.5 | 5.0 | 5.2 |

Source: Office for National Statistics

Neither has there been an even labour market picture within Wales, from a spatial perspective. This can be seen from Table 2, which presents unemployment rates (ILO and claimant count) for Welsh Unitary Authorities (UAs), as well as the percentage employed in the public sector.⁴ Overall, there was around a 3 percentage point rise in unemployment in the two years following March 2008 before unemployment began to fall in mid-2010. However, whilst some very large rises in the ILO unemployment rates are noticeable (especially in the South Wales Valleys), a fall was recorded in some parts of north Wales (Anglesey and Gwynedd). In contrast, particularly high and rising ILO unemployment rates have been observed for Blaenau Gwent, Merthyr Tydfil and Caerphilly. Some of these areas also display relatively high rates of unemployment using the claimant count definition (the top two unemployment blackspots in Wales are again shown to be Blaenau Gwent and Merthyr Tydfil). However, the rates produced under this definition are far lower, with the discrepancy compared to the ILO definition quite marked for some areas outside of the South Wales

⁴ The International Labour Organisation (ILO) unemployment rate is the official measure of unemployment used in the UK. It is based on willingness to work and can be used to make direct comparisons with rates in other countries. It is however subject to sampling variation for smaller geographical areas because the estimates are based on survey data. In contrast, although the claimant count rate relates to a narrower definition of unemployment since it just includes benefit claimants, it is obtained from administrative records published on a monthly basis.

Valleys including Swansea, Neath Port Talbot and Bridgend, where the difference between the rates is in excess of five percentage points.⁵

Table 2 also reports the percentage employed in the public sector.⁶ The public sector is a very important employer throughout Wales, accounting for at least a quarter of total employment in each UA. However, the public sector is particularly vital in certain parts of the country, especially in Swansea, Ceredigion, Anglesey and Cardiff and, where more than 35% of the workforce are employed in government supported jobs. These local economies would therefore appear to be very susceptible to the public sector cuts that were announced in the Comprehensive Spending Review in October 2010 since the loss of relatively well paid and stable public sector jobs could have a major impact on the purchasing power within these areas.⁷ Another possible consequence of cut-backs in the public sector could be a negative impact on the gender pay gap in Wales. Blackaby *et al.* (2011) find that across the UK regions the gender pay gap, measured in terms of gross hourly pay, is equal lowest in Wales and Northern Ireland. The (mean) gender pay gap in these two regions, which have the highest proportion working in the public sector, was less than 10% in 2009, compared to 16% in the UK as a whole and is particularly high in the South East in 22%. Despite the recession, average wages have continued to rise in all regions. Interestingly, Wales experienced one of the smallest increases in mean earnings between April 2008 and April 2010, of 4.1% compared with a UK average of 4.7%, but the second highest growth in median earnings (6.8% compared to 4.9% in the UK as a whole) after the North East. This may again be reflective of the relative strength of public sector employment over this period.

⁵ Artis and Sensier (2011) examine differences between Welsh UAs in terms of when they entered and exited recession. They report some variation across Wales, with Blaenau Gwent entering recession first and Anglesey remaining the only Welsh UA not to have emerged from the recession by February 2010.

⁶ These figures are based on information from the Labour Force Survey (LFS). They differ from the 'official' estimates using Public Sector Employment statistics since the LFS estimates tend to overstate the amount of workers employed in the public sector. See James (2009) for details.

⁷ The Centre for the Cities (2011) suggest that Newport and Swansea are the two most vulnerable UK cities with respect to job losses in the public sector following the announced cuts to public sector funding.

Table 2**Unemployment Rates, Public Sector Employment and Qualifications for Welsh UAs
and Wales**

| | ILO Unemploy. | | Claimant Count | | % employed in pub. sector Jun. 10 | % with degree Jan.-Dec. 2009 | % with no quals |
|-----------------------|--------------------|---------|----------------|---------|---|------------------------------------|--------------------|
| | rate (year ending) | | Unemp. Rate | | | | |
| | Mar. 08 | Jun. 10 | Mar. 08 | Jun. 10 | | | |
| Anglesey | 6.0 | 5.3 | 2.9 | 4.3 | 35.6 | 16.8 | 13.7 |
| Blaenau Gwent | 5.0 | 14.4 | 4.4 | 6.5 | 33.2 | 9.1 | 21.6 |
| Bridgend | 6.8 | 9.0 | 2.1 | 3.7 | 31.9 | 18.3 | 15.0 |
| Caerphilly | 6.4 | 10.4 | 3.0 | 4.7 | 25.6 | 10.8 | 23.0 |
| Cardiff | 6.6 | 8.8 | 2.1 | 3.9 | 35.4 | 30.9 | 12.9 |
| Carmarthenshire | 5.2 | 7.0 | 1.9 | 2.9 | 32.5 | 18.7 | 16.0 |
| Ceredigion | 5.5 | 5.3 | 1.2 | 1.6 | 35.6 | 24.6 | 9.3 |
| Conwy | 4.3 | 5.9 | 2.6 | 3.5 | 30.8 | 18.5 | 13.0 |
| Denbighshire | 5.3 | 8.1 | 2.5 | 3.4 | 30.7 | 16.0 | 13.8 |
| Flintshire | 2.5 | 7.2 | 1.8 | 3.2 | 24.8 | 16.7 | 9.9 |
| Gwynedd | 6.1 | 5.3 | 2.2 | 2.8 | 29.4 | 20.3 | 14.3 |
| Merthyr Tydfil | 7.9 | 13.7 | 3.6 | 5.9 | 34.1 | 11.4 | 21.9 |
| Monmouthshire | 3.3 | 5.7 | 1.3 | 2.0 | 26.7 | 29.3 | 9.4 |
| Neath Port Talbot | 5.7 | 9.4 | 2.4 | 3.6 | 30.1 | 11.4 | 18.3 |
| Newport | 5.9 | 9.2 | 2.9 | 4.9 | 26.1 | 17.8 | 14.8 |
| Pembrokeshire | 4.3 | 7.0 | 1.5 | 3.2 | 26.0 | 16.5 | 14.6 |
| Powys | 4.0 | 4.6 | 1.4 | 2.0 | 25.1 | 19.2 | 13.1 |
| Rhondda, Cynon, Taff | 6.3 | 9.4 | 2.3 | 4.0 | 32.6 | 14.3 | 18.9 |
| Swansea | 5.7 | 8.8 | 2.1 | 3.4 | 35.5 | 18.4 | 16.3 |
| The Vale of Glamorgan | 7.0 | 8.3 | 2.1 | 3.5 | 30.8 | 24.6 | 9.1 |
| Torfaen | 8.0 | 9.4 | 2.7 | 4.2 | 32.7 | 13.6 | 17.1 |
| Wrexham | 4.9 | 6.0 | 2.0 | 3.5 | 28.8 | 14.2 | 12.9 |
| Wales | 5.6 | 8.1 | 2.2 | 3.6 | 30.8 | 18.7 | 15.0 |

Source: Office for National Statistics

Lee (2011) argues that the major factor determining area increases in unemployment rates during the recession was the skill profiles of local economies. Glaeser (2009) also notes that highly-skilled areas have a higher proportion of entrepreneurs and innovators, who can create new firms and even industries in a rapidly changing business environment. This implies that skills can drive the success of individuals, cities and nations. Therefore, Table 2 also presents information on the percentage of the working age population who have a degree and the percentage who have no qualifications for the 22 UAs. The highest increase

in ILO unemployment rates over the period and the highest rates in June 2010 are found in Blaenau Gwent, Merthyr Tydfil and Caerphilly, which are the UAs that have the lowest proportions of graduates amongst the working age population and the highest levels of people with no qualifications.

Policy Responses

As mentioned above, the UK government introduced a range of policy measures in order to try and mitigate the early impact of the recession. These included temporarily reducing VAT, the bringing forward of capital expenditures, the car scrappage scheme, the provision of loans for car manufacturers and major suppliers. In addition, the Bank of England cut interest rates sharply after October 2008 and the base rate has been maintained at 0.5% since March 2009 and an attempt to increase bank lending through quantitative easing. However, given the emphasis placed on deficit reduction by the coalition government, this would seem unlikely to provide much stimulation for the labour market. Even the announcement of reducing benefits may not help get claimants back into work because an appropriate level of benefits can facilitate effective job search.

The policy instruments that the Welsh Assembly Government (WAG) can use to influence the labour market are fairly constrained given that many of the policy decisions in this area are made at the UK level. Again WAG was initially fairly active in introducing counter-cyclical policies such as bringing forward investment projects in Wales, making a commitment to speed up payments to suppliers and the implementation of the ProAct and ReAct schemes aimed at limiting the extent of redundancies through subsidising training and wages. However, the scope for the WAG to have an impact on the Welsh labour market has been further limited by the recent budget cuts, especially since the Welsh settlement appears to be less favourable than that announced for Scotland or Northern Ireland. Moreover, the relative weakness of the private sector in Wales brings into question whether it will be possible for businesses to bridge the gap. Therefore policies directed towards the Welsh labour market will need to be 'smart' in how scarce resources are to be used and fit the issues facing Wales.

Skills and education may be one policy area where something positive can be done. More skilled/highly educated individuals and areas have greater flexibility in terms of their labour market options and are thus more resistant to the impact of economic downturns. For example, Lee (2011) finds that the recession has had the smallest impact in cities with the best skills profiles. Gregg and Wadsworth (2010b) report that the unemployment rates of more educated people are far lower and that the gap widens during a recession. For

example, they report that the unemployment rate for highly educated 16-24 year old males (females) in 1986 was 12.7% (10.4%) compared to 26.4% (24.2%) for those with low levels of education. Blanchflower and Bell (2010) provide figures for the working age population for 2009/10, which continue to indicate large differences in unemployment rates by educational level. In particular, unemployment rates were just under 4% for graduates, just under 10% for those with O level/GCSEs and around 15% for people with no qualifications. This not only implies that it is important to keep high levels of investment in education but also suggests that growth areas should be identified and to ensure that human capital is developed to meet these needs. The need to broaden and deepen the skills base in Wales was recognised in WAG's new economic policy framework *Economic Renewal: A New Direction* and such a stance should be endorsed, especially as developing a more highly skilled workforce is vital if higher value added firms are to be created and attracted to Wales. However, even if such a policy is successful then this will also take time since investment in skills is a long term objective rather than a short-term fix.

Nevertheless, even greater efforts need to be put into improving the education system in Wales, especially as it is recognised that in a world where the same equipment is available to all, it is the skills and the resourcefulness of those operating the equipment which determines economic success. Yet WAG in its 2008 strategy document, *Skills that Work for Wales*, noted that "the skills of the Welsh workforce lag behind more prosperous regions in the UK and compare poorly to the world's leading countries". Furthermore, it is particularly concerning that recent reports have highlighted a widening gap between Wales and comparator areas. For example, Burgess *et al.* (2010) identify a fairly dramatic relative decline in the examination performance of Welsh school pupils at the GCSE level when compared to their counterparts in England. Similarly, the Programme for International Student Assessment (PISA) results for 2009 indicate that Wales has slipped further down the international league table in terms of the test performances of 15 year olds in reading, maths and science.

Identifying successful short term fixes is an even more difficult task. Policy initiatives introduced following the recession in the 1980s, principally based around attracting large inward investors initially seemed to be successful in creating new jobs. However, critics of this policy have pointed to the fact that many of these were low value added jobs and have contributed to the steady decline in relative Welsh gross value added over the past two decades. The task of designing policies to encourage the right amount and right level of new jobs will be made even trickier by the fact that public sector jobs will need to be replaced following the budget cuts and the knock-on effects that this is likely to have on some parts of

the private sector. It therefore appears that a relatively diversified and balanced approach needs to be adopted so that there is not an over-reliance on certain 'preferred' sectors to create new employment, especially by investing in new industries which may not be able to sustain significant employment growth. As a result, efforts should be directed in creating an accommodating business environment that allows for new firm entry and allows existing firms to expand in a broad range of sectors.

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