

# CENTER ON CAPITALISM AND SOCIETY

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*Preventing the jobs crisis from casting a long shadow*

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Ladies and gentlemen,

It is a great pleasure for me to **participate in the 7<sup>th</sup> Conference of the Center for Capitalism and Society** and, in particular, to contribute to this panel on the labour market and social dimension of the economic crisis.

I would like to address two main issues in my introductory remarks. First, I would like to briefly review how the labour market has been adjusting during the economic crisis and, in particular, highlight the main cross-country differences. I will stress the serious risk that the sharp rise in unemployment observed in many countries will persist well into the recovery with high economic and social costs. Second, I would like to discuss some of the key labour market and social policy responses adopted by the different OECD countries during the crisis and the policy challenges going forward.

## 1. The jobs crisis so far and the short-term outlook

### *We are facing a severe jobs crisis*

**The past 18 months have seen the OECD labour markets making a sharp U turn.** Less than two years ago, at the end of 2007, the unemployment rate in the OECD area reached a 25-year low, at 5.6%, and, even more importantly, 2/3 of individuals of working age had a job, the highest rate ever recorded.

This seems history now, given the sharp deterioration observed during the financial and economic crisis. Indeed, **the unemployment rate peaked at a post-war high of 8.8% in October**, just over 3 percentage points above its December 2007 level -- equivalent to an increase of almost 17.9 million persons, bringing the OECD total to just over 49 million unemployed.<sup>1</sup>

### *The margins of labour market adjustment have been very different across countries*

There are **major differences in the way the labour market has adjusted** during the economic crisis. Most OECD countries have experienced sharp declines in output in late 2008 and the first two quarters of 2009.<sup>2</sup> But this has resulted in very different labour market adjustment patterns. The **US**, as well as a number of other economies, namely **Ireland, Spain** and to some extent the **UK** -- have seen massive job losses. Since December of 2007, the unemployment rate doubled in the **US**,<sup>3</sup> corresponding to an increase of nearly 8 million in the ranks of the unemployed. In **Spain**, the unemployment rate reached 19.3% in October, from 8.3% in 2007 and in Ireland it rose by almost 180% to 12.8% in October.

By contrast, in a number of continental EU countries, the adjustment on the *extensive margin* (employment) has been partially mitigated by a large adjustment on the *intensive margin* (hours of work). This is most evident in **Germany**, where unemployment has actually declined slightly since the end of

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<sup>1</sup> We also have November data for three countries: Australia, Canada and the US. In each case, the latest data show a small decline in the unemployment rate. For Australia and Canada, the good news is that each recorded a significant increase in full-time employment in November.

<sup>2</sup> The GDP is expected to decline in the US by 2.5% in 2009; by 5.3% in Japan; by 4.9% in Germany; by 2.3% in France; by 4.8% in Italy; by 4.7% in the UK and by 2.7% in Canada. Among the non-G7 countries, GDP declined by 3.6% in Spain and by 7.5% in Ireland.

<sup>3</sup> A simple decomposition of the evolution of labour input during recessions into the extensive (changes in employment) and intensive (changes in average hours per workers) margin suggests a shift away from hours adjustment in the US towards an employment adjustment.

2007 and most, if not all, of the adjustment has been on hours worked. Similarly in **Japan**, hours adjusted first and then employment started declining with a concomitant increase in unemployment.

The fact that labour market adjustment differs a lot across countries is no news; but the sharp contrast across countries is rather unprecedented. We are still analysis this, as detailed data keep coming, but we can identify two main factors: i) the nature of the shock varied a lot across countries; and ii) the underlying institutions and the policy responses had a strong impact on the way firms adjusted to the sharp decline in demand.

The burst of the **house price bubble** was a key driver of job losses in some countries with the largest increase in unemployment. From the last quarter of 2007 to the third quarter of 2009, the construction sector lost almost 20% of its employment in the US, In the construction sector, employment declined by almost 20% in the US; by more than 25% in Spain and by more than 30% in Ireland. In these and other countries, the initial job losses in construction rapidly spread to manufacturing and then to the service sector: for example, in the US, more than half of all job losses have been in the service sector since the beginning of the crisis.

**The global crisis hit other countries mainly via the collapse in trade**, affecting in particular the tradable sector which tends to be characterised by larger and more capital- and skill-intensive firms. Especially in those countries where before the crisis there were serious problems of skill shortage and where dismissal costs are high, firms have – to the extent possible – relied on adjusting hours worked and not renewing the contracts of their temporary workers. In many countries, most notably in Germany, the reduction in working time has been strongly supported by public subsidies (e.g. the *Kurzarbeit* in Germany). In Germany, employment declined by about 2% in manufacturing, was stable in construction and actually increased in services.

### ***The already-vulnerable groups are bearing most of the brunt of the job losses***

As in previous severe economic downturns, already disadvantaged groups in the labour market – youth, low-skilled, immigrants, ethnic minorities and, among them, those on temporary or atypical jobs – are bearing most of the brunt of the job losses. **The disparities across socio-economic groups have, however, increased.** In Europe and to some extent in Japan, the combination of larger shares of temporary workers and short-time working subsidies (for regular workers) has **concentrated the job losses among those on atypical contracts** – in particular temporary and short-term contracts, including apprentices. Up to the second quarter of 2009, temporary employment accounted for about 85% of all job losses in Spain and for all job losses in Italy; and in France, employment in the *contrats d'interim* fell by more than 20% in the year to the third quarter of 2009.

### ***The economic recovery is in sight, but not yet a job recovery***

The latest labour market data give some hope that **the ongoing economic recovery is starting to affect the labour market.** **Australia** already had a decline in the unemployment rate in the fall -- boosted by the sharp recovery in Asia; **German** unemployment ticked down again in November after falling for four months; and the latest jobs report in the **US** surprised everybody with a small decline in the unemployment rate and almost stable employment. These are all good news but the expected modest recovery in 2010 is unlikely to tilt net job creation back into positive territory. I will go back to this point later.

The **OECD growth projections** were revised upward last month.<sup>4</sup> Bearing in mind the substantial uncertainty that still characterises the global economy and the still large imbalances, the projections suggest that the unemployment rate will peak at a new record high level in mid-2010 and will only gradually decline. However, even at the end of 2011 it is projected to be around 8.5%, not far from where it is now. This suggests that the **labour market slack will persist well into the recovery**. By the end of 2011, total employment in the OECD area is projected to be still more than one percent below its level at the end of 2007. If we take into account that, in the meantime, the OECD working age population will increase, we may be facing an employment gap (to regain the employment-to-working-age-population rate of 2007) of about 4.4%; or in other words, we will still be missing about 23 million jobs in the OECD area.<sup>5</sup>

### *We are facing a serious risk of persistent unemployment and under-employment*

**There is a serious risk that the large hike in unemployment observed in many countries becomes structural in nature**, as many unemployed drift into long-term joblessness, see their human capital deteriorate and some even leave the labour market altogether. This phenomenon is well known in OECD countries when the unemployment remained at a new higher plateau compared with the pre-crisis level even after output recovered. For example, it took about 4-5 years in the US to reabsorb the sharp increases in unemployment that took place after the first and second oil shocks; and in Europe it took much longer (7-8 years) and in some cases even longer. It goes without saying that high and persistent unemployment brings in its train major social and economic costs: poorer health, lower living standards and less life satisfaction for the unemployed and their families; increased crime and lower growth potential for society.

**High and persistent unemployment is widening dualism in the labour market even further.** The most vulnerable workers have been hard hit by job losses in many countries. And even in those where short-time working schemes have been used extensively to limit job losses, vulnerable workers on temporary contracts or already unemployed are unlikely to have much benefitted from these schemes. Without vigorous job creation vulnerable groups (outsiders) in many countries are at risk of long-term unemployment, poverty and possibly exclusion from the labour market with severe social costs as well as negative effects on potential output and short-term growth

### *Avoiding the scarring effects of the crisis on youth*

**Youth are a particularly vulnerable group in most labour markets.** Even in good times, the youth unemployment rate is two to three times that of adults in many countries. An economic downturn sharply diminishes the labour market prospects of less qualified youth and greatly increases their vulnerability to long-term unemployment. In the Q3 of 2009, the OECD average youth unemployment rate reached, 20.5%; it was almost 42% in Spain and at or above 25% in France, Italy and Ireland and among teenagers in the US.

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<sup>4</sup> The OECD and other international organisations have recently revised upward their macroeconomic projections. GDP is estimated to decline on average by 3.5% in the OECD area in 2009, with a rebound to a 1.9% growth in 2010 and some strengthening of growth in 2011 with GDP expected to grow at 2.5 on average in the OECD. Thus, the recovery has emerged sooner than what we expected only a few months ago

<sup>5</sup> The employment gap will be 7.8% in the US (about 10 million jobs); 12% in Spain.

## 2. The policy responses

Most of the fiscal stimulus packages introduced recently by OECD countries to support aggregate demand include **additional labour market and social policy measures** to cushion the negative effects of the crisis on workers and low-income households.

Measures to sustain labour demand have played an important role in some countries in reducing the impact of the crisis on employment

One of the key innovative features of the policy response to the current crisis has been a strong emphasis in many – mostly European – countries on measures to support labour demand. The majority of the OECD countries have introduced or scaled-up subsidies that encourage firms to retain or hire workers. As many as **22 countries have encouraged the retention of existing workers** by introducing or expanding their short-term working schemes. Others (16) have introduced new **wage subsidy for firms hiring laid-off workers** – like Australia where the subsidy targets new apprentices and trainees – and a considerable number of countries (16) have also **temporarily reduced employers' social security contributions**.

Judging from the outcomes observed so far, short-time working schemes seem to have been rather successful in containing the job haemorrhage, especially in those countries where they have been widespread, as best exemplified by the *Kurzarbeit* scheme in Germany that involved about 1.5 million workers in May 2009, and could have helped saving about 500 thousand jobs (since workers involved in the scheme tend to work 1/3 less).

**But, as with any subsidy, there are costs: deadweight**, as firms are being subsidised for hires they would have made anyway, and **timing**: the subsidy may simply delay the dismissals or bring forward hiring with little or no long-run positive impact on employment. The question is therefore whether there is any special reason why the short working time subsidies or other wage subsidies are more justified during this crisis compared with previous ones. A key factor characterising the recent crisis is the fact that more than ever firms have been battered by a collapse in demand coupled with a major credit crunch, which could have resulted in massive, inefficient – both socially but also economically -- lay-offs. If this provides ammunition to those who have promoted wage subsidies, some key principles in their implementation remain vital to reduce deadweight and substitution effects.

**Intervening quickly:** It goes without saying that short-time working schemes could work if introduced or scaled up at the beginning of a crisis, when firms – especially SMEs -- face serious liquidity constraints. In this sense, it was easier to intervene with STW scheme in Germany (as well as in France and Italy) that already had STW schemes in place and it was “just a question” of scaling them up.<sup>6</sup> Many other countries have introduced these schemes *de novo* and it remains to be seen how successful they have been. In this context and despite several calls to introduce (or scale up as it already exists in 17 US states), a work-sharing programme in the US may be too late, since job losses have already taken place.

**Targeting:** while it is very difficult to target STW schemes to most at risk workers, stock and marginal wage subsidies can, and indeed have been, directed towards the most vulnerable workers. While stock measures that cover the entire group(s) of targeted workers are very costly and run large deadweight

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<sup>6</sup> This is not entirely true since all three countries changed key parameters of their programmes – lengthening maximum duration and increasing the generosity (Germany and France) and expanding the coverage to other sectors (services in Italy).

costs, they are also very easy to implement. 16 OECD countries have implemented them.<sup>7</sup> **Marginal subsidies** – like the 1970s US New Job Tax Credit (NJTC) -- are more difficult to implement<sup>8</sup> but less costly and more suitable in a country like the US at present with mass unemployment and still sluggish labour demand. A variant of that that increases the firm subsidies to **take youth on apprenticeship** seems highly desirable to avoid the scarring effects on the current generation of entrants.

I would go one step ahead and even suggest that an increased **reliance on public-sector job creation schemes targeted to the hardest-to-place jobseekers** might provide a useful, temporary backstop to activation regimes during the recession. However, past experience with such measures is not very encouraging in terms of their ability to help the most at-risk job-seekers. Therefore, in designing these measures, it will be very important to build in incentives to ensure that participants exit from them into regular jobs and the schemes can be unwound quickly once the recovery gathers pace.

Altogether, these schemes should be temporary otherwise they run a **high risk of becoming not only ineffective in preserving jobs but also an obstacle to the recovery**, by putting a break on the required reallocation of workers from declining to expanding firms. From a political economy point of view it is very difficult to withdraw them any time soon.

***It is essential to help the many jobseekers to quickly return to work***

*The first line of defence is adequate safety nets, ...*

Despite the efforts in many countries to scale up programme to support aggregate demand and, in many cases, protect jobs many workers have lost their job and are at risk of sliding into long-term joblessness and possibly exclusion.

**The first line of defence is to provide adequate social safety nets** (unemployment benefits and social assistance) which provide an essential income support to job losers during the economic downturn. Here as well, there are major differences across the board. Coverage rates, even in good times, vary a lot: from 20-30 % in Japan and the US to close to 100% in the Nordic countries. The generosity of benefits varies even more: with the replacement rate ranging from less than 30% for someone at the average wage in the first year of joblessness, to almost 70-80% in a number of European countries (NLD; SWI, BEL); and while in some countries UBs and social assistance provide support for a protracted period of time, this is not the case in many Anglo-Saxon countries.

A new feature associated with the current downturn is also the **weak coverage of the traditional UBs of part-time, temporary and other “non-standard” workers**, who account for a growing share of the workforce. Such workers have often been the first to be laid off and have weaker benefit entitlements. In a number of countries, some efforts have been made to extend the coverage and, in some cases, the maximum duration of benefits to provide a more effective safety net. However, such measures should be carefully designed so as to minimize adverse effects on work incentives which could lengthen the joblessness spell.

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<sup>7</sup> Sweden has actually introduced a deferral of social security contributions for 1 year at 8% interest rate.

<sup>8</sup> While a number of studies (e.g. those of Bishop and Hamermesh) gave good marks to the NJTC introduced by the Carter administration in the late 1970s, others (e.g. Burtless) indicated the very low take-up rate by firms, relatively high deadweight and that most of the job gains were simply timing effects.

*... while also providing re-employment services*

One of the main labour policy reforms in the OECD over the past decade has been the **implementation of activation/mutual-obligation strategies**, where, in return for paying benefits and offering effective re-employment services, recipients are required to participate in active job search or training or employment programmes, enforced by the threat of benefit sanctions. Evidence shows that such strategies have had success in moving people off benefit rolls and into work. During the crisis **governments have also sought to scale up the resources for active labour market policies (ALMPs)**. However, when compared with the overall resources available in the fiscal stimulus packages and the magnitude and pace of the job losses in the current crisis, the increase in spending on ALMPs is rather modest in many countries.<sup>9</sup> While calls for additional public spending on labour market policies have to bear in mind that public finances are facing growing constraints in many countries due to the actual and projected build-up in public debt, they can be justified on cost-effectiveness grounds.

In particular, it will be important to build on this past success and not throw away the activation approach just because there are fewer job vacancies to which job-seekers can be referred. Instead, the activation approach needs some modification to the circumstances of a deep economic downturn. It is essential to maintain core job-search assistance through the downturn. Even in a deep recession, many jobs are created by firms that are able to exploit new market opportunities and employment services can play a decisive role in helping fill these vacancies quickly.

At the same time, it is advisable to shift somewhat the focus and resources behind the activation strategy from the “work-first” approach which tended to dominate prior to the crisis to a “train-first” approach for those at high risk of long-term unemployment. This is likely to be particularly important at present, since the global economic crisis is accelerating structural adjustments in OECD countries and measures to foster skill formation and training can play an important role to ensure that workers are well-equipped with the appropriate skills for emerging jobs.

Ladies and gentlemen,

Let me conclude my introductory remarks by saying that while from a macroeconomic perspective we are indeed on a recovery path, we are still very much in a job crisis which is threatening some of the important achievements reached over the past decade in terms of inclusion in the labour market. In this context, it is essential that in the months to come policy makers focus their attention to policies to promote a quick reintegration of jobseekers into employment and avoid the risk that the sharp recession we have just experienced casts a long shadow on the labour market.

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<sup>9</sup> In countries such as the US, Ireland and Spain, spending per unemployed has declined by more than 40%.