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New Labour and the Labour Market

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Abstract

The recent run of good macro-economic news masks mounting evidence that worklessness is increasingly concentrated on selected individuals, households, socio-economic groups and geographical areas . Simply focussing on the aggregate unemployment rate bypasses many of these issues. Likewise, concentration on average wages and wage growth obscures the highest level of wage inequality ever statistically observed. These micro aspects have been overlooked, or ignored, over the last 20 years, but, we believe, now form the most pressing labour market and social problems facing this administration. It is this legacy and the current government's response that this paper is concerned with.

For brevity, in this paper, we focus on what we view as the governments selected priorities. They are the following areas of concern:

- the concentration of unemployment on certain individuals, groups and areas.
- increasing inactivity, especially marked among less educated, older men.
- low pay and especially the persistence of low wages and its relationship with job loss.
- the distribution of work across households and child poverty.

This paper looks in turn at the evidence for Britain on what lies behind each of these issues and at the current state of policy to reduce their scale or intensity. The paper documents the mounting evidence that many of these problems leave lasting scars on peoples' lives. Successful intervention could thus change the people's future life-course trajectories. Here then the inter-connections among these issues could create virtuous circles. However, if policy is under powered at one or more stage in any cycle, then such interventions are prove at best partially successful.

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Non-technical summary

Work is the principle means of generating and distributing wealth in an industrial society. Unemployment is one of the three key variables, alongside growth and inflation, continuously addressed of macro-economic policy. Often the unemployment rate serves as a short hand measure of two, rather different, issues. First, it is thought to capture the extent of labour market slack and hence is used as a gauge of potential inflationary pressure in the economy. Second, it is also used as a measure of social distress and exclusion stemming from joblessness. On the first basis, the state of the labour market looks healthy. Britain now has (the lowest unemployment rate for twenty years) and an employment-to-population rate that is one of the highest among developed nations. However, this good news masks mounting evidence that worklessness is increasingly concentrated on selected individuals, households, socio-economic groups and geographical areas. Simply focussing on the aggregate unemployment rate bypasses many of these issues. Likewise, concentration on average wages and wage growth obscures the highest level of wage inequality ever statistically observed. In other words, whilst the macro-economic signals coming from the labour market look good, the evidence on the distribution side is far less rosy. These micro aspects have been overlooked, or ignored, over the last 20 years, but, we believe, now form the most pressing labour market and social problems facing this administration. It is this legacy and the current governments' response that this paper is concerned with.

For brevity, in this paper, we focus on what we view as the governments' selected priorities. They are the following areas of concern:

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This paper looks in turn at the evidence for Britain on what lies behind each of these issues and at the current state of policy to reduce their scale or intensity. The paper documents the mounting evidence that many of these problems leave lasting scars on peoples' lives. The paper suggests that there is reasonably strong evidence for scarring effects from unemployment and child poverty and high wage persistence. The evidence for area effects is very sparse in the UK and the US evidence suggests that such effects are broadly limited to teenagers. Successful intervention could thus change the peoples' future life-course trajectories. Here then the inter-connections among these issues could create virtuous circles. However, if policy is under powered at one or more stage in any cycle, then such interventions are prove at best partially successful.

1. Introduction

Work is the principle means of generating and distributing wealth in an industrial society. Unemployment is one of the three key variables, alongside growth and inflation, continuously addressed of macro-economic policy. Often the unemployment rate serves as a short hand measure of two, rather different, issues. First, it is thought to capture the extent of labour market slack and hence is used as a gauge of potential inflationary pressure in the economy. Second, it is also used as a measure of social distress and exclusion stemming from joblessness. On the first basis, the state of the labour market looks healthy. Britain now has an unemployment rate below 6 per cent[1], (the lowest for twenty years) and an employment-to-population rate that is one of the highest among developed nations, only just below the rate witnessed in previous cyclical peaks. Indeed, the DFEE estimates that it is higher than the level typically observed during the 1960s (Bell, 2000). Yet even at this rate, the rate of inflation is currently lower than for any sustained period since the 1960s.

However, this good news masks mounting evidence that worklessness is increasingly concentrated on selected individuals, households, socio-economic groups and geographical areas. Simply focussing on the aggregate unemployment rate bypasses many of these issues. Likewise, concentration on average wages and wage growth obscures the effects of a level of wage inequality without precedent for a hundred years. In other words, whilst the macro-economic signals coming from the labour market look good, the evidence on the distribution side is far less rosy. These micro aspects have been overlooked, or ignored, over the last 20 years, but, we believe, now form the most pressing labour market and social problems facing this administration. It is this legacy and the current governments' response that this paper is concerned with.

Encouragingly, the government has recognised many of these concerns and is developing strategies to address them. Whilst it is hoped that these policies will raise overall employment without generating additional inflationary pressure, the primary motive is to reduce the inequalities of economic opportunities across society and to use work as part of a strategy to tackle growing poverty among marginalised groups and communities. This then is more firmly rooted in the debate about inequality of life chances than in macroeconomic policy. Indeed the number of initiatives and potential indicators used to monitor the efficacy of policies is now legion. For brevity we focus on what we view as the governments selected priorities. They are the following

areas of concern:

- the concentration of unemployment on certain individuals and areas and the impact this has on an individuals subsequent job opportunities and life chances.
- increasing inactivity, especially marked among less educated, older men.
- low pay and especially the persistence of low wages and its relationship with job loss.
- the distribution of work across households and child poverty.

This paper looks in turn at the evidence for Britain on what lies behind each of these issues and at the current state of policy to reduce their scale or intensity. There are obvious connections between these priorities and this means a degree of cross-referencing. Unemployment and inactivity have to a degree a common root - constrained job opportunities. Job loss and low pay are inter-connected through the low pay-no pay cycle. Lack of work and low earnings at the household level drive child poverty. The government clearly believes that many of these problems have lasting effects on peoples lives (see HM Treasury, 1999). If so, successful intervention can change the trajectories of peoples' futures. For instance, if reducing child poverty can improve educational attainment, this in turn may help protect individuals against early unemployment and so on. Here then the inter-connections among these issues could create virtuous circles. However, if the extent of structural dependence is modest or policy is under powered at one or more stage in any cycle, then such language is likely to prove optimistic. For a number of these priorities there is a secondary debate about the importance of geographical distribution in explaining the observed patterns and in policy response. We therefore, wherever possible draw out this dimension.

2. Unemployment

Britain is now enjoying record levels of employment. Even adjusting for population growth, the employment rate is just short of the peak of 75% last observed in the economic booms of 1979 and 1990. Generating employment is reasonably straightforward at an aggregate level. GDP growth has to exceed around 2% a year and jobs begin to flow. Macro policy limits job generation because of fears of inflationary pressure emanating from rising real wage growth when labour becomes scarce. The government, like the Bank of England, is currently taking the view that we are close, perhaps even below, the level of unemployment where inflation picks up. The potential for inflationary pressure, in the medium to long-term becomes more endogenous, in that it can be

shaped by policy. The government is trying to reduce inflationary pressure by reducing the concentration of worklessness on certain individuals, groups and communities. This is done by attempts to reduce mismatch and to increase the effective job search of the unemployed, exemplified in the various New Deals.

Mismatch across groups

Whilst it is not known exactly how unemployment restrains wages, the dominant thinking suggests that the more unemployment is concentrated on specific groups the less efficient it is in restraining wage pressure. The implication is that the level of unemployment at which inflation starts to rise is higher than might be otherwise, (see Layard, Nickell and Jackman, 1991). However, mismatch, as measured by area or skill, seems to have contributed little to the rise in unemployment since the sixties. Greater unemployment differences between regions and to a lesser extent skill groups did emerge in the late 1980s (see Jackman and Savouri, 1999 and Bell and Nickel, 1995), but since then differentials have returned to something like their historical norms. Yet because these concentrations are not unusual does not mean that they are either efficient or inevitable. Table 1 outlines the major variations in unemployment rates observed in 1998 (see Nickell, 1999). The greatest variation is by ethnic origin, with one third of Bangladeshi and Pakistani men unemployed. Unemployment rates are also high among the young, the less educated and men.

Unemployment is concentrated on certain individuals

Whilst knowledge of an individual workers characteristics will help predict whether anyone is unemployed at a point in time, the best predictor is whether the individual was unemployed yesterday. To some degree it is obvious that people move between employed and unemployed states relatively infrequently, but even over longer time intervals the bulk of unemployment falls on a minority of individuals. One example drawn from the JUVOS database serves to clarify this.[2] On a broadly representative day in 1995, 1.27 million males aged between 22 and 59 were registered as claimant unemployed (approximately 9% of the workforce). Over the whole year approximately twice this number experienced a spell of unemployment. But just 650,000 (26%) of those ever unemployed in the year, accounted for half of the total number of days in unemployment. This concentration of unemployment within a year is not very sensitive to the cycle (see Figure 1). Unemployment is even more concentrated over longer periods of time. Over three years the number experiencing any unemployment rises to three times that observed on a typical day. But concentration intensifies, such that only 760,000 men (19% of the ever

unemployed) accounted for half of all days of unemployment. Evidence from the National Child Development Survey suggests that those people who had experienced more than one year of unemployment by the age of 23 are subsequently unemployed for a fifth of time between ages 24 and 33. By contrast, those who experienced no unemployment by the age of 23 spent under two per cent of the time up to age 33 unemployed.

This concentration is in part, explained by the fact that unemployment exit probabilities fall by duration of spell. For most people unemployment is brief, but for the minority who do not leave quickly unemployment becomes prolonged. Inflows into unemployment are now only a fraction above those in late 1960s, but durations are more than double, (Nickell, 1999). This decline in exit rates appears to be common to most countries, except Sweden, and has remained broadly constant over time. However, Machin and Manning (1999) show that the UK has the steepest deterioration in exit rates in Europe. Britain is achieving relatively low unemployment rates because of a high overall exit rate, but the deterioration in the chances of leaving unemployment with duration remains among the steepest in Europe. The other important factor leading to heavy concentration is the repeat incidence of unemployment. Those entering unemployment often have a history of past unemployment. Figure 2 shows that of all men starting a spell of unemployment in 1997, half had left a previous spell within the last 6 months. This repeat incidence has been rising since 1991 and is most common among prime-age men, where unemployment rates are generally low.

Structural Dependence

This heavy concentration raises the question whether unemployment causes more unemployment. To some extent unemployment concentration will be correlated with the kind of observed characteristics, such as education levels, described above. To the extent that it is not, we need to able to untangle the impact of unemployment on later out-turns from any residual unobserved individual heterogeneity.

There are various approaches to examine whether past unemployment truly increases the likelihood of future unemployment, (see Lancaster, 1990, and Heckman and Borjas, 1980, on these methodologies). Here the analysis of whether duration of a spell reduces the chances of leaving unemployment requires strong identifying assumptions. Lancaster (1990 p157) concludes ‘identification can be achieved when certain functional form restrictions can be assumed.

Unfortunately these functional form restrictions generally have no economic-theoretical justification'. However, for past unemployment spells such assumptions are often not necessary (see. Arulampalam et al.1998 and Gregg, 1999, for recent UK evidence). The general thrust of the evidence is that past unemployment damages future employment prospects. However, it is not clear exactly how this occurs. It could be because the experience of unemployment changes the person or diminishes the relevance of their skills, or because employers discriminate against those with bad labour market histories in the recruitment process. There is no strong evidence that search activity by the unemployed diminishes with duration anywhere near as early or as fast as the exit rate declines with duration. Manning (2000) provides evidence that employers don't select the unemployed for job interviews with the same frequency as those currently in work, even for low skill entry positions.

The Geography of Joblessness

The North-South divide is a constant fixture in the debate about Britains economic performance. Yet regional unemployment differentials are lower now than they have been for many years, (Jackman and Savouri 1999). Jackman and Savouri (1999) suggest that the heavy labour shedding in manufacturing and production industries throughout the eighties led to a greater balance in the industrial composition of regions by the nineties. So that regions are likely to be less divergent over the cycle as they once were. However broad regional aggregates do not capture the real patterns of geographical divergence in unemployment. There is, and always has been, much greater variation in unemployment performance within regions than between regions. It is possible to observe areas of near full employment in some regions alongside areas of severe deprivation[3]. The proportion of working age men not in work is from 13 to 26% across our regions. At county level this spread nearly doubles from 8 to 31%. At finer levels of disaggregation this dispersion is greater still. Webster (1999) shows how Inner London and our major cities have unemployment rates around twice that of the counties outside the cities. More disaggregated analysis highlights the plight of many coastal towns and the former coal mining districts, alongside the major urban areas.

The worst geographical concentrations of joblessness are in our social housing estates. Here unemployment rates of 25%+ are common place. These concentrations are undoubtedly driven, in part, by the shrinkage of the social housing sector and the selection of who is placed in these estates, but the intensity of deprivation remains astounding (see Brennan et al. 2000 in this

volume). At this very disaggregated level of analysis it is far from clear to what extent there should be small area or individual based responses to individual joblessness. The answer depends on whether area concentration creates its own additional problems for the jobless to secure work. Lack of local labour demand and fewer job-finding networks are potential reasons why area may matter. Yet as Kleinman (1999) highlights, the existing, mainly US, evidence on area effects at a very local level suggests that the area is not that powerful relative to individual and family background characteristics in explaining the chances of being out of work. In many of our northern cities the general lack of work will inhibit both neighbourhood and individual based policy initiatives.

Policy Response

Joblessness is concentrated on a minority of the workforce and in certain geographic areas. The more unemployment an individual faces, the greater the extent of future unemployment that person faces. Large wage falls on return to work are likely to compound these problems (see section 4) for they are likely to extend job search among those who are not prepared to take large cuts in wages in order to secure a rapid return to work. The patterns of persistence of low wages and wage growth after returning to work are also explored in section 4.

The governments' current strategy consists of:

1. Improving skills and reducing the supply of low skill labour through improving basic education. Elements of New Deal programmes for youth also involve education and training.
2. Intensifying the pressure to search for work and to take available vacancies through the New Deal Gateway. Compulsory placement if independent search is unsuccessful and the intensified monitoring of search activity.
3. Increasing the net take home pay from low wage jobs. This includes the National Minimum Wage, the reduction in income taxation and NI contributions focused on lower paying jobs and the WFTC for low-income families with children.

To the extent that these measures reduce individual experience of unemployment and raise labour market attachment then there will be second round effects through the reduced impact of any structural dependence.

New Deals

The New Deal tag has been used extensively to reflect a re-organisation of the job search process and transition into work by claimants. There are five main New Deals but only two are primarily aimed at the claimant unemployed:

New Deal for Youth: The New Deal for Youth consists of an attempt to secure accelerated entry into work during the Gateway, followed by placements designed to raise job experience and observable skills. This covers 18 to 24-year olds who have been receiving Job Seekers Allowance (JSA) for six months. This New Deal starts with a Gateway, where the claimant is assigned a case worker for the whole New Deal period. The Gateway is designed to focus on the claimant's job search and support needs. The Gateway period lasts for up to four months, varying according to the agreed route through the New Deal. The first aim is usually to secure employment in the conventional labour market without subsidy. If after two or three months this has been unsuccessful, the claimant becomes eligible for the subsidy but still searches on his or her own initiative for the best match until the end of the Gateway. More recently the Gateway has been divided into the basic model, as above, and an intensive period which is used for more detailed assessment of support needs, motivation and monitoring of search activity. If no work has been found at the end of the Gateway period, the claimant is given one of four main options:

- a subsidised (,60 a week) six-month job earmarked by employers who sign up to support the New Deal;
- a place on an education or training course for up to twelve months (the average so far is nine months);
- a six-month Taskforce placement working on environmental projects or in the charitable sector; or
- self-employment, eligible for subsidy (provided that the claimant can convince the case worker and the intermediate partnership that the business idea is viable).

One day of training each week is guaranteed in jobs and in Taskforce placements. Employers receive £750 for each New Deal placement towards training costs. Job search remains part of all the options. Towards the end of the placement, the case worker starts the off-flow strategy if the job is not to continue. Intensive job search starts again, using conventional Employment Service support strategies, (for example three-week work trials, job interview guarantees). The buoyant macro-economy means that only around 150,000 people will pass through the New Deal each year, somewhat less than originally anticipated. So far around 126,000 people have gone through the New Deal and have moved into sustained employment, (as of October 1999). The numbers

returning to claim benefit again are quite low. However, it is not yet known to what extent this is due to the programme or the healthy economy. Anderton et al. (1999) suggest that the New Deal for Youth reduced youth unemployment by 30,000 in its first full year of operation. This is equivalent to 40% of the stock of long-term unemployed youth. To date the job subsidy has been surprisingly rarely used. Employers are not waiting for the subsidy before hiring workers and those reaching the end of the Gateway are typically going into further education. The job search aspect of the Gateway has been intensified, even within the short life of the New Deal programme. This, in part, reflects the opportunities provided by the tightening labour market.

New Deal for Adults: This covers ages 25 to 59 (over-60s are exempt) and starts at two years duration of JSA claim. It consists of case-management Gateways, relaxation of rules concerning part-time education/training while claiming benefit and a job subsidy scheme akin to the New Deal for Youth. The subsidy is £75 a week and training is not guaranteed. The alternatives to work options are of shorter duration, (three to six months) and are less likely to involve education or on-the-job training. A claimant must do something at the end of the Gateway, but the approach is less prescriptive than the youth equivalent. Claimants are allowed to move between options if this is deemed a sensible strategy by the claimant and case worker. From April 2001, compulsory participation on one option is to be introduced at the end of the Gateway for those with unemployment in excess of two years. In addition and perhaps more important, all those with 6 months duration will have greater supervision of search effort with the Employment Service interviewer having a longer period to go through search evidence, to promote specific vacancies to the unemployed person and to check what follow up action was taken. This is to be developed progressively from April 2000. New vacancy call centres and web sites are being set up to notify unemployed people of available vacancies in their broad locality as they arrive. This package will be developed from the Autumn of 2000.

Limitations of the Strategy

There are a least four clear limitations of the strategy developed so far.

- The scale of intervention is modest and skill development poor on the taskforce elements at least. These placements may also reduce search during placement period and so reduce job finding. Although continued job search is encouraged. These limitations then may raise the quick return to benefit highlighted above. A six month job placement can inevitably have only

a marginal impact on a persons lifetime opportunities. It should be remembered that the rate of earnings return to a year's education is around 8 per cent. Hence, if these policies are to be as successful as education in improving life chances, large investments are needed to have an impact on the earnings of marginalised groups.

- Even if the quick return to benefit is not accelerated, it remains true that many of the jobs found in the Gateway period or Off-flow period are likely to be short. As intervention stops on entering unsubsidised work, little is being done to raise the probability of sustained employment or wage progression for these marginal groups.
- There have been continuous questions about the potential of the strategy in unemployment black spots or those facing labour market discrimination by employers. The plight of those on our social housing estates screams for action. But it is far from clear whether action should be area based or acting on individuals with poor characteristics who have been progressively sorted onto our worst estates.
- The tightening labour market and the relative success of intensive job search enhancing schemes, highlighted by Robinson (2000), suggests that the Employment Service, (ES), should use much more specific vacancy referral and get feedback from employers on unsuccessful candidates limitations. This can then be used to both improve matching applicants to vacancies and identify which support services would most effectively raise a candidates chances.

It should be noted that although the mix of spending is different under the New Deal, the total level of spending will not be high relative to successive Conservative governments (see Robinson, 2000, in this edition). The emphasis is more on youth and less on short, low-cost off-the job training schemes. These training programmes were found to produce only a marginal improvement in future prospects. As the labour market tightens, securing initial entry will be easier and the total numbers involved smaller. So as the primary objectives become easier to achieve, the New Deal may well evolve to take on the wider concerns, outlined above.

3. Economic Inactivity

The incorporation of the ILO/OECD search based measure of unemployment into the governments' basket of labour market indicators is a welcome improvement. One feature of the movement toward a search based measure of joblessness by the government is that it is relatively

easy to analyse as to whether the unemployment measure adequately captures the true extent of labour market slack and the true extent of social distress caused by lack of work.

One important development over the last twenty years that policy based solely around the unemployment rate would overlook has been the decline in male labour force participation. Men have dropped out of the labour force in unprecedented numbers. There are now some 2.3 million men of working age, excluding students, who are economically inactive according to the Labour Force Survey, (LFS), twice the number of unemployed. Twenty years ago there were just 400,000 men outside the labour force. Why this has come about is less clear, but we can say with confidence, (see Campbell 1999, Gregg and Wadsworth 1999), that inactivity amongst men is highly correlated with labour market conditions, being concentrated amongst older, less skilled men and amongst those living in local authority housing. Inactivity is also greatest in areas with the highest unemployment rates and lowest employment rates.

Male inactivity has risen amongst all age groups, (Table 3). In absolute terms, the most dramatic increase has been amongst the over 50s. 28% of men over 50 are now economically inactive, some 1.3 million, compared with less than 7% in 1975. However, it is important to recognise that this problem is not confined to older workers. Around 8% of non-student men under 50, some 1 million, are now inactive. In 1975 less than 1 per cent of men under the age of 50 were outside the labour force[4]. Perhaps the most striking incidence of inactivity is among men resident in social housing. Here 30% of men are inactive and only 54% of men are in work.

Participation rates are also highly correlated with educational attainment. The lower the level of qualifications held, the more likely it is that an individual will be economically inactive. More than 25% of men with no or few formal qualifications are now inactive. If the graduate rate (8%) is taken as a benchmark rate of labour market withdrawal then it seems that less skilled men are 3 times above this norm.

What the table also shows is how in the latest recover activity rates have continued to fall, whereas in the 1980s upturn they were broadly flat. So for similar employment increases (just over 2 a percent per year), there has been a much larger fall in unemployment. This feature of the recovery is most marked among less qualified men and those in social housing. The large fall in unemployment amongst men in social housing is almost entirely driven by declining activity.

Table 4 also shows how inactivity is negatively correlated with the level of local labour market performance. Counties with the lowest employment rate, less than 70%, have over one in four less skilled men inactive. Whereas those with employment rates over 78% male inactivity is half this. In the latest six years of this recovery, those counties with rising in economic inactivity rates amongst less skilled men are those with employment gains less than 2 percentage points. However even in the best performing areas male inactivity rates for less skilled men have not fallen much despite extended economic recovery. Though female inactivity rates in these areas have indeed fallen markedly. The inability of the recovery to halt the decline in male participation suggests that aggregate labour demand is only a partial explanation of this development. It may be that less skilled men are perceived as being at the very end of the queue of potential labour supply and so are ignored by employers until the local labour market is very tight indeed. Alternatively, they may be put off by the low entry wages on offer, (see section 4).

So any policy aimed at dealing with inactivity has to begin to address why male inactivity has risen most amongst older, less skilled workers in depressed labour market areas. If declining labour force participation was largely a voluntary, supply driven issue, we would expect to see higher withdrawal rates amongst groups with alternative incomes (savings and pensions). This has not happened. The prime reason given for inactivity by men under 60 is sickness rather than retirement. Campbell (1999) highlights how many of these sick men pass through unemployment prior to inactivity. All this suggests that high levels labour demand are a necessary condition but the inability of the current upswing to make a significant dent in inactivity suggests that it is not a sufficient condition.

Policy Response

The Labour government has continued where the previous administration left off in tightening the eligibility rules for and generosity of sickness and invalidity benefit, in a, rather blunt attempt to stem the inflow into inactivity. On the more constructive side are the:

New Deal for the Sick and Disabled. As for lone parents, job search assistance was not available for sick and disabled workers. A small number of innovative pilots have started in conjunction with leading disability charities. A job-search case worker approach akin to that for lone parents was piloted from October 1998 and April 1999 in twelve areas**.** Early signs are that few people

are participating in this programme.

New Deal for Over 50s. This open to any person aged 50 plus who has on benefits of any form for 6 months. It offers any person moving into full-time work a £60 a week earnings top up which is not withdrawn with income but is capped at £15,000 a year. For a part-time job the payment is £40 a week. Like the WFTC this is trying to raise the attractiveness of the available low wage jobs. But unlike WFTC payment is limited to a year. Job search support services run by the Employment Service are also available. This came into operation nationally in April 2000 but pathfinders were operating in nine Employment Service areas since October 1999. Inactive men with children who enter work may be eligible for the WFTC (see section 5), of course.

Limitations of the Strategy

This strategy appears under-powered compared with other policy areas. The New Deal for the over 50s is explicitly trying to provide financial incentives to return to work quickly before older people drift into inactivity. But in the main it appears that the government is hoping that the recovery will sort things out. The clear correlation with local labour market performance suggests that inactivity rates could begin to fall back if recovery can be sustained and balanced. Yet the recovery has not touched male inactivity to date. In the future it may be that government should investigate if firms can be dissuaded from shedding older workers through the rules governing early retirement and redundancy. The very high levels of inactivity among men in social housing may suggest that the New Deal for Communities and tackling disincentives associated with the Housing Benefit system would help.

4. Low Pay

Britain has experienced an unprecedented rise in income and wage inequality over the past twenty years. This increase followed a period of declining dispersion in the 1970s. Wage inequality has continued to rise through the 1990s but the scale of the increase has been tempered somewhat. Machin (1999) shows that dispersion of hourly earnings, as measured by the Gini coefficient, increased by 30% for males and by 27% for females between 1979 and 1990. In the 1990s the Gini coefficients continued to increase for males at 1.2% a year but actually fell slightly for females between 1990 and 1996. The marked deterioration of the low pad (bottom decile) relative to the median in Britain is in contrast to most other industrialised countries. A notable exception to this is the US which has also suffered from a large rise in pay dispersion.

Some of this increase in wage dispersion has occurred between different education groups. Machin (1999a) reports the (weekly) wage differentials associated with educational qualifications in Britain between the mid 1970s and the mid 1990s. He shows that the return to educational qualifications fell in the 1970s but increased sharply in the 1980s for both males and females. The increase in the return continued into the 1990s for males but for females education returns fell slightly. The large increase in the return to education in the 1980s occurred despite an increase in the supply of more highly educated workers. This suggests that demand for more skilled workers was rising faster than the supply. The increased supply of highly educated workers picked up in the 1990s. So while the increase in supply of more skilled workers may have tempered the rise in inequality in the 1990s, relative demand shifts towards the higher skilled are still evident.

Low Wage Persistence

The sharp increase in the cross sectional dispersion of earnings clearly has serious welfare implications. However, the degree to which increases in cross-sectional dispersion translate into increases in lifetime earnings dispersion will depend on the persistence of individual earnings. Dickens (2000) presents information on the extent of earnings mobility in Britain. He shows that there is considerable immobility within the earnings distribution from one year to the next. For example, over 48% of males in the bottom decile of the hourly earnings distribution in 1993 are still there in 1994. Many of these low paid workers drop out of employment so that only 20% actually move up the pay distribution. Most of those that do progress tend not to move very far, with two thirds of these moving into the next decile and virtually nobody moving beyond the median. Mobility is somewhat greater when earnings are observed over a longer time period. For example, only 22% of males in the bottom decile in 1989 are still there in 1994. However, again many have dropped out of employment so that only 30% have actually moved into a higher decile over this five year period with very little long range movement.

As noted above, in the light of increasing cross sectional inequality the important question is not so much about the level of mobility but the extent to which there have been any changes in mobility. Dickens (2000) presents evidence that short run mobility has fallen since the late 1970s. Computing a mobility index based on changes in the individuals ranking within the earnings distribution from year to year he shows that this index has fallen by some 41% for both males and females between 1980 and 1994.[5] This is rather disconcerting because it suggests that A lifetime

earnings dispersion has increased by more than that observed in cross section data on earnings.

The Low Pay - No Pay Cycle

In addition to persistence in low pay it is also evident that the low paid are much more likely to leave employment than those higher up the pay distribution. Stewart (1999) shows that employees paid below £3.50/hour (in April 1997 prices) were three times more likely to be out of work one year later than those paid above £3.50/hour. In addition, some 33% of those employees who were out of work a year ago are paid below, 3.50/hour. This compares to 8% of those who were in work the year before. So the low paid are more likely to exit work and new entrants are likely to enter into low paying jobs.

Furthermore, there is evidence of persistence in low pay across employment spells that results in a cycle of low pay - no pay for certain individuals. Looking at re-entrants to work who were out of work a year ago Stewart (1999) reports that some 42% of those who were in low paid work two years ago will enter low pay again compared to 14% of those high paid two years ago. Some workers, therefore, face a cycle of movement in and out of low paying jobs and non-employment.

The Cost of Job Loss

Unemployment also affects future earnings. Figure 3 shows the typical points in the earnings distribution that men leave employment from and return to. Men who lose jobs involuntarily are more likely to be low paid, but they return to a wage that is even lower. Moreover this return wage has fallen over time. As Figure 4 shows, the wage decline an individual faces after job loss has grown from 7 to 17% over the last twenty years. For workers over 45 the wage fall has increased from around 12 to 26% (Dickens, Gregg and Leonardi, 1999). In the year prior to job loss, displaced workers had wage growth 5% below that of other workers and the year after returning they recovered the same amount.

Weekly entry wages after a spell out of work have not risen in real terms over the last twenty years (see Gregg and Wadsworth, 2000). Since the entry wage gap has increased secularly it is not being driven by the cyclical behaviour of the economy or by the stricter treatment of the claimant unemployed. More likely the explanations are linked to the same factors underlying growing wage inequality. Low entry wages have important implications for work incentives. Groups with high out-of-work benefits, typically those with children or high housing costs, are

often little better off in work than out, (see Gregg, Johnson and Reed, 1999). Whilst those with the income provided by a working partner or youths living in the family home have fewer disincentive problems to take low paid work.

This suggests that the cost of job loss may have increased. Nickell, Jones and Quintini (1999) find that the wage penalty after a spell of unemployment increased by about 70% between the early 1980s and the 1990s. This earnings loss is larger for older workers and the more highly skilled. In addition, the earnings penalty associated with unemployment has increased most for these groups. Dickens, Gregg and Leonardi (1999) report similar results using data on annual earnings. They find an overall increase in the wage penalty associated with an unemployment spell from 10% to 17% between the early 1980s and mid 1990s.

Policy Response

The most obvious policy response has been the introduction of the National Minimum Wage. The level at which it was set was modest, £3 an hour for 18 to 21 year olds and £3.60 an hour for those 22 and older. The low pay commission estimated that around 1.9 million workers (8% of the workforce) would be affected by the NMW and that their pay would rise by 30% on average, giving a national wage bill increase of around 0.6%, (Metcalf, 1999). However, measurement error in the data used to make these estimates and the ability of firms to repackage bonuses and other payments to meet the minimum wage will mean that this is very much an upper bound estimate. As the NMW will only be up-rated marginally for some years (the youth rate is rising from £3 to £3.20 in June 2000 and the adult rate to £3.70 in October), then its impact on low pay will be small.

Other policy developments may also produce minor reductions in pay inequality. Reductions in the numbers leaving school with no qualifications and the recently attained high staying on rate in education at 16 and 18, may well reduce returns to education a little. The tight labour market and the new union recognition legislation may have this effect too. But it is evident that the government, in the guise of making work pay, is placing more emphasis of reducing post-tax earnings inequality more than the gross wage picture. The WFTC, 10p rate and NI reforms are all geared to raise the take home pay of low waged work. But there is little to date to tackle the low pay - no pay cycle, the cost of job loss or the lack of upward wage mobility from low paid work. Strategies for life time learning, such as individual learning accounts or post-placement

support after New Deal participation, are welcome but do not appear high powered.

5. The Distribution of Work Across Households and Child Poverty

Worklessness has normally been studied across individuals whilst poverty and income inequality are conventionally measured at household level. Only recently has the employment status of the household been highlighted as an important area for investigation, (see Gregg and Wadsworth, 1997 and 1999). Looking at the household is a crucial step in linking individual employment/earnings patterns and household poverty and inequality.

Rise of Workless Household

Over the last thirty years, the rise in the number of workless household has been striking, especially for households containing children. Table 5 shows that 17% of households were workless in Spring 1999, (just over 1 in 6). These households contain 4 million adults and 2.6 million children, (13% and 18% of the respective totals). All these proportions are roughly three times larger than those found in the seventies and four times those seen in the late 1960s. Not surprisingly, these workless households are generally also poor. In 1996, some 70% of workless households were poor and this rises to 90% in households with children present. In many cases worklessness is not a temporary state. In 60% of workless households, no resident adult has worked in the last three years. This extended worklessness is also true for households with children. As with inactivity above, the most striking feature is that 48% of working age households in social housing were workless in 1999, compared to 8% in owner occupied accommodation.

Origins of the Rise in Workless Households

The rise in workless households can be decomposed into the contributions from aggregate employment changes, changes in family structure and changes in the distribution of the available work across households. To do this we take a prediction of whether a household is workless based on a random distribution of work among adults. So if, as in 1999, 24% of working age people (excluding students) were out of work and this joblessness was evenly distributed across, then we would expect to observe 24% of single adult households workless and 6% workless rate amongst 2 adult households. The extent to which the actual rate deviates from the predicted rate can be taken as a measure of polarisation of work across households.

In 1977 the predicted rates almost exactly matched the actual rates, so there was no substantive polarisation of work. The overall workless household rate has risen nine percentage points since then but the employment rate is not trended over this period and therefore does not contribute to the change. The move towards more single adult households[6] explains around one third of the total rise since the seventies, (Table 6), but the majority of the explanation lies with how work is shared out across households, (increased polarisation). The trends in the distribution of work by gender, age and skill group outlined in the previous sections account for about a third of the observed polarisation. The rest follows from how female employment has generally risen only in households where the partner is already in work. Likewise men have dropped out of work more often if they are single or their partner does not work.

When comparing Britain with other countries in this dimension, two things stand out. Polarisation of work across households was greater in UK than all other countries in 1996, on the basis described above (Source OECD 1998). In other words, given our high employment rate we had disproportionately more workless households. Also the UK had substantially more workless households with children than any other developed nation (see Figure 5).

Child Poverty

With nearly 1 in 5 children growing up in workless household and 90% of these are poor it is not surprising that child poverty is high and has risen so fast. In addition working poverty is also increasing, (see Gregg, Harkness and Machin, 1999). Around 1 in 3 children now lives in a relatively poor household.[7] Micklewright (1999) shows that child poverty in the UK is much higher than in other European Union countries. Over the last 10 years, children have replaced pensioners as the group with the highest incidence of poverty in the UK. Whilst this is in itself worrying, the case for intervention is also made by recent evidence on the effect of deprivation on children (see Gregg and Machin 1999, Hobcraft 1999, and Feinstein, 1998). This literature suggests that childhood deprivation reduces educational attainment and future earnings and increases the risk of youth unemployment and early pregnancy.

Policy Response

The most laudable response so far from this government, has been the commitment to eliminate child poverty over the next twenty years. The strategy to achieve that commitment consists of:

- Redistribution of income towards poorer households with children. For those out of work, this is being done through Income Support payments for children, especially young children. For those in work with children, earnings among the low paid will be supplement by the Working Family Tax Credit and from April 2001 the Children's' Tax Credit. Treasury estimates suggest that these combined changes will move 3/4 million children out of poverty.
- Making work pay more for low earners through a combination of the WFTC, minimum wages and tax/NI reductions.

Tax Reductions: The National Insurance system had a peculiar structure. For wages below a given threshold (£62 a week in 1997) no contributions were levied, but above the threshold 2 per cent was levied on all, not just marginal, earned income. This created incentives for firms to pay wages below the threshold. The entry fee system was abolished in 1998 and it was proposed to raise the lower earnings limit to around £85 a week, (the starting rate for income tax). This would imply a rise in take home pay of around £3 a week. The 1999 budget reduced the starting rate of tax from 20 per cent to 10 per cent over the first £1500 of taxable annual earnings. In addition, a new tax break for families with children is to be introduced but has not yet been implemented.

Working Family Tax Credit: The WFTC is an In-Work income supplement for low-income families with children. It replaced the existing Family Credit system in October 1999. The main differences are that the WFTC is withdrawn less aggressively, with a net taper of 55 per cent (after tax/NI) rather than the 70 per cent rate under Family Credit. It is also withdrawn when earnings reach £90 rather than £80 a week. The main impact is to raise net income for full-time jobs paying the minimum wage to a minimum of around £5 an hour. The total revenue committed to this initiative is about £2 billion, equivalent to a national income tax rate reduction of one penny. The Child Care Tax Credit is available to low income households where all parents are in work, and hence is of most use to lone parents. It covers up to 70 per cent of child-care costs, to a maximum of £100 a week for the first child. Each subsequent child raises the maximum credit by £40. Under these systems it is possible to receive some support on incomes up to around average earnings.

Whilst employment rates of women with children have generally risen, they have barely changed over the last twenty years for lone parents and the partners of jobless men (see Desai,

Gregg, Steer and Wadsworth, 1999). Lone parents in the UK have very low employment rates by international standards (see Bradshaw et al. 1996). The financial incentives to work outlined above are expected to raise labour supply among marginal groups. Evaluations of the US Earned Income Tax Credit and especially the Canadian Self-sufficiency Programme (described more fully in Blundell 2000, in this volume) suggest that lone parents are most influenced most by such incentives. His estimates suggest that the WFTC alone could raise labour supply by around 30,000. The reduction in the number of workless households is about 60,000 because some second earners stop participating in the labour market and hence reduce the overall labour supply effect. This then will probably reduce the numbers of children living in workless households by around 100,000. Note also that the WFTC is just part of the making work pay package and that the lower taper means that more of this money feeds through into take home pay.

- **New Deals**

Again there are New Deal programmes for lone parents and the partners of the unemployed. These non-compulsory programmes are designed to encourage and support job search should any individual wish to enroll.

New Deal for Lone Parents: In the past, lone parents were ineligible for job-search support provided by the Employment Service. The New Deal for Lone Parents remedies this. Participation is entirely voluntary and is initiated by a letter from the Department of Social Security. Those wishing to join the New Deal are assigned to case workers whose job is to help them secure work. This will often involve help with claiming income supplements and child-care arrangements, as well as job search. Initially only lone parents whose youngest child was at least five years old were contacted, but the scheme has since widened. Early indications are that about 18 per cent of lone parents contacted agreed to participate and about 30 per cent of these got jobs in the first six months in the trial areas.

New Deal for Partners of the Unemployed: This is yet another previously excluded group who will now be offered voluntary placement on New Deal programmes if their partner is also eligible. Otherwise they can elect to join a job search support group akin to that for lone parents above.

- **National Childcare Strategy**

Lack of affordable childcare facilities is often identified as major barrier to work among mothers with younger children. Again the Child Care Tax Credit should help in this regard.

- **Special Interventions**

The third major arm of the strategy is to try to reduce the impact of deprivation on educational attainment and to limit problems recurring throughout adulthood. There are a number of initiatives originating often from the Social Exclusion Unit, targeted at key life stages. Sure Start is perhaps the most important. It is targeted on children aged 0 to 3 living in disadvantaged areas of the country. It aims to promote physical, social and emotional development of children and hence to make them more ready to learn by he time of entry into school. There are also initiatives to reduce numbers leaving school with few or no qualifications, to reduce teenage pregnancy and to encourage children from poor families to stay on at school, (Educational Maintenance Allowance pilots).

6. Conclusion

The Labour government has produced a stream of initiatives aimed at tackling many of the distributive labour market problems highlighted here, but the slow-moving ship of state takes a long time to absorb these changes. Further, many of the initiatives have been confined to pilot studies designed to assess what works in practice. We do believe that the government is now aware of and, encouragingly, willing to address many of the most pressing labour market problems. But the scale of intervention needs to be large to tackle the large inequalities of opportunity described above. The programmes developed to tackle declining labour market participation among the over 50s and the persistent low pay and employment stability at the bottom end of the labour market seem under developed and in most need of attention. Whether the measures currently in place will be sufficient to begin to ease the problems that twenty years of indifference or wilful neglect have engendered will only become apparent over the next few years.

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Table 1 ILO Unemployment Rates for selected groups in Spring 1998

	All	Men	Women
Age 16-24	12.4	14.0	10.4
Age 25-49	5.2	5.6	4.8
Age 50+	4.9	5.8	3.5
Degree	3.0	3.0	2.9
Higher	4.2	4.5	3.8
Lower	7.1	8.3	5.9
None	12.2	15.6	8.4
White	5.7	6.3	4.9
Black	14.6	15.4	13.7
Indian	9.1	9.1	9.0
Pakistani /Bangladeshi	20.4	19.7	22.3
Other	12.7	14.8	10.1

Table 2. The Relationship between Youth Unemployment and Adult Unemployment in the National Child Development Survey

(1) Men

	No in sample	% time spent Unemployed Between 24-33	% time spent Non-employed between 24-33
All in sample	**4449**	**4.0%**	**5.0%**
of which:			
No unemployment 16-23	**2607**	**1.5%**	**2.1%**
1<6 months unemployment 16-23	**1025**	**3.1%**	**3.8%**
6<12 months unemployment 16-23	**451**	**6.9%**	**8.0%**
12+ months unemployment 16-23	**366**	**21.7%**	**25.5%**

(2) Women

	No in sample	% time spent Unemployed Between 24-33	% time spent Non-employed between 24-33
All in sample	**4533**	**2.2%**	**27.9%**
of which:			
No unemployment 16-23	**2769**	**1.3%**	**26.8%**
1<6 months unemployment 16-23	**1011**	**2.3%**	**26.1%**
6<12 months unemployment 16-23	**439**	**3.1%**	**31.8%**
12+ months unemployment 16-23	**314**	**8.2 %**	**38.1%**

Source National Child Development Survey taken from Gregg (1999)

Table 3. Male Employment, Inactivity and Unemployment by Age, Education and Housing Tenure, 1984-99

	Employment/ Population	Lab. Force/ Population	Unemployment/ Lab. Force
Men			
1984	80.9	91.4	11.5
1990	84.6	91.2	7.2
1993	77.6	88.7	12.5
1999	81.2	87	6.6
Ln90-Ln84	0.045	-0.002	0.047
Ln99-Ln93	0.045	-0.019	0.064
Men Low Quals.			
1984	73.9	87.3	15.3
1990	79.3	88.3	10.2
1993	70.8	85.4	17.2
1999	73.6	81.7	9.9
Ln90-Ln84	0.071	0.011	0.059
Ln99-Ln93	0.039	-0.044	0.083
Men Council House			
1984	63.5	84.8	25.1
1989	66.5	82.2	19.2
1993	52.5	77.8	32.5
1999	53.7	69.9	23.1
Ln90-Ln84	0.046	-0.031	0.076
Ln99-Ln93	0.023	-0.107	0.13
Men 50-64			
1984	70.1	76.9	8.9
1990	70	75.9	7.8
1993	63.8	72.5	12
1999	68.3	72.4	5.7
Ln90-Ln84	-0.001	-0.046	0.047
Ln99-Ln93	0.068	-0.001	0.069

Note: Table excludes students. Participants on active labour market programmes are classified as employed. Log differentials calculated using 1 - unemployment rate in column 3. Log differentials may not equate due to rounding error. LFS weights used. Share of low qualified in male population = .54 (1984), .51 (1989), .46 (1993), .43 (1999)

Table 4. County Employment Patterns and Inactivity of Less Skilled Workers, 1999

Area Employment Rate	Inactivity Rate less skilled women	Inactivity Rate Less Skilled Men	Inactivity Rate Less Skilled Men (age 45+)	4 year Rise in Area Emp. rate	4 year change in inactivity rate Less Skilled women	4 year change in inactivity rate Less Skilled men	4 year change in inactivity rate Less Skilled Men (age 45+)
< 70 %	39.4	28	40.7	< 2 point	-3.5	1.1	1.7
70-74 %	35.2	23.3	32.4	2-3 points	-5.1	-1.1	-1
74-78 %	31.2	18	24.9	3-4 points	-5.1	-0.6	-0.2
> 78 %	26.9	14.8	20	> 4 points	-6.8	-1.9	-1.1

Source: LFS

Table 5. Workless households

	Workless households (working age)		Households where all adults work		Working age adults in workless households		Children in workless households		Employ ment rate
	(000s)	%	(000s)	%	(000s)	%	(000s)	%	
FES									
1968	540	4	7150	52.8	800	2.6	520	4	76.3
1975	870	6.2	7800	55.5	1330	4.4	990	7.2	77.7
1981	1530	10.6	7800	55.4	2540	8.1	1730	13.2	73.1
1985	2370	15.7	8030	53.6	3730	11.6	2090	16.9	70.8
1990	2180	13.3	10340	63.1	3200	9.6	1890	15.6	76.7
1995	2870	16.7	10470	61.2	4110	12.6	2400	18.3	75.1
1996	2990	17.4	10570	61.5	4330	13.2	2560	19.6	75.7
LFS									
1975	900	6.5	7880	56.7	1230	4.3	-	-	76.8
1981	1570	10.9	7480	52.1	2360	7.8	-	-	72.9
1985	2470	16.1	8100	52.8	3690	11.7	-	-	71.6
1990	2280	14.1	9840	60.7	3140	9.8	2280	14.5	76.9
1995	3300	19.1	10420	60.4	4480	14.1	2880	20.4	73.9
1999	3080	17.4	11320	64	4130	12.7	2620	18.4	76.4

Source: Labour Force Survey 1975-1998, spring quarter. Family Expenditure Survey 1968-1996.
Notes: - data not available. * numbers have been adjusted to include households with unknown economic activity. Excludes students and households where head is above retirement age or absent.

Table 6. Decomposition of the workless household rate in Britain between 1977 and 1999 (LFS)

	Workless Household Rate (1)	Predicted Rate (2)	Predicted holding Employment rate as 1977	Predicted holding Family Structure as in 1977	Polarisation (1) - (2)
1977	8.2	8.5	8.5	8.5	-0.3
1990	14.1	9	9.2	8.3	5.1
1999	17.4	11.1	11.2	8.5	6.3
	Change in the workless household rate	Change in the predicted rate (A)	Change due to family structure (B)	Change due to employment (C)	Change in polarisation
77-99	9.2	2.6	2.6	0.1	6.6
77-90	5.9	0.5	0.7	-0.2	5.4
90-99	3.3	2.1	1.8	0.3	1.2

Note: Predicted is based on a households probability of being workless if work was randomly distributed across the working age population.

Figure 1
Proportion of the unemployed that experience half of all days unemployment in year : 1983 - 1997

Notes: JUVOS longitudinal cohort. Males aged 22-59.

Figure 2
Time since last unemployment spell: Males

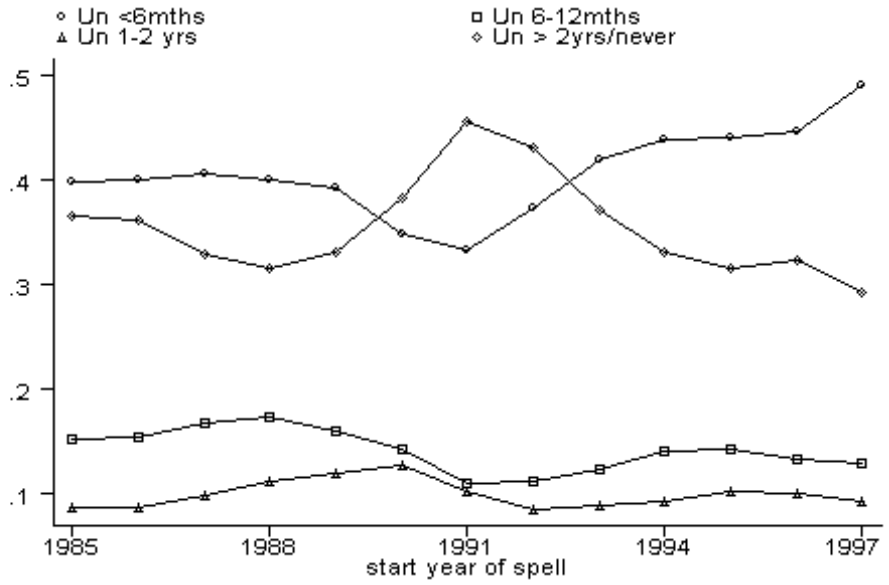


Figure 3:
Entry and exit wages

average entry wage is average wage percentile of those who go back to work after having been on credits

average exit wage isaverage wage percentile of those who leave work to go on credits.

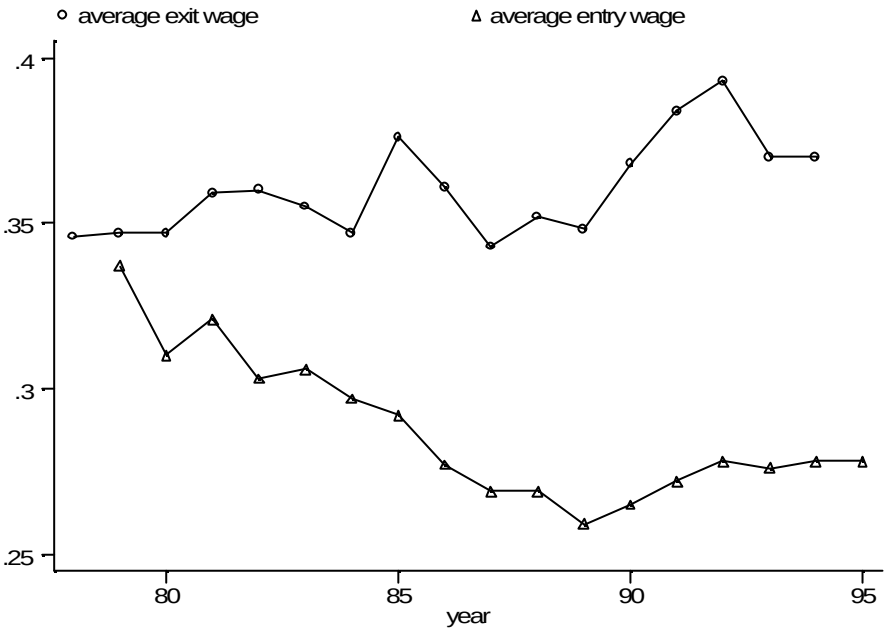
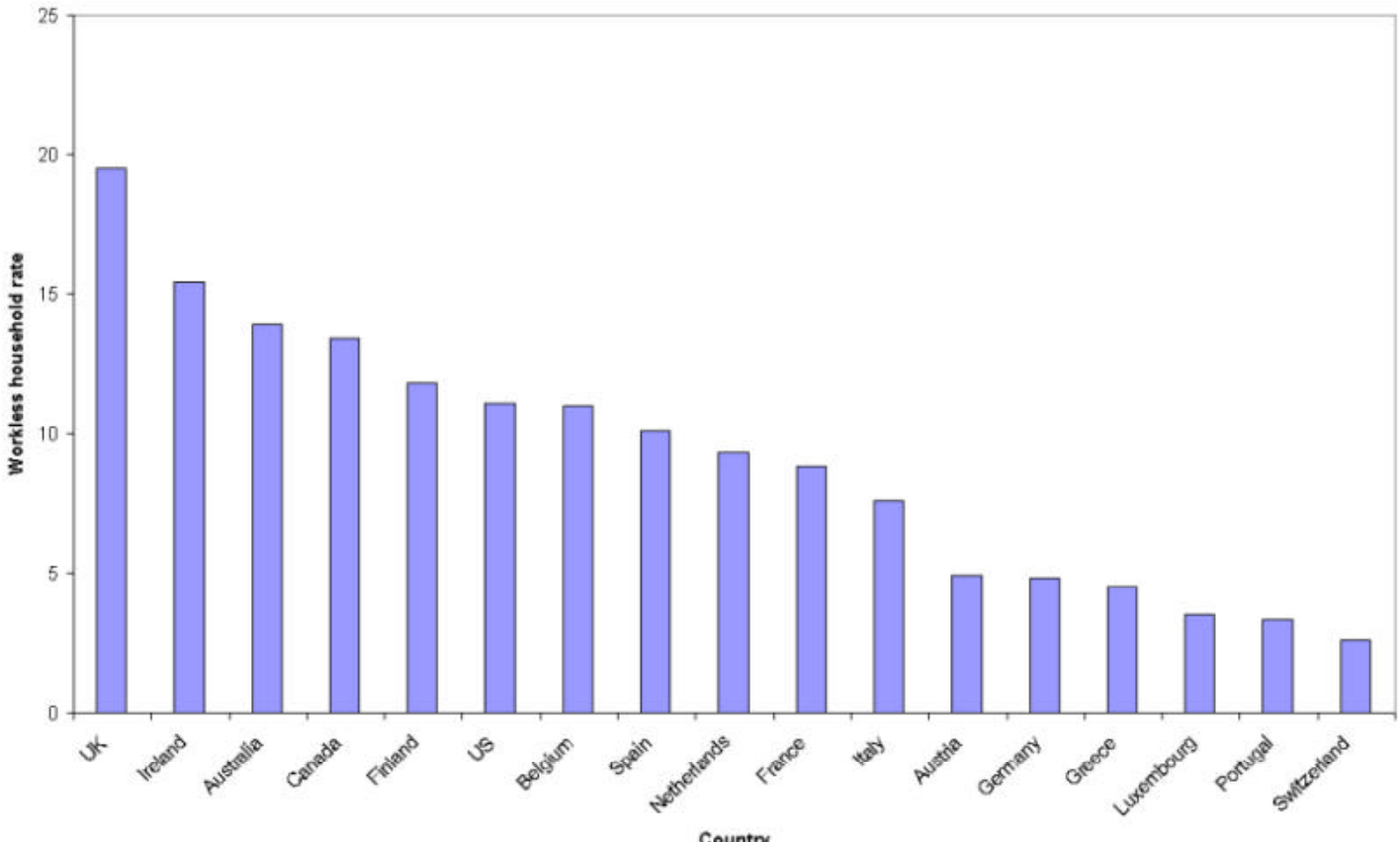


Figure 4:
The cost of job loss for the over 45s

Job loss defined as unemployment credits during year t.
The wage loss and wage growth before and after job loss refer to the event of unemployment benefits in year t.

Everything is defined as the difference in the averages of those that experience unemployment in year t and those that stay continuously in employment.

Figure 5. Workless household rate across countries for households with children - OECD 1996



End notes

1. This is using the internationally agreed ILO/OECD search based definition of unemployment, rather than the administrative claimant count which is currently around 4%.

2. JUVOS is a database of claimant unemployment records for a 5% sample of the population. Those with less than 5 days of unemployment are excluded.

3. For example, the claimant count unemployment rate in Macclesfield was 1.6% and 11.7% in Knowsley in October 1999, the average for the North West region was 4.6 %. Source Labour Market Trends.

4. For women, most of the rise in participation has been amongst women aged between 25 and 49. For this group, inactivity fell from 3.2 to 2.5 million.

5. Dickens (2000) also examines the fall in this index after controlling for changes in the inflation rate, which is strongly correlated with mobility. He reports evidence that mobility has fallen by 22% for males and some weak evidence that it has fallen by 11% for females.

6. Note that lone parents only make up a minority of single adult households.

7. Poverty here is defined as below half average household income (after housing costs) equivalised for family size.