# Welfare to What?

## Prospects and challenges for employment recovery

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The success of the Coalition's supply side reforms in reducing worklessness and poverty will be determined by the scale, quality and distribution of employment opportunities in the economy and how these new jobs match the skills, experience and location of those currently claiming benefits.

The 2010 White Paper setting out the Coalition's proposals for a universal credit has been described as a fundamental reform of the British welfare system. The Department for Work and Pensions (DWP) suggests that up to 500,000 working age adults might be moved out of poverty through employment and take up of in-work benefits. The proposals certainly have some attractions such as simplification and improved in work benefits for some people. Their impact on the labour market and their ability, in isolation, to make major inroads in to poverty and worklessness are less certain.

Job entry alone is not a sufficient outcome if the government are to succeed in significantly reducing poverty and increasing individuals' social mobility. In the UK, there is a still long 'tail' of low skill, low wage employment and there are an estimated ten million people earning less than £15,000 per annum. Too often individuals become trapped in a revolving door between low paid, poor quality work and unemployment. Low paid workers were also more vulnerable to pay reductions (through hours reductions and falls in real wages) and job loss over the course of the recession with falls in employment concentrated in the largest low wage sectors and occupations.

The majority of jobs lost over the course of the recession – skilled and semi-skilled manual, unskilled workers, and administrative workers – do not typically recover as a share of employment post recession. There is also some evidence of a polarised job pattern emerging – share of employment has fallen in manual and semi-skilled occupations – reminiscent of the 1980s and early 1990s, with potentially significant implications for individuals' social mobility. Major mismatches are likely to remain between educational and vocational skill levels of these workers and the sort of education and skill levels and experience the new jobs require.

Labour challenges are highly spatially concentrated, as demand and supply side processes interact to maintain high unemployment and low wages locally even when the labour market has become more buoyant at the aggregate level. Across England, 41 per cent of Job Seekers Allowance (JSA) claimants are concentrated in the fifth of small areas with the highest concentration of claimants. Spatial wage disparities have been very persistent, if not widening, over time. In some parts of the UK, including Blackpool, Grimsby and Hull, around a third of residents earn less than £7 per hour (below both the Minimum Income Standard and the Minimum Living Wage). The quantity and quality of jobs available locally is likely to be of particular importance to welfare claimants and low paid workers, as their travel horizons are likely to be lower.

Both the geography of the recovery and the public spending cuts are likely to widen spatial disparities and exacerbate the problems of labour market demand deficiency at the local level. With the accelerating pace of job loss in the public sector and lack of overall growth in the private sector, initial signs of recovery in employment have been halted: over the last quarter to September-November 2010 employment fell by 69,000 in the West Midlands.

As part of the response to the macro-challenges facing the UK, policy makers should:

- **Develop a growth strategy based on a thoughtful, focused and sustained approach to policy making that engages business and other organisations on a more systematic basis.** The real problem with the OBR forecasts is not that the economy is incapable of generating jobs on this scale at a time of public spending cuts, but the fact that the 1990s recovery was powered by much stronger economic growth.

In order to support individuals into sustainable employment with progression, policy makers should:

- **Focus on getting people into jobs with more than 16 hours of work a week**. This would be much more in line with the grain of the labour market – the UK labour market has not generated many 'mini-jobs' of less than 16 hours a week in the past – and it would also have more impact on low income households.
- **Reconsider self-employment as a viable option for the more disadvantaged** – there is a great risk of swapping one form of precarious, low income existence for another with no long term benefit.
- **Promote the role of labour market intermediaries[1] in helping reallocate labour more efficiently, in particular their role for those already in work in the 'Bottom Ten Million'**. The rise in labour market intermediaries may have facilitated the workings of the labour market. We suspect their role is most developed for more skilled and specialist groups of labour and for moving people from unemployment and inactivity into work, and least developed among those already in work in the 'Bottom Ten Million'.
- **Consider the potential role of local employers both in helping disadvantaged groups secure sustainable employment** and in giving them additional skills and experience so they can progress upwards.
- **Increase investment in skills, especially skills below degree level, and tackle the root causes of under-utilisation in the workplace**. Unless the problem of under-utilisation of the skills and experience that people already have is addressed, supply-side interventions, such as skills development, will only have limited impact on improving individuals' employment prospects. Combined they have the potential to increase productivity in lower wage industries and businesses, and open up more job opportunities for those on low incomes.

[1] Labour market intermediaries include private, public and voluntary organisations listing employment vacancies and referring or placing applicants for employment, where the individuals referred or placed are not employees of the employment agencies, supplying workers to clients' businesses for limited periods of time to supplement the workforce of the client, and providing other human resources

- **Consider a wider range of measures, used in parallel with the NMW and working tax credits, in order to continue to combat in-work poverty**. A key challenge is to seek to improve the performance of low wage businesses, through for example, procurement practices and business forums.

In response to labour market challenges faced by the UK's cities and towns, policy makers need to:

- **Ensure local authorities and their partners have the flexibility, including greater budgetary control, to shape labour market policy and customise interventions in a way that responds to local circumstances**. It is simply not possible to dictate the detail of policy design from the centre and expect this to work in an undifferentiated way across the UK.
- **Understand how to manage public sector cuts at the same time as rising to other strategic challenges**, prioritising and taking decisions about where costs will be reduced with a clear vision of the desired outcomes for service delivery across public service providers.
- **Consider the appropriate balance between increasing individual mobility so as to widen access to job opportunities and rebuilding the economic base to provide more and better jobs locally**, based on a realistic assessment of job opportunities and the pace of regeneration in local areas.

# 1. Introduction

This paper is the first in a series of publications as part of The Work Foundation's new research programme, *The Bottom Ten Million*, which focuses on the employment prospects of Britain's low earners between now and 2020 and seeks to identify the priority measures that need to be taken if they are to share in the sources of growth and prosperity over the next decade. There are ten million people in Britain who currently have annual incomes of less than £15,000 and for many life is a continuous struggle and one that is hard to escape.

The Coalition government has announced an ambitious intention to tackle worklessness and poverty. The 2010 White Paper on the universal credit suggests that up to 500,000 working age adults might be moved out of poverty through employment and take up of in-work benefits. We support the broad thrust of the Coalition's reforms but this paper is not directly concerned with the benefit system. We instead focus on the labour market challenges, both national and locally, that the Coalition must also address if the welfare reforms are to have the hoped for impact. There has been little official discussion of the scale, quality, and distribution of employment opportunities the economy is likely to generate, nor how the new jobs match the skills, experience, and location of the workless. Even less has been said about how the Coalition's policies might help those already in work on low incomes.

Low earners are more vulnerable, on average, to job loss than high earners partly because they have fewer skills. Too often the result is a revolving door between unemployment and low skill, low paid work. Although the recession has made these trends worse, many were clearly apparent in the decade leading up to the recession. These are deep-seated structural problems which a return to full employment at the national level will not of themselves solve.

The position of this group is set to worsen without further initiatives. As we show in this report, the one constant of previous economic recessions is that they speed up structural change with job losses falling disproportionately on manual, unskilled and administrative jobs, while job generation in recoveries has been consistently skewed towards higher skilled jobs associated with the growth of the knowledge based economy. Moreover, there is a widening gap between the prosperity of UK cities that the recession and recovery is likely to reinforce. High earners and those with skills and capital can travel or move to new centres of growth. Those in the 'Bottom Ten Million' of earners typically cannot – deterred by rigidities in the social housing market and high travel costs.

The Coalition's Local Growth White Paper signals a shift away from the traditional objective of narrowing regional economic disparities to one that focuses more on different places and their potential for growth. The economic argument is that policy should correct market and policy failures at the local level where this is realistic, but also equip individuals with the ability to participate in growth wherever it occurs. Whether this is sufficient to offset the structural changes described above remains to be seen.

These challenges would be significant in more normal economic times. Over the next five years there will be a major run-down in public sector employment, with at least 600,000 jobs expected to be lost from the public sector by 2015-2016, as well as further job losses expected in private firms supplying the public sector. Nonetheless, the Office for Budget Responsibility (OBR) is projecting a net increase of two million in private sector jobs over the same period. This would be a commendable performance by past standards. Even more challenging is matching the spatial distribution of new jobs in the private sector against job losses in the public sector.

The Coalition has inherited a benign labour market that in some respects is working well. The loss of jobs and the rise in unemployment over the past two years has been much less than past experience would expect. In the short term at least the economy has demonstrated it can produce new jobs – though questions remain about how sustainable job growth will be. Welfare reform by successive governments and a willingness of employers to hoard labour have been significant factors. But we also hypothesise that a further underlying reason has been the rise of labour market intermediaries as part of the wider knowledge economy story. These institutions – private, public, and voluntary – have helped improve flexibility and job-matching. These improvements of themselves will not ensure the low earners benefit from the recovery, but they provide a sound base from which appropriate policies can be developed.

# 2. The welfare to work policy framework

Welfare reform has been seen as a way of delivering several different economic and social objectives by successive governments. However, the Coalition has said relatively little about how the welfare reforms connect to policies for growth and the creation of a more balanced and sustained economy.

## 2.1 Welfare reform

**The recent White Paper setting out the Coalition's proposals for a universal credit has been described as a fundamental reform of the British welfare system.** The proposals certainly have some attractions such as simplification and improved in work benefits for some people. Their impact on the labour market and their ability, in isolation, to make major inroads to worklessness are less certain.

In the 2010 White Paper, *Universal Credit: welfare that works*, the Department for Work and Pensions (DWP) says that the proposals will reduce the number of workless households by 300,000 and the number of workless individuals by 500,000. These are impressive figures. Moreover, even though the transition to universal credit starts in 2013 and will not be fully completed until 2017, the DWP nonetheless thinks the full effect will be realised within two to three years of implementation (i.e. between 2015 and 2016). This is a big change in a short period.

The latest official statistics show that there were just over 3.9 million workless households with at least one person of working age. This compares with 3.5 million working age households just before the recession. So the reduction in workless households predicted by DWP would not be enough to take us back to pre-recession levels. However, most of the increase in workless households over the recession was due to unemployment and some of the increase will therefore reverse as unemployment falls in the recovery. We do not know how 'sticky' worklessness will prove in the recovery, so it would be reasonable to assume that by 2016 the number of workless households will be somewhere between 3.2 million and 3.6 million if the reforms have the full impact assumed by the DWP.

This would be a significant advance by past standards. Even though the economy was at full employment over much of the decade before the recession, little impression was made on the number of workless households. Between 1997 and 2008 the number of workless households fell by just over 180,000. Some of this was due to an improving economy and some to government policies, although we do not know where the balance lies. One interpretation is that previous policies were ineffectual because they were badly designed and lacked the ambition of the current proposals. The previous government was itself planning to introduce significant reforms of the welfare system to focus more intently on workless households. However, previous lack of success could also be seen as a warning signal that making real progress in tackling such a deep rooted structural problem may be much more difficult than the Coalition has allowed for.

The DWP contrasts its own estimates of the impact of future reform with independent research into the impact of previous measures. For example, the combined impact of tax credits, New Deal for Lone Parents, and childcare strategy put 80,000 lone parents back to work, according to one study dating back to 2003.[2] The DWP assumes universal credit will have a bigger impact because it is on a bigger scale than previous reforms. It is not obvious it is comparing like with like. For example, the DWP statistics show that between 2000 and 2010 the number of lone parents on income related benefits (whether in work or not) fell by 240,000 or 26 per cent.[3] Moreover, past experience suggests that when properly researched independent evaluations are done after the policies have been introduced and the results, while often positive, seldom match the high hopes surrounding their introduction.

The DWP estimates that the big impact of the reform will be achieved by moving 250,000 households in to what the DWP terms 'mini-jobs' of less than 16 hours a week. However, the UK labour market historically has not generated many new mini-jobs. Between 1993 and 2008 the number of employees working less than 16 hours fell slightly, with the share of employee employment in such jobs dropping from 10 per cent to 8 per cent (Table 2.1). The DWP may be right in assuming that the labour market will automatically respond to an increase in the number of people offering themselves for low hour work by generating more mini-jobs. However, it must be just as plausible that employers have not offered more of such jobs in the past for good reasons, and an increase in the supply of people wanting them is not sufficient for employers to reorganise work to accommodate them.

**Table 2.1: Mini job generation in the UK, 1993-2010**

| Annual average (UK) | Employees (000s) | % under 16 hours | Under 16 hours (000s) |
|---|---|---|---|
| 1993 | 21,405 | 10.1% | 2,162 |
| 1998 | 23,182 | 9.5% | 2,202 |
| 2003 | 24,427 | 8.7% | 2,125 |
| 2008 | 25,407 | 7.8% | 1,982 |
| 2010 (Q3) | 24,923 | 8.0% | 1,994 |

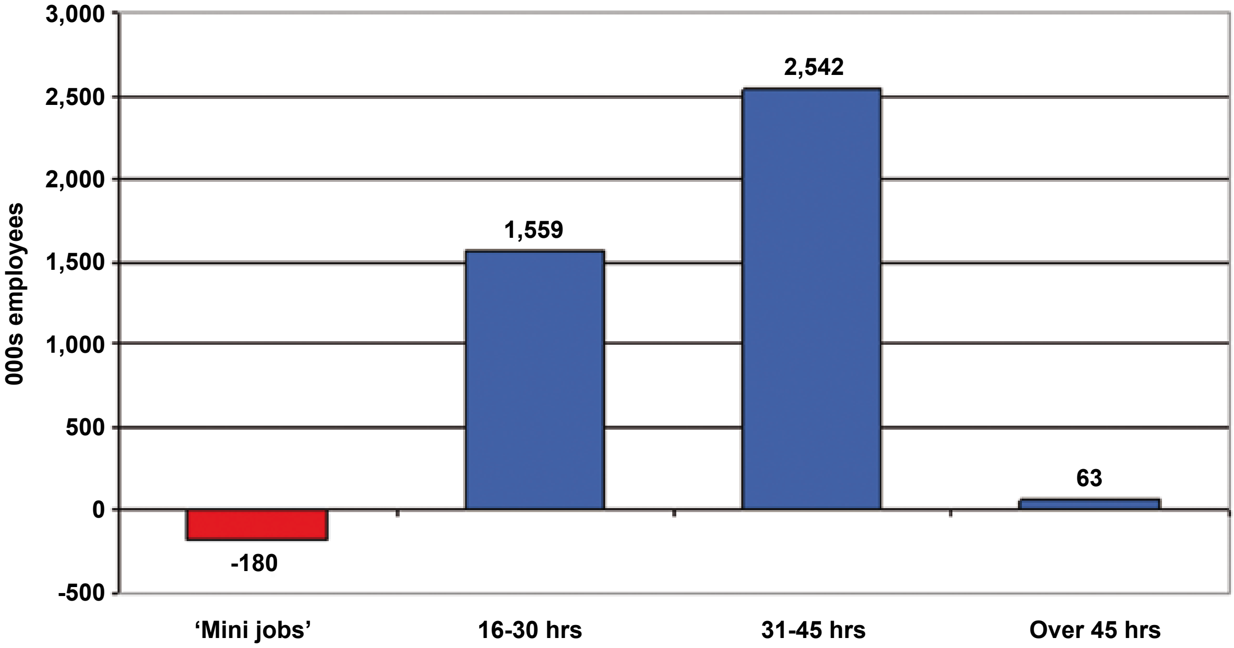
*Source: Office for National Statistics*

**Note:** all figures UK, seasonally adjusted. Usual hours worked.

The DWP also says that another 100,000 workless households will be moved into what the DWP terms 'full time jobs' of 16 hours or more. This is an unconventional definition as most statistical authorities define full time work as at least 30 hours a week. But at least the historical experience suggests the economy is quite capable of generating jobs involving 16 hours or more in large numbers. Between 1993 and 2008 the share of employee jobs involving between 16 and 30 usual hours a week increased from 14 per cent of employees to 18 per cent, and by the third quarter of 2010 to nearly 20 per cent. Overall, between 1993 and 2008 the economy generated just over 1.5 million employee jobs offering between 16 and 30 hours of work a week and 2.5 million employee jobs offering between 31 and 45 hours a week (Figure 2.1).

[2] Gregg, P. and Harkness, S. (2003) *Welfare reform and lone parents employment in the UK*, CMPO working paper series no. 03/072
[3] Not all those moving off benefit will have moved to paid work and many lone parents may have found work anyway. The additional impact of any reform is therefore likely to be less

**Figure 2.1: Employee job generation by usual hours worked, 1993-2008**




*Source: Office for National Statistics, UK seasonally adjusted, usual hours worked*

So far we have taken the DWP estimates at face value. However, as the DWP itself says, the conventional models and analytical tools it uses internally cannot precisely estimate the impact of universal credit: *'we acknowledge that the true impact is highly uncertain'*. The DWP says it uses 'plausible' assumptions, although one would hardly expect the Department to use implausible ones. However, the estimate of a reduction of 100,000 workless households by people moving into the DWP's definition of a full time job appears to be based in part on an '*illustrative example of the potential impact of improving these aspects of the benefit system'*. This sounds too much like educated guesswork to make us entirely comfortable with the predictions.

**In addition to the proposed universal credit, the Coalition has already announced plans to tighten the eligibility for disability related benefits and 'work capacity assessments' are being piloted in selected areas.** These measures build on the previous government's intended welfare reforms. Over the next three years all adults of working age on incapacity related benefits will be assessed. The DWP has suggested that between a firth and a quarter of all those assessed will be found work-ready, although it is not clear what this figure is based on. The procedures are currently being reformed after an independent review found significant shortcomings, with up to 40 per cent of appeals against the initial assessment proving successful.

**The Coalition has already announced reforms – namely the introduction of the Work Programme – to the way support services and employment programmes for the unemployed are to be delivered.** These include consolidation of some existing initiatives into a single Work Programme and a tightening up of ‘payment by results’ requirements for providers bidding to run these services in the future. Providers are being asked to put in bids for future service provision linked to outcomes.

**The Coalition has also announced a ‘New Enterprise Allowance’ scheme to help unemployed set up their own business with an objective of at least 10,000 new businesses being formed in 2011.** This looks a credible albeit modest objective, although at the time of writing the scheme has still to be piloted before full roll out in April 2011. The scheme offers those on Jobseekers Allowance (JSA) for more than six months access to a business mentor to assess the viability of the idea, payment of the equivalent of JSA (just over £60 week at current adult rates) for three months and at half that rate for the next three months, and possible access to an up front loan worth £1,000. The DWP estimates the potential value of the overall package at £2,000 per eligible person. Such schemes are not new and have been used by successive governments in the past. The previous government had a number of initiatives to encourage the unemployed to move into self-employment. The current self-employment credit for example offers JSA claimants an allowance of £50 a week for 16 weeks.

However, there are major concerns about ‘deadweight’ (people who would have set up on their own without the subsidy), ‘displacement’ (existing business forced out by subsidised competition), and ‘sustainability’ (how long do the new businesses last). So even if the government meets the 10,000 target, it does not follow that there will be 10,000 additional businesses in the economy or that the 10,000 will survive for a significant length of time. In the decade before the recession the ONS estimates there were between 250,000 and 300,000 births per annum, partially balanced by between 200,000 and 230,000 firm deaths. ONS estimates suggests that about 20 per cent of new businesses close after two years, and over 50 per cent within five years.[4] The survival rate of some low entry sectors such as hospitality is lower, with 30 per cent of new businesses closing after two years and 65 per cent closing within five years. With such high levels of natural ‘churn’ there is always a danger that publicly subsidised births will either substitute for births that would have happened anyway or displace existing businesses. This is more likely in markets where entry and exist is easy and overall market growth is constrained.

The evidence from past schemes shows they have had at best, mixed results. One summary of the evaluation literature of such schemes published by NIESR in 2003 found that ‘*dead-weight in such schemes is typically high and the net impact quite low (estimates of 60 to 70 per cent deadweight are common; and that ‘displacement rates can be high, with many subsidised businesses established in low margin, service activities with low barriers to entry’*.[5] The study suggested that up front grants helped because it allowed entry to less intensely competitive markets, and also stricter screening of potential applicants. An evaluation of Australian schemes found that about 35 per cent of participants said they would have found work easily without the scheme, another 32 per cent said they could have found work with some difficulty, and the remainder said either they would not have found work or only with great

[4] ONS Business Demography Statistics 2008. The closure figures include people who decide to close their business for reasons other than failure. Survival rates refer to businesses set up in 2003
[5] Meager, Bates, and Cowling (2003) NIESR Review October 2003

difficulty.[6] This suggests deadweight of somewhere between 35 and 67 per cent. However, the results were much better for older unemployed workers, and some targeting of the measure towards older age groups might therefore also improve effectiveness.

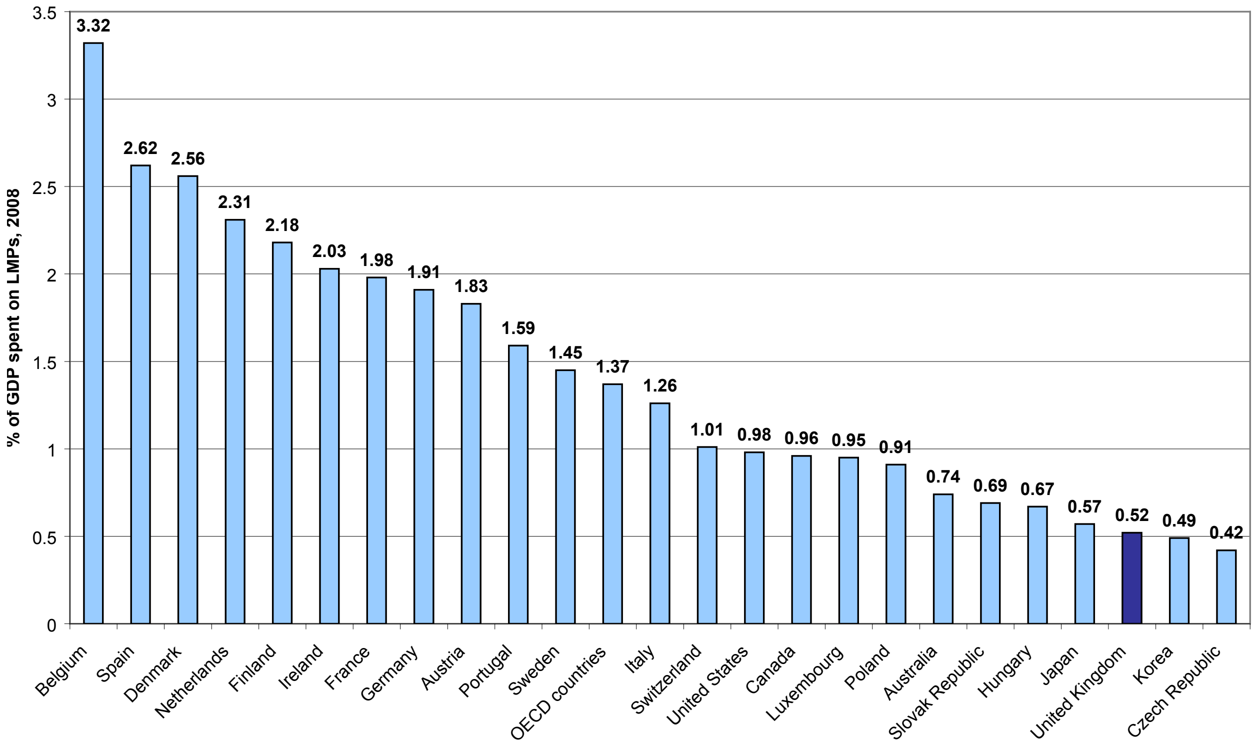
The NIESR study highlighted difficult policy trade-offs – targeting the most able increased survival rates but also increased deadweight, while targeting the least able reduced survival rates unless costly ongoing support was provided. A recent study[7] of how self-employment might offer routs for some out of unemployment also raised this issue. The study noted that success was higher for older workers, the better educated, and those with relevant labour market skills or experience. However, it also concluded: '*For many people entry into (and success in) self-employment remains a difficult and at times precarious activity and hence consideration should be given to how far policies should encourage potentially vulnerable groups to choose such a difficult route'.*

Some have claimed that participation in such schemes improves long term employability even if the business proves unsustainable. However, the same NIESR study referred to above included an evaluation of enterprise support schemes for the young operated through the Prince's Trust. This found that survivability was relatively high after 20 months (around 74 per cent) partly because scheme participants were better educated and were more likely to have a self-employed parent than the average for these age groups. But there was no impact on the long term employability of those whose had left the scheme as they were no more likely to be in work or have higher earnings than those who had not been through the scheme.

**The UK's investment in active labour market policies (ALMPs) is relatively low compared to other OECD countries** (Figure 2.2). ALMPs can be categorised under four main headings: employment services to support job search for the unemployed; training measures to increase the skills of the unemployed; wage subsidies for employers to increase demand for labour; temporary jobs (usually in the public sector). The UK lags far behind the higher investment strategies of EU economies and the US and Canada. UK ALMPs rely very heavily on spending to help the unemployed look for work (we outspend every EU economy except the Netherlands). In contrast, the UK spends very little on training, employment support or incentives to set up businesses for the unemployed.

[6] Kelly, Lewis, Mulvey (2002) *Self-employment programs and outcomes for designated jobseekers*, Centre for Labour Market Research Discussion Paper 02/3
[7] Kellard, K., Legge, K. and Ashworth, K. (2002) Self-employment as a route off benefit (DWP Research Report 177), Leeds, CDS

**Figure 2.2: Spend on active labour market policies (as a percentage of GDP) across OECD countries, 2008**




*Source: OECD*

The UK's heavy reliance on job search reflects in part the view that the UK's labour market is more flexible than many of those in the rest of Europe and therefore the main focus of policy should be on helping match workers to jobs, especially when job generation was strong and levels of unfilled vacancies historically at high levels. The heavy investment in labour market programmes in other economies could therefore be seen as a necessary counter-weight to greater inflexibilities, for example stronger employment protection legislation, that slow down the workings of the market.

**In addition, UK policy has given higher priority to quantity over quality.** So getting the unemployed into any job has been given higher priority than more intensive improvement of their skills while unemployed so that they can take better jobs. The work first approach promoted by the Work Programme, paying employment providers only when they place someone in work, has been criticised for not taking account of the quality of jobs. So whilst the work first approach may have the largest short term gains, in the longer term it may be financially ineffective and counterproductive.[8] Yet there has been considerable scepticism about the effectiveness of large-scale general training and other support schemes for the unemployed based on the UK and other economies' past experience.

[8] Dickens, R. and McKnight, A. (2008) 'The Impact of Policy Change on Job Retention and Advancement', Centre for Analysis of Social Exclusion Report 134, LSE

## 2.2 Towards sustainable employment?

**The success of the Coalition's supply side reforms will be determined not only by the scale of jobs created but also by the quality of jobs created in the recovery.** For many in the UK the financial gains of entering work are low. This is in part a reflection of the state of the labour market. In the UK, there is a still long 'tail' of low skill, low wage employment and there are an estimated ten million people earning less than £15,000 per annum.[9] Clearly financial incentives to work will not only be impacted on by reform to the benefits system but also by the wages available in the labour market. Getting the 2.5 million people into work will have much less of an impact on poverty than might be imagined due to individuals' low earnings power, affected by both the supply and demand side. Job entry alone is not a sufficient outcome if the government are to succeed in significantly reducing poverty and increasing individuals' social mobility.

**Box A: Defining in-work poverty**

**The Poverty Line –** the poverty level is typically defined as an income less than 60 per cent of median income.

**The Minimum Income Standard –** The Joseph Rowntree Foundation defines this as the income needed to afford a socially acceptable standard of living in Britain today. Beyond traditional essentials such as food, clothes and shelter, this standard includes the opportunities and choices necessary to participate in society. The minimum wage rarely provides the Minimum Income Standard (MIS), and the poverty line falls far short of it. A single person requires earnings of £14,400 a year (based on assumptions about minimum housing costs) to meet the MIS in 2010.

**Low-to-middle earners (LMEs) –** The Resolution Foundation defines LMEs as people of working age with income in the bottom second to fifth deciles, and who receive less than one-fifth of their gross household income from means-tested benefits. These LMEs are not the poorest in society, but they struggle to get by, and have been hard-hit by the recent recession and cost-of-living increases.

**National Minimum Wage (NMW) –** the legal minimum hourly rate payable to workers irrespective of industry, region, employer size or employee characteristics. Currently it stands at £5.93 an hour for employees aged 21 and over.

**Minimum Living Wage (MLW) –** the hourly rate of pay required to provide workers with the Minimum Income Standard. It represents income after tax, and does not include housing or childcare costs. The Joseph Rowntree Foundation calculates the 2010 MLW for a single adult living outside of London to be £7.38 an hour, and the GLA calculates the London MLW to be £7.85 an hour.

[9] Based on employees and self-employment estimates from the Labour Force Survey and Family Resources Survey, 2009

**The proportion of low income working households has risen over the last ten years despite a series of government initiatives designed to 'make work pay'.** The link between low pay and poverty is complex: '*most low paid workers are not poor but low paid workers face a much higher risk of poverty than workers who are not low paid*'.[10] Indeed, Nickell found that 72 per cent of workers in poor households are low paid.[11] Many low earners live on the edge of their means and report increasing difficulties with debt and household bills. The DWP estimates that the average gain for low income households who would typically be expected to receive the universal credit will be between £2.40 and £3.60 a week, or between 1.5 and 2 per cent. This has a substantial impact on official measures of poverty by lifting large numbers just below the 'poverty line' to just above it. However, the impact on the majority of people in the 'Bottom Ten Million' is likely to be small.

**Low paid workers are less likely to stay in employment than high paid workers.** Numerous studies have highlighted the revolving door between low paid work and unemployment thought to contribute to recurrent poverty. A 2010 study looking at the experiences of a group of low paid workers (restricted to a sub-sample of low-skilled respondents in order to capture work patterns of the disadvantaged workers) over five years found that just over half the sub-sample stayed in employment.[12] A quarter of the group entered work and then exited it within the two-year study period; the rest remained unemployed.

**Low paid workers face difficulty not only retaining work but also progressing in work.** The quality of work and opportunity for progression has a strong influence on the tendency of individuals stay in work. It also improves long-term job prospects and reduces risk of recycling individuals through the system. This is clearly recognised by policy makers – hence the introduction of new targets around 'sustainable jobs with progression' – but to what extent has the policy succeeded in addressing the problem? There is mixed evidence as to whether in-work benefits have increased employment rates and limited evidence that they provide a step up to better paid jobs. Dickens *et al* found that 30 per cent of Working Family Tax Credit (WFTC)[13] claims last more than two years.[14] The study also found that 15-20 per cent of claimants start a new claim within three months and 30-40 per cent a new claim within the next year. The findings of this study suggest that, whilst WFTC did not have a detrimental impact on wage growth, more needs to be done in order for people to progress in work.

**Individuals may be trapped in cycles between low paid, poor quality work and unemployment for a variety of reasons: local labour market conditions, skills, transport, psychological, health, cultural and demographic factors.** Low paid workers are more likely to have low skills and work for small firms with limited opportunities for progression. Less structured opportunities are likely to restrict

[10] Lawton, K. (2009) *Nice Work If You Can Get It*: *Achieving a sustainable solution to low pay and in-work poverty,* London: IPPR
[11] Nickell, S. (2003) 'Poverty and Worklessness in Britain,' CEP Discussion Papers dp0579, Centre for Economic Performance, LSE
[12] Ray, K., Hoggart, L., Vegeris, S. And Taylor, R. (2010) *Better off working? Work, poverty and benefit cycling,* York: Joseph Rowntree Foundation
[13] Working Family Tax Credits were a pre-cursor to the current Working Tax Credit
[14] Dickens, R. and McKnight, A. (2008) *ibid*

progression for those in temporary employment.[15] Low paid workers are also less likely to be offered training opportunities, which are often the keys to progression. Here cuts in public sector employment cause some concern as public sector employers have historically been major investors in workforce development.[16]

The success of the Coalition's supply side reforms will be determined by the scale, quality and distribution of employment opportunities in the economy and how these new jobs match the skills, experience and location of those currently claiming benefits. Welfare saving and poverty reduction will only be achievable if individuals are supported into quality, sustainable employment with progression. The UK's labour market challenges are discussed in further detail in the next two sections.

[15] Ray *et al* (2010) *ibid*

[16] See Wright, J., Brinkley, I. and Clayton, N. (2010) *Employability and skills: Redefining the debate,* London: The Work Foundation

The Coalition's supply side reforms also require the economy to generate a large number of jobs, jobs with the right mix of skill requirements, and jobs in the right place. How the labour market is likely to perform is at least as big a determinant of future success than the mechanics of benefit reform. In this section we review recent labour market performance and set out the implications for the future.

**In some respects the Coalition inherits a far more benign labour market than previous governments.** Moreover, the reality is that the Coalition also inherits a benefit system that in many respects works much better than it did in the past. Over the recession we saw several major departures from previous downturns:

- Employment fell by much less, despite a much bigger fall in GDP;
- Unemployment peaked at a much lower level, especially measured by the claimant count;
- The rise in long term unemployment has been less than expected, especially for claimants;
- There has been no significant increase in working age economic inactivity.

**The resilience of employment seems to have been a combination of greater hours and wage flexibility by employees**, employers and trade unions and a greater degree of 'labour hoarding' by employers reluctant to lay off skilled workers they would need in the upturn. In that sense, employers have not been acting in the 'hire and fire' fashion that simplistic and one dimensional models of labour market flexibility would have predicted. We look at the prospects for job recovery in more detail later in this report.

Previous recessions imposed major scars on the labour market that persisted well into the recovery with big increases in long term unemployment and working age inactivity as people became 'parked' on long term benefits. Both groups found it hard to get back into the labour market in the recovery. Unemployment is measured in two ways – the ILO survey measure which includes all those who said they looked for work in the previous four weeks and were able to start a job in two weeks time, and the claimant count measure which just includes those able to claim JSA. In previous recessions, these two indicators have moved in line. In this recession they did not, with claimant unemployment stabilising at 1.5 million in mid 2010 compared with 2.5 million on the wider ILO measure.

**There has also been remarkably little increase in the share of long term unemployed claimants (defined as out of work for more than twelve months) over the recession** – 13 per cent in 2008 Q2 to 18 per cent in 2010 Q3. To be sure, some of this must be down to the usual 'recycling' of claimants coming up to the 12 month threshold moving to special schemes and then back to the unemployment count as a new entrant. But it also looks as if people were being moved back into work faster and more effectively than in the past.

**The problem of long term unemployment has not however gone away.** The wider measure of ILO unemployment shows a more significant rise in long term unemployment, from 24 per cent to 33 per cent between July-Sept 2008 and July-Sept 2010. The ILO measure asks people whether they actively looked for work in the four weeks before the survey and are able to take a job in two weeks time. Whether they claim benefit or not is irrelevant. By the ILO definition there were nearly 820,000 people who were long term unemployed in July-Sept 2010, but by the claimant count measure 260,000. As eligibility for claimant benefits has become more restrictive and the value of the benefit has declined significantly, fewer people may be able or inclined to sign on in this downturn than in previous downturns; or alternatively, more of those on non-JSA benefits may be actively looking for work. The potential for longer term disengagement from the labour market remains.

Past recessions were also associated with surges in inactivity among the working age population and a consequent rise in the numbers on long term benefits. In the 1980s recovery working age inactivity fell in the recovery but in the 1990s recovery it did not. Over the course of this recession working age inactivity went up by about 200,000 – but almost all of this was due to increased numbers of students. Non-student working age inactivity hardly changed at all.

**The benefit statistics show that the numbers on non-JSA benefits (employment and support allowance, lone parent, and other income support benefits) went down slightly over the course of the recession**, comparing May 2008 and May 2010. As a share of the working age population, those on non-JSA benefit fell slightly from 9 per cent to 8.9 per cent over the same period. Small changes, it is true, but it is clear that parking people on long term benefits as a way of coping with recessions are firmly in the past. Reductions in the numbers of lone parents claiming benefits have however been significant – falling by 8 per cent over the same period. The benefit system kept people in touch with the active labour market in ways that it did not in the past.

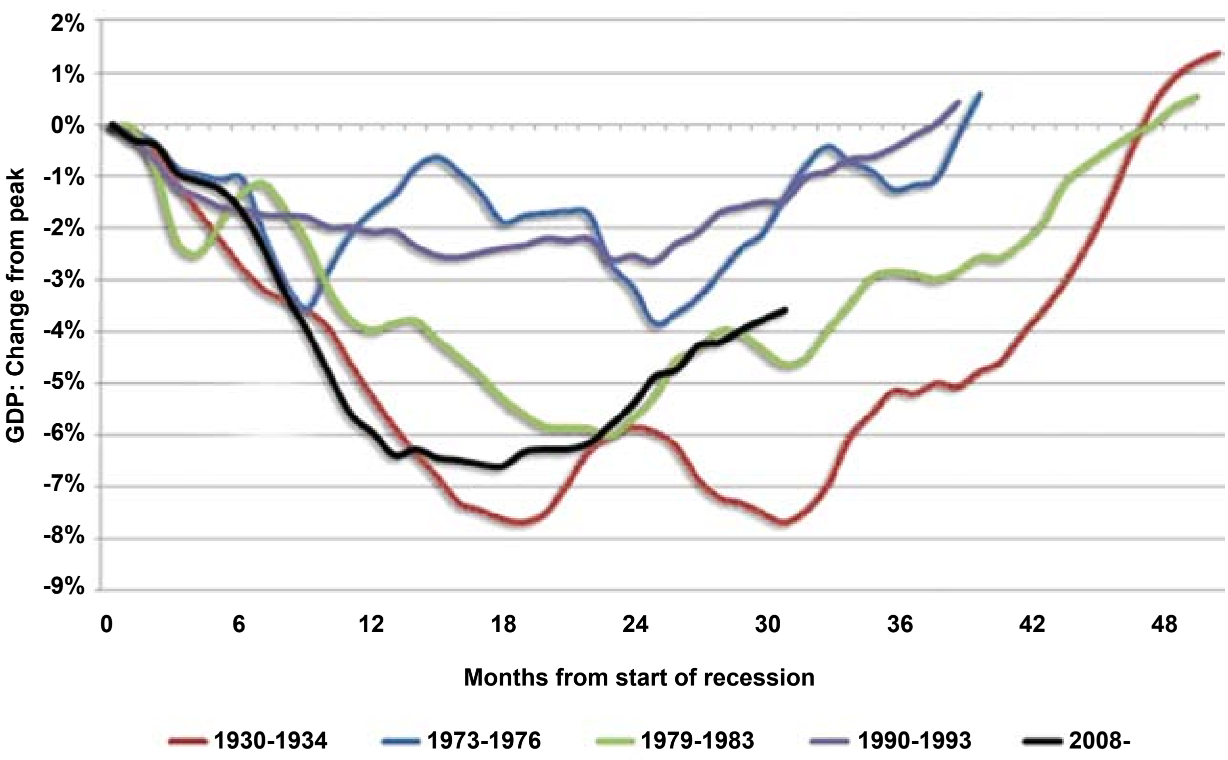
### 3.1 The macro-challenges

**The first and most obvious challenge is that the economy fails to generate the number of new jobs required to both reduce those already actively seeking work in the labour market and the additional flow back into the active labour market triggered by welfare reforms.** It would be relatively easy to move significant numbers of people from long term benefits to JSA by for example imposing much more demanding work assessment tests. This would save money because JSA benefits are lower than disability related benefits. However, it would also increase working age poverty rates unless these individuals could move into employment that increased their overall net income.

**So far the recession has been deeper but shorter than those in the 1980s and the 1990s.** According to the National Institute for Economic and Social Research (NIESR) the economy has been consistently expanding since November 2009. GDP figures shows the economy has been slowing through 2010, and the most recent figures show a fall of 0.5 per cent in activity in the last quarter of 2010.

The most recent short-term economic forecast from the OECD based on 'leading indicators' is for slower growth in the UK and some other major OECD economies.[17] This 'stop-start' pattern is not unusual in recoveries. At present, the recovery is tracking that of the early 1980s. What is striking is that all previous recoveries saw a 'double dip' after the initial recovery in GDP – albeit short-lived – before a more sustained recovery began. This is shown in Figure 3.1 below produced by NIESR. The recent slowdown is not exceptional by past standards, but it remains to be seen how strong growth will be in 2011. The figure also shows that even if the strong recovery of the 1980s is reproduced, it will still be close to four years from the start of the recession before GDP returns to its pre-recession level.

**Figure 3.1: The profile of the depression: Months from the start of the depression**

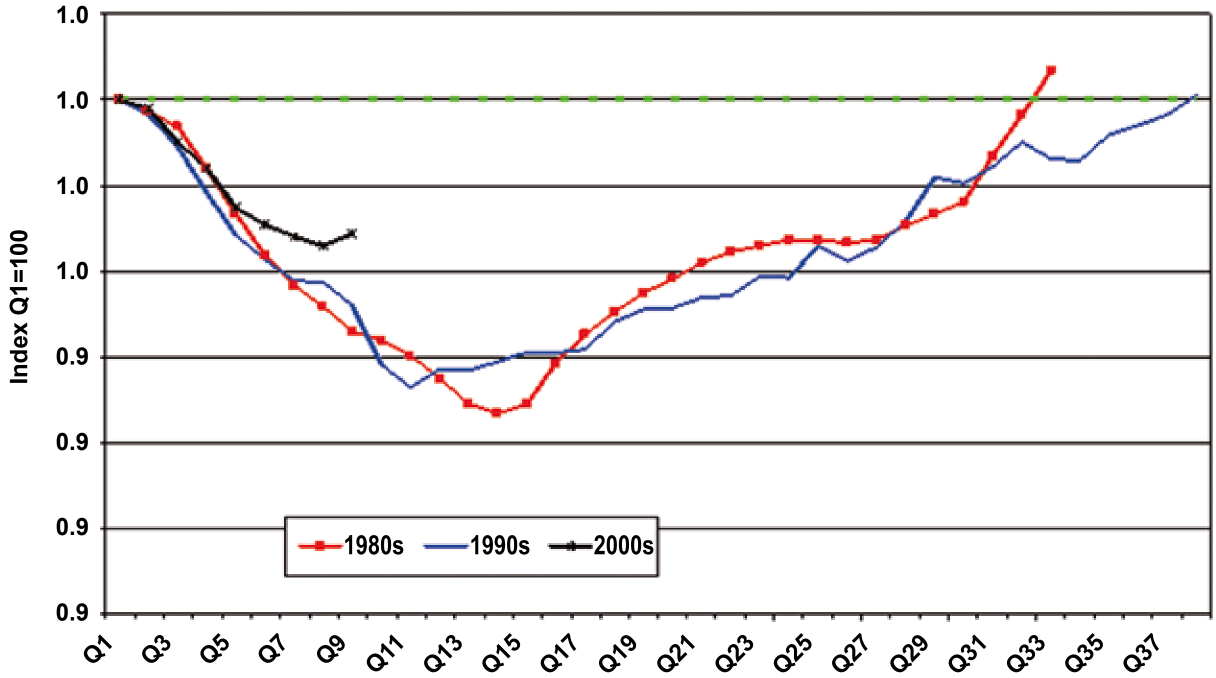



*Source: NIESR, October 2010*

**The labour market has performed much better than in previous downturns with significantly fewer job losses** – despite bigger falls in GDP. Moreover, there has been a much earlier recovery than in either the 1980s or the 1990s. Changes in employment have become much more responsive to changes in GDP. In the recoveries of the 1980s and the 1990s it took around 10 years before employment returned to pre-recession levels. In principle, employment recovery in this recession should be quicker. This is shown in Figure 3.2 below.

[17] OECD Composite Leading Indicator October 2010. The OECD is predicting a downturn in Canada, France, the UK and Italy, expansion in Japan and Germany, and a possible peak in the US

**Figure 3.2: How fast will the labour market recover? Employment recoveries from previous recessions**




*Source: Workforce jobs. UK, seasonally adjusted. Pre-recession peak of employment (1979 Q4/1990 Q2) = 100 Q1*

The reasons why it was so different this time round are nicely summed up in a recent analysis published by NIESR[18]: *'Policymakers did the right thing in saving the banks, cutting interest rates and inducing fiscal and monetary stimuli, all of which have helped maintain demand and firms' cashflow. Workers did the right thing in accepting lower nominal wage growth, although real wage growth was sustained by cuts in interest rates and VAT. Firms did the right thing, wherever possible, in holding onto valuable labour in the face of the pressure on profits and the severe nature of the crisis. Employers entered the recession in good financial shape and this has helped avoid the level of job shedding that occurs when firms get into deep financial trouble.'* These factors have kept more people in work than would have otherwise been the case.

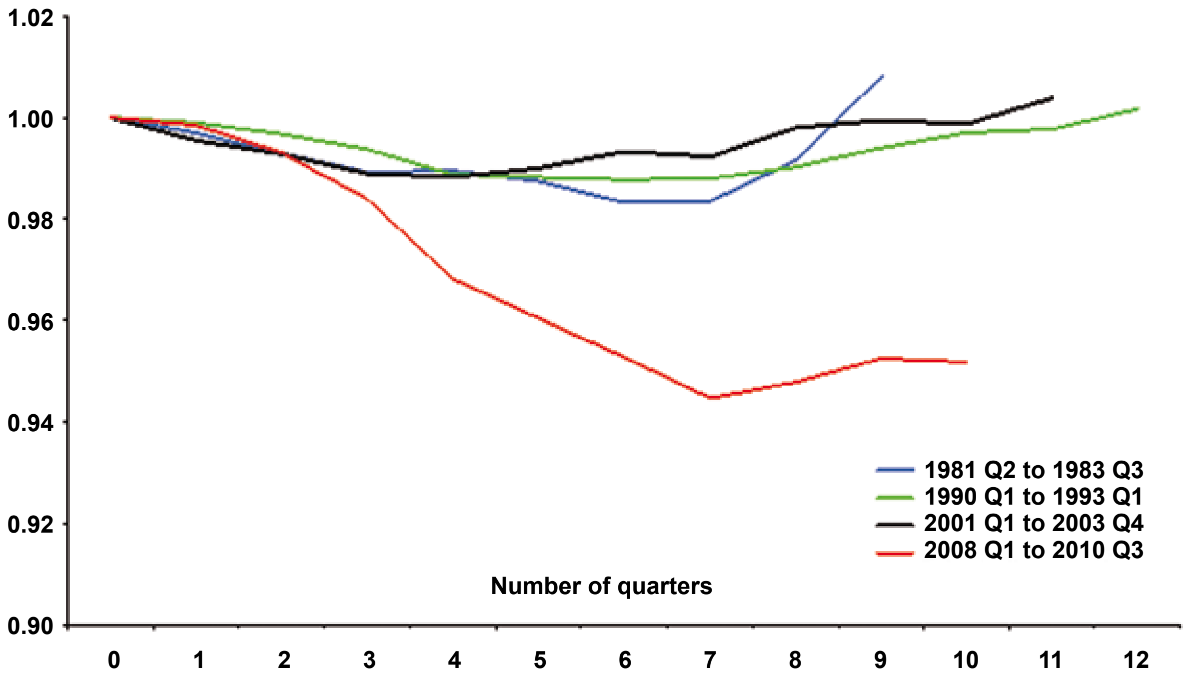
The latest analysis from the Office for National Statistics shows that in the decade up to the recession between 400,000 and 450,000 people who had been unemployed by international definitions moved into work each quarter. This flow remained remarkably stable through the recession, suggested new hiring might also have been more buoyant than in previous downturns. However, as the ONS analysis did not cover previous downturns, this can only be a speculation.

**The UK is not alone in showing differences in labour market performance compared with previous recessions and recoveries.** In many OECD economies labour markets have done better than in the past, but in some cases the outcome has been much worse. The global recession has challenged the simplistic notions of ultra-flexible 'hire and fire' Anglo-Saxon labour markets on the one hand, and

[18] Gregg & Wadsworth (2010), The UK Labour Market and the 2008-2009 Recession, NIESR Review May 2010

rigid 'sclerotic' European labour markets on the other. Germany has come through the recession with barely a job lost through a mix of flexible collective bargaining institutions, employers hoarding labour, and successful government interventions encouraging short-time working.[19] The US in contrast has seen massive job loss and the emergence of long term unemployment as a serious problem: latest figures suggest 40 per cent of US unemployed have been out of work for more than 12 months. The US performance looks more like Spain, in many ways the exact opposite of the US in terms of labour market regulation. Figure 3.3 below shows how very different the US response has been to the crisis compared with previous downturns when US employment proved very resilient and recovered very quickly.

**Figure 3.3: Job recovery from the US recessions compared**




*Source: BLS, October 2010; The Work Foundation estimates*

**Note:** all figures employment peak to return to pre-recession levels, recession periods as defined by the National Bureau of Economic Research (NBER). Total employment, US definitions

The contrast with the UK is stark. But the apparently very different response of employers and employees in the two economies raises some difficult questions as to why – both economies have similar industrial structures, relatively weak labour market regulation by OECD standards, strong conditions attached to unemployment related benefits, and relatively low rates of benefits compared with average earnings.

[19] The OECD estimates that about 20 per cent of the hours reduction in Germany was directly attributable to short term working (STW) schemes, where the state subsidises the wages of workers placed on short time working. Another 40 per cent came from negotiated hours reductions and another 40 per cent from reduced overtime and employees running down accrued leave in individual working time accounts. The OECD notes this may understate the STW effect as the schemes may encourage other forms of hours reductions (OECD Economics Working Paper 756, April 2010)

### 3.2 Pay and the recession

**In the UK low paid workers were more vulnerable to job loss over the course of the recession with falls in employment concentrated in the largest low wage sectors and occupations.** Many of the jobs that the 'Bottom Ten Million' rely upon have disappeared in the downturn: the majority of job losses have been in manufacturing, construction and low value service industries, and amongst manual and unskilled workers. Employers have been reluctant to make skilled workers redundant to avoid future recruitment difficulties, whereas lower skilled workers are likely to be easier to replace. Employers are also less likely to have invested in training amongst low paid staff.

**Nominal wage growth has been weak over the course of the recession for all workers.** Adjustments in employment and hours have not been as significant as might have been expected from previous experience given the fall in output. Firms have deployed other mechanisms, including wage adjustments, in response to the severity of the recession. Wage growth had been weak leading up to the downturn and continued to be so during the course of the recession. In the first year of the recession (April 2008 to April 2009) the gap between full-time average weekly earnings in the public (£539) and private (£465) sectors widened, following annual increases of 3.1 per cent and 1.0 per cent respectively.[20]

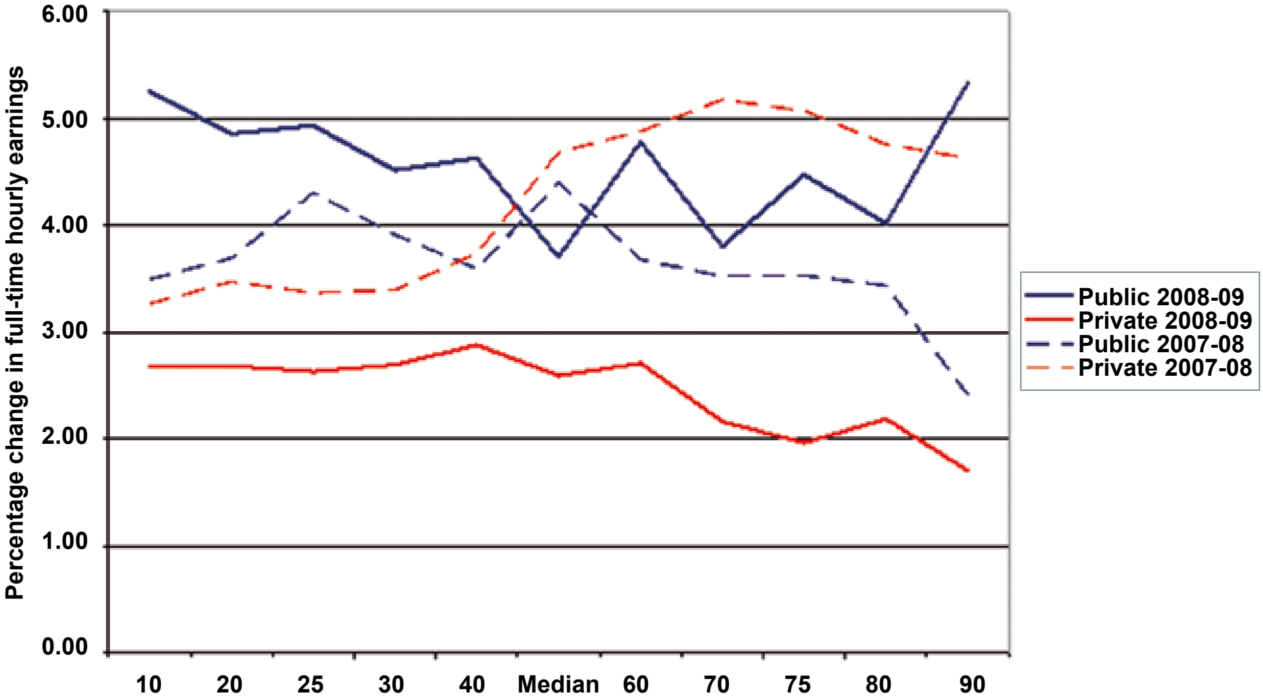
**The recession has also seen a change in the distribution of earnings across the public and private sectors** (Figure 3.4). Prior to the onset of the recession, within the private sector full-time hourly wages had increased most significantly at the higher end of the wage distribution. Over the first year of the recession (2008-2009), this pattern reversed. Whilst the increases in earnings were lower than the previous years across the earnings distribution, those with higher wages saw lower percentage increases than those earnings less than the median. Higher increases were seen across the earnings distribution within the public sector.

**A different pattern emerges when examining the annual change in the distribution of weekly earnings amongst all workers** (Figure 3.5). Changes within the private sector over 2007-2008 follow a similar pattern to changes in hourly earnings. In the first year of the recession, whilst wage increases have been weak in the private sector across the earnings distribution, the lowest paid workers have seen a fall in average weekly earnings. This suggests that low paid workers were more vulnerable to hours reductions that impacted on weekly pay rather than reductions to hourly pay.

**Low paid workers may also have seen a fall in real wages over the course of the recession.** The Low Pay Commission found that overall real earnings fell sharply in the early stages of the recession. In the latter stages of the recession real wages increased due to falls in inflation. Real wages will not have increased for all employees, however, as low inflation resulted largely from reduction in bank base rates leading to falls in mortgage interest payments.[21] Low paid workers, many of whom are not homeowners, may have seen either no increase in real pay or a modest fall. There is some indication that average

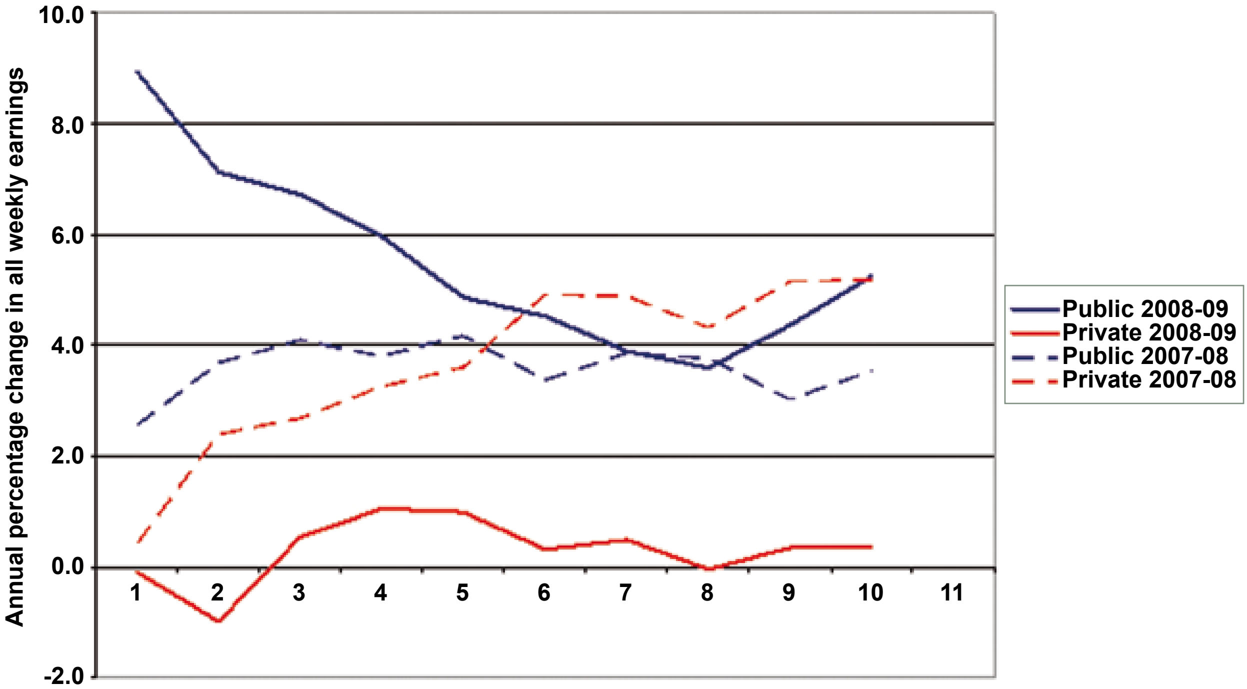
[20] Annual Survey of Hours and Earnings
[21] Low Pay Commission (2010) *National Minimum Wage*, Norwich: The Stationary Office

**Figure 3.4: Change in full-time hourly earnings across the earnings distribution in the public and private sectors**




*Source: Annual Survey of Hours and Earnings, 2010*

**Figure 3.5: Change in all weekly earnings across the earnings distribution in the public and private sectors**




*Source: Annual Survey of Hours and Earnings, 2010* take-home incomes grew slightly over the first year of the recession, in part due to tax cuts and more generous tax credits.[22] Tax credits have potentially made it easier for low paid workers to accept reduced hours and smaller pay rises.

### 3.3 The rise of intermediaries

**One institutional change that has largely gone unnoticed is the rise of the labour market intermediary.** As defined by the official statistics, the numbers classified to labour supply agencies grew very strongly as the demand for specialist and related outsourced HR services to supply high skilled permanent labour for firms has greatly increased. We hypothesise that their rise has facilitated the workings of the labour market – moving people from unemployment to work and from job to job more efficiently than in the past.

The same phenomena has been seen the US where researchers have suggested temporary agencies now act as 'strategic shock absorbers' for the wider economy. The US researchers have however placed it in a different context, as part of a shift towards insecure low cost labour where the costs of labour adjustment are passed on to a peripheral workforce. This may be because they were focused on the demand and supply of temporary labour, an important but still only part of a much bigger story.

We think the rise of labour market intermediaries is however much bigger than this. It is often taken as an article of faith that the knowledge economy has seen large scale 'disintermediation' – a clumsy way of saying that advances such as the Internet bring customers and producers of goods and services closer together and cut out the middle man. In reality the knowledge economy is simultaneously cutting out the middle man and reinstating him/her in different ways and places on an even bigger scale. The knowledge economy is characterised by specialist intermediaries providing a wide range of business services, both nationally and increasingly at the global level.

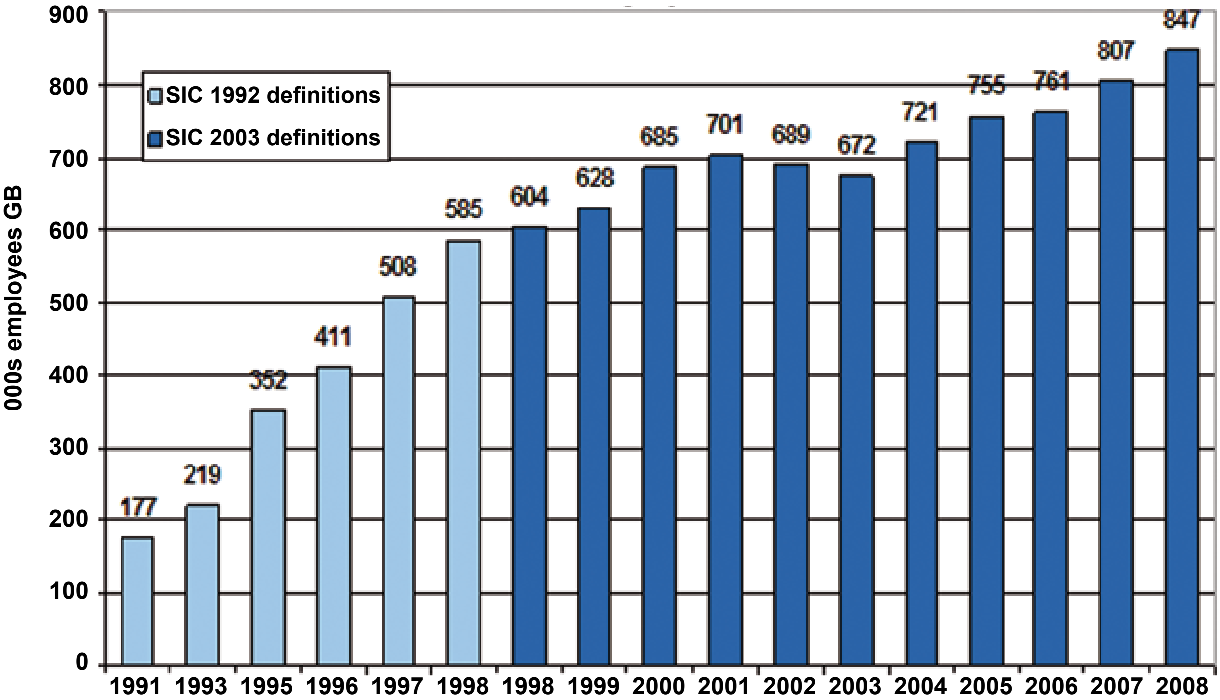
The CBI has suggested that businesses are moving towards a new employment model building on the flexible behaviours shown in this recession. The CBI speculates that as part of this repositioning, business may move beyond the old employment concept of a secure permanent 'core' and an insecure 'periphery' to one they term 'core plus periphery' which puts more emphasis on corporations collaboratively working with a range of partners in the private and public sector to draw on outsourced specialist services and share higher skill human resources. How far this new model happens in reality and what the implications for employment structure are is still unknown.

One indicator of the rise of labour market intermediaries are employees classified to 'labour recruitment' agencies and institutions. The standard industrial classification has changed over time, so we have to look at two periods using somewhat different definitions. Between 1991 and 1998 the number of employees in labour recruitment more than tripled, rising from 177,000 to 585,000. Between 1998 and

[22] Joyce, R., Muriel, A., Phillips, D. and Sibieta, L. (2010) *Poverty and Inequality in the UK: 2010*, London: Institute of Fiscal Studies

2008 the numbers employed on a somewhat different definition went up from 604,000 to 847,000, a rise of 40 per cent (Figure 3.6).

**Figure 3.6: The rise of labour market intermediaries, 1991-2008**




*Source: Office for National Statistics, 2010*

**Note:** Standard Industrial Classification (SIC) 74.50 labour recruitment

## 3.4 A jobless recovery?

**The recovery in employment might be held back if the recovery in GDP was 'jobless'.** If there had been significant 'labour hoarding' (which temporarily lowers labour productivity) and hours flexibility, then employers might be able to cope with rising demand without making any new hires for some time. A recent OECD analysis[23] looking at 27 previous recoveries found that temporary falls in labour productivity due to labour hoarding during the recession are quickly reversed in the recovery, whereas hours reductions take much longer. According to the OECD, the US is least at risk of a jobless recovery because there was little change in labour productivity, hours, or participation over the recession and hence employment took the strain. In contrast, Germany saw much of the adjustment fell on hours, so the recovery is unlikely to see strong job growth. The OECD analysis shows the UK sitting somewhere in between these extremes with moderate risk of a job-poor recovery, although the OECD admit that these estimates are highly uncertain.

[23] OECD (2010) *Labour markets and the crisis*, OECD Economics WP 756

The UK over the recession showed a very strong fall in productivity, measured by output per worker – consistent with extensive labour hoarding. According to a recent government growth paper, the fall in productivity in 2009 was the biggest annual fall since the statistical series began in 1960.[24] Productivity measured by output per worker went up by between 7 and 8 per cent in the recessions of the 1980s and the 1990s, but fell by 4 per cent over the current recession. In contrast, hours reductions were less marked than in previous recessions. Total hours worked fell by between 8 and 9 per cent in the 1980s and the 1990s recessions, compared with about 4 per cent over the current recession.

**Table 3.1: Changes in productivity and hours across three recessions**

| Whole economy | Output per worker | Total hours worked (millions) |
|---|---|---|
| 1980s recession (1980Q1 – 1982Q4) | +8.2% | -9.0% |
| 1990s recession (1990Q1 – 1992Q4) | +7.0% | -8.3% |
| 2000s recession (2008Q1 – 2009Q4) | -3.9% | -4.2% |

*Source: Office for National Statistics*

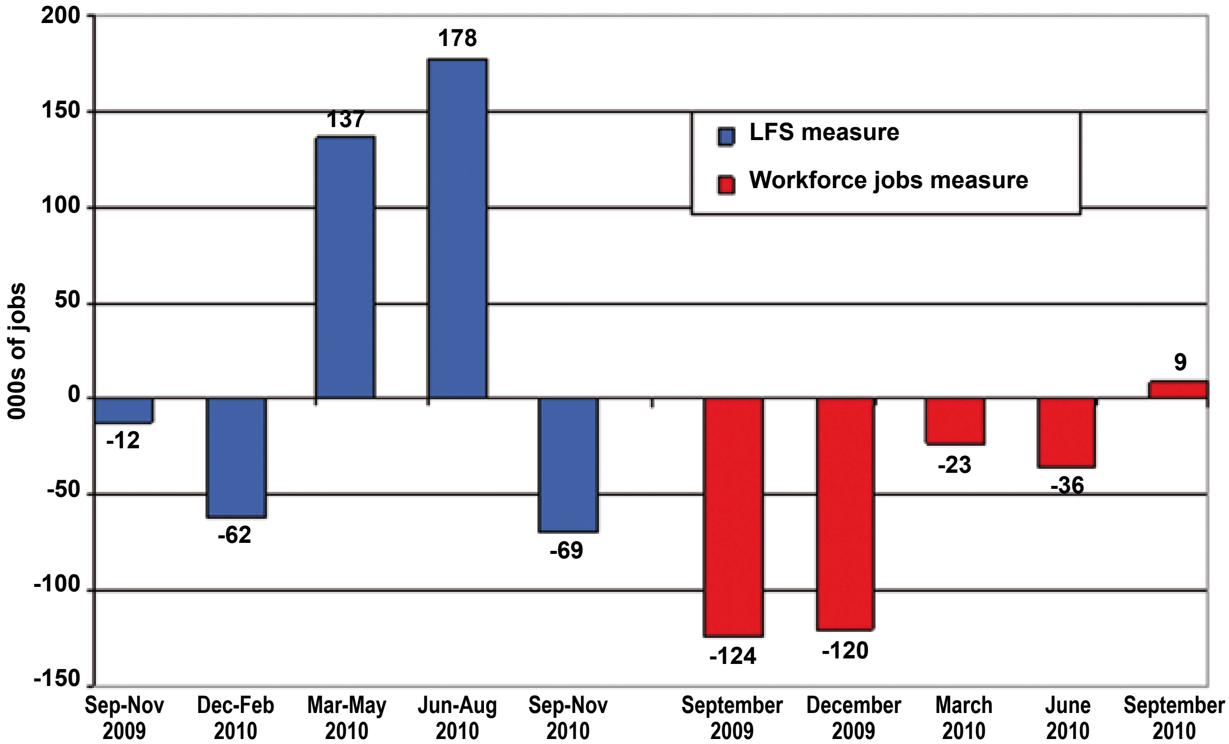
**Note:** manufacturing and services output per filled job, whole economy output per worker. Both change in index 100=2006 UK. A better measure of underlying productivity is output per hour worked, which takes into account changes in the composition of jobs (for example, more part time jobs). This measure is not however available for previous recession periods. Over the current recession (2008Q1 to 2009Q4) output per hour also fell (by 1.6 per cent) but by less than the output per worker measure.

**The economy showed strong employment growth on the back of faster GDP growth in the first half of 2010. With much slower growth and the recent fall in activity in the second half, employment has recently contracted.** In principle the speed with which employers on average start expanding their workforces in the recovery depends on how much economic slack remains within firms to cope with rising demand without adding to the payroll and also how confident employers are about the durability of the recovery. In the three months to August 2010, employment by the LFS measure[25] boomed – up by nearly 180,000. More recently in the three months to November 2010, employment fell by 70,000. The less timely Workforce Jobs measure showed a decrease of jobs of just over 36,000 in the three months to June and then a modest increase of 9,000 jobs in the three months to November. Figure 3.7 on the next page shows quarterly changes in total employment using the two measures over the year to September 2010.

**The LFS figures overstate the strength of the recovery in jobs in the first half of 2010 because it is largely made up of part time work.** In the second quarter over 80 per cent of the total increase in employment was made up of part time jobs. The remainder was accounted for by growth in full-time self-employment. For employees, all of the increase was part time, with full time employment falling slightly.

[24] BIS Economics Paper No 7, *Understanding Local Growth*, p.10,October 2010, BIS/CLG
[25] LFS includes employees, self-employed, people on special government schemes and unpaid family workers. The Workforce Jobs measure includes employees (from payroll data), the self-employed, HM forces, and people on special schemes (administrative data). ONS estimates of employment in the private sector takes employment in the public sector as reported by employers and subtracts it from the LFS total

**Figure 3.7: The jobs recovery in 2010**




*Source: Office for National Statistics*

**Note:** LFS measure is a household survey and includes employees, self-employed, those on government employment and training schemes and unpaid family workers. The Workforce Jobs measure includes payroll employees as reported by employers, self-employed, HM forces, and those on government employment schemes.

Typically, sustained recoveries see significant increases in full time employee employment, so a net increase in full time employee employment would be a clear indicator that the recovery is more firmly based.

## 3.5 What sort of jobs will we see in the recovery?

The UK labour market has been remarkably resistant to fundamental structural change over the past 30 years. For example, the share of permanent employees has changed little since the mid 1980s and the average time that employees say they spend in their current job has overall changed little.[26] We should therefore be cautious about endorsing statements that this recession and recovery will fundamentally change, for example, the balance between permanent and temporary work. The big changes in employment have been driven by the rise and fall of industries.

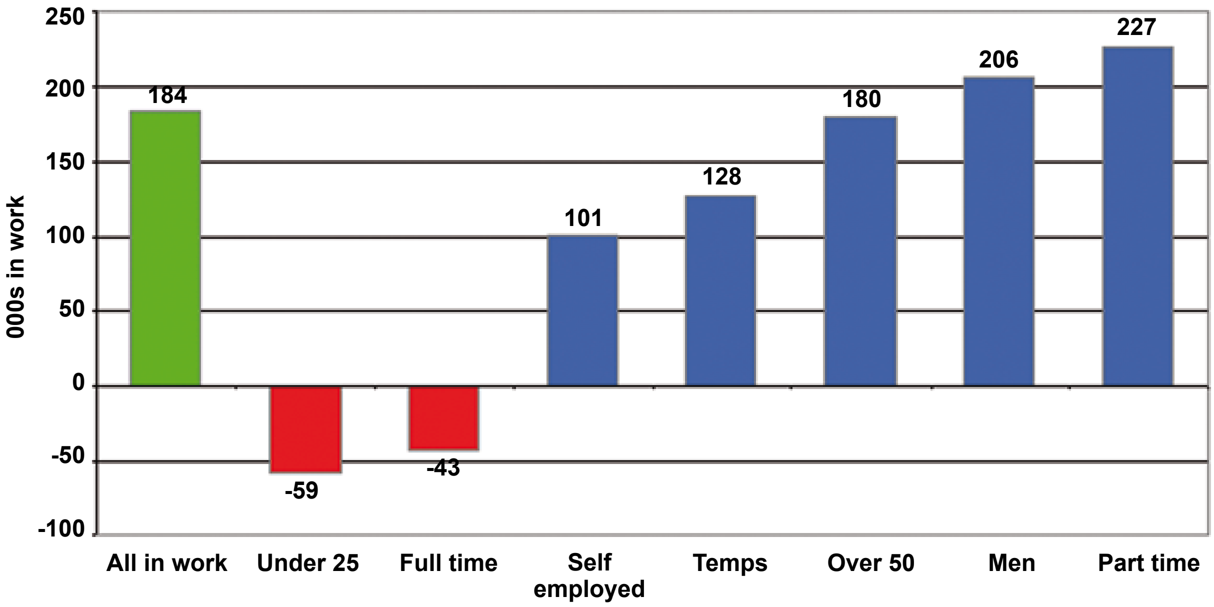
**Typically, recessions fall most heavily on the young, full time workers, men in manual jobs, and the unskilled.** This recession has been no exception, but with more losses among white collar workers

[26] There has been more change below the surface, with for example falling average tenures for men and rising average tenures for women

reflecting bigger impacts on service industries. Self-employment has proved very resilient and has grown over the recession, as has employment for older workers and part time workers.

**The recovery so far has been dominated by job growth for men, the self-employed, part time work, and temporary jobs, and among older workers.** The growth in male jobs and consequent weak recovery in women's jobs is striking. The growth in male jobs is almost equally explained by the growth in self-employment but also very strong growth in males taking part time work, including increasing numbers of students, men forced to take part time work because no full time jobs are available, and men working beyond the current normal state pension age of 65. The relative weakness of women's employment growth is entirely because of fewer full time jobs for women, reflecting in part the lack of new hires from the public sector and continued loss of full time jobs in some female intensive sectors such as distribution and retail banking. Figure 3.8 shows employment change over the past year.

**Figure 3.8: Employment change in the recovery**




*Source: Office for National Statistics*

**Note:** all figures UK seasonally adjusted, year to September-November 2010. LFS definition of employment, employees plus self-employed, unpaid family workers and those on government training schemes.

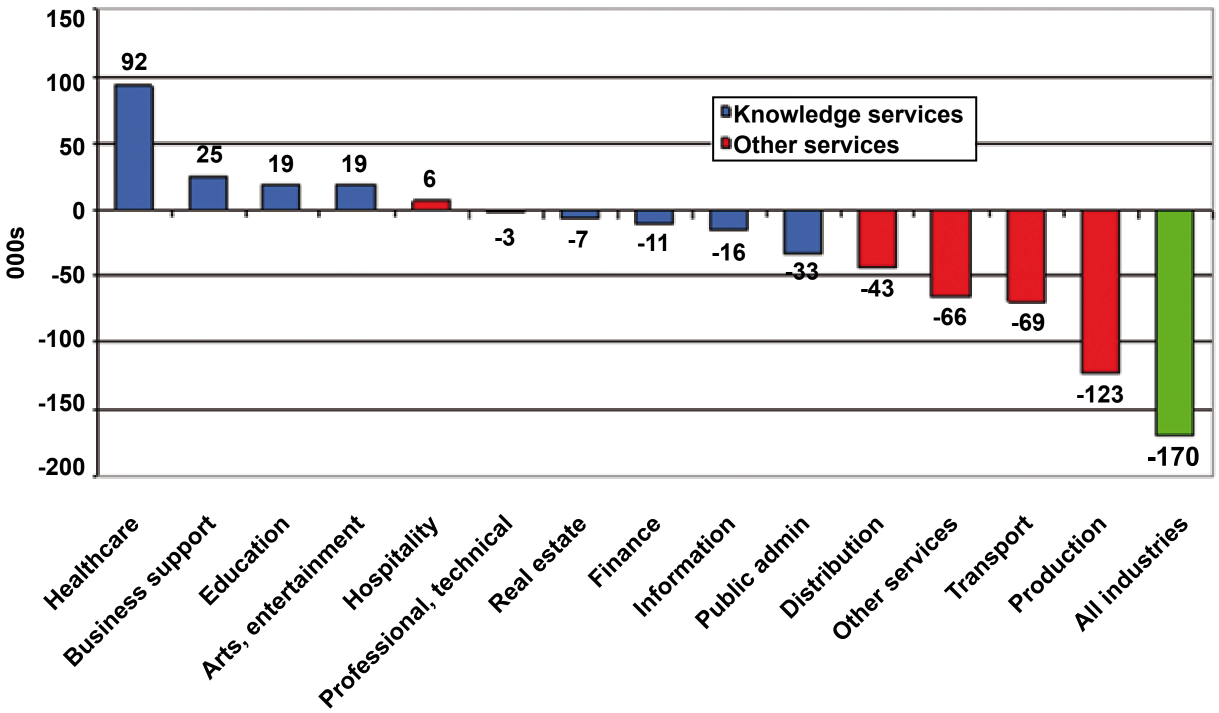
**We would expect employment for full time workers, women, and the young to be restored if the recovery continues.** We would not expect the expansion in temporary jobs to be sustained. The shift towards self-employment looks more like a permanent structural change, reflecting the longer term shift in self-employment towards white collar, professional employment in high tech and business services often operating 'mini-businesses' from home. Similarly, the growth in employment among both men and women among the over 50s is a part of a long run structural change driven both by the underlying ageing of the workforce, less generous private sector pension provision delaying exit from work, and wider availability of part time jobs.

**One consistent characteristic of past job recoveries has been that they have been led by knowledge based industries.** For industrial analysis we use the workforce jobs measure which is less timely than the LFS measure shown above and is not always consistent. Over the twelve months to September 2010, total employment by the workforce measure went down by 170,000. However, private sector based knowledge intensive service employment went up by 7,000 and public sector based knowledge employment went up by 78,000. In contrast, more traditional service sector employment in areas such as distribution and hospitality went down by 172,000 and manufacturing and construction added another 123,000 job loses. The relative slow growth in private based knowledge services reflects significant job shedding from information and communication services (down 16,000), financial services (down 11,000), real estate (down 7,000), professional, scientific and technical services (down 3,000) and offsetting stronger growth in business support services, and arts and recreation. Following job losses in public administration (down 33,000), growth in health and education is likely to be severely curtailed overall by the cuts in the growth of public spending, although some offsetting growth in privately provided services is possible. This means that the continued expansion of knowledge based services overall will rest largely on growth among businesses supplying professional, technical, and scientific services and business support services.

**We expect distribution, transport, and hospitality to recover and then expand, but it is unlikely that sectors such as distribution will be as strong a creator of jobs over the next decade as it has been in previous recoveries.** For example, the growth of jobs in retailing will be affected by changes in markets and technology such as less labour intensive on-line shopping and slower growth in consumption than in the decade before the recession. In less knowledge intensive services there has been significant job-shedding over the past year in distribution (down 43,000) and transport (down 69,000) and 'other' services (down 66,000). Hospitality has seen modest growth over the last year (6,000). However, the primary sector (agriculture and mining) has seen strong growth over the past year.

**The occupational story is more complex; the pattern of job loss is showing signs of reversal in the early stages of the recovery.** Over the recession itself, job losses were very heavily concentrated in manual, unskilled and admin jobs. This was consistent with previous experience and represented a speeding up of structural change away from such jobs and towards both knowledge intensive employment and in other areas such as care work. More recent figures that include the first stages of the recovery in employment show more job losses in knowledge intensive occupations than previously (primarily among managers) and a significant slowing in the rate of job loss among manual skilled and semi-skilled workers. In the year to July-September 2010 there was significant job growth amongst both knowledge intensive occupations (managers, professionals, and associate professionals) and the least skilled and typically less well paid jobs in areas such as care, hospitality, and sales. Manual and administrative work has contracted, with falls for semi-skilled manual and administrative jobs partly offset by a rise in skilled trades. The number of managers has however contracted. The managerial group is

**Figure 3.9: Employment change by industry over the past year, September 2009 to September 2010**




*Source: Office for National Statistics, The Work Foundation estimates based on OECD/Eurostat definitions of knowledge based industries*

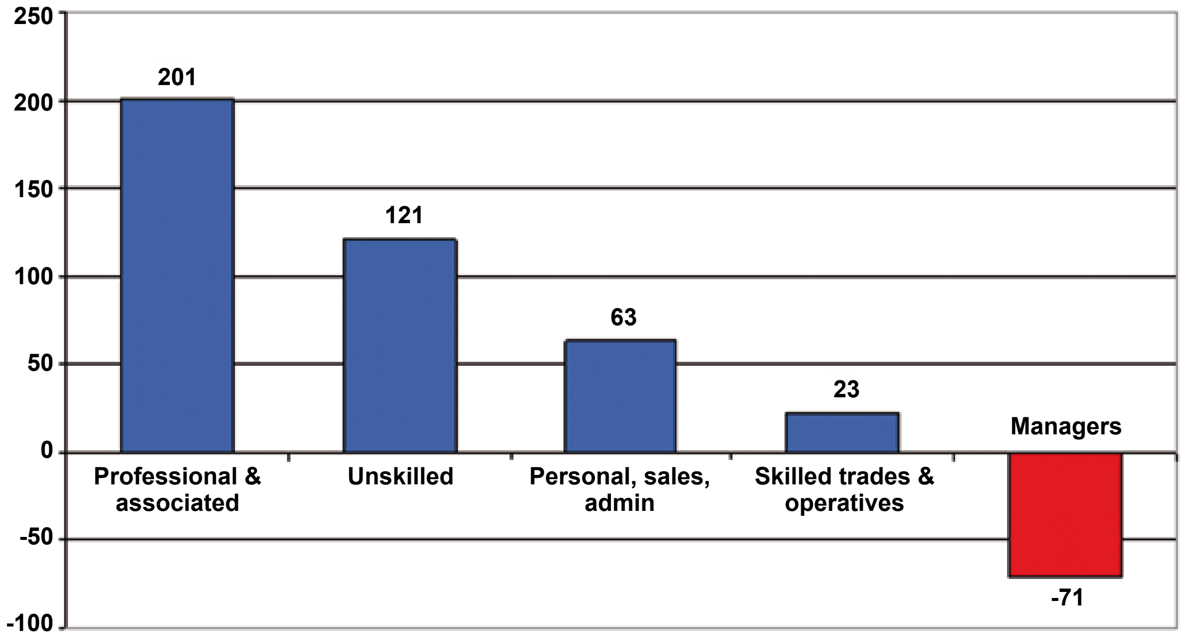
**Note:** knowledge economy services are education and healthcare; information and communication; professional, scientific and technical; business s support; financial services; real estate; arts, entertainment and recreation services; other services includes distribution, hospitality, transport, public administration, and other services. Production is manufacturing, construction, energy and water. All industries also includes primary sector.

extremely wide, ranging from senior corporate managers and specialists to general 'middle' managers and managers of small shops and stores.[27]

**This pattern of job growth, if sustained, would have some similarities but also some important differences from the past.** The growth of professional and associated professional and technical jobs is not surprising and is line with historical experience. However, pre-recession forecasts of employment growth commissioned by UKCES show unskilled work falling as a share of the total and managerial jobs growing as a share of the total. Indeed, managerial jobs showed one of the strongest growth rates of any of the occupational categories. The current pattern shows a polarised job pattern, reminiscent of the 1980s and early 1990s. We are however cautious about putting too much weight on the figures shown in Figure 3.10 below as a guide to the longer term.

[27] The UK appears to have an exceptionally wide use of the title 'manager' compared with most other European economies. The share of managers in the UK workforce is much higher than in, say, France and Germany

**Figure 3.10: What sort of jobs are being created in the UK recovery? (2009 Q3 to 2010 Q3)**




*Source: Office for National Statistics. Employees plus self-employed*

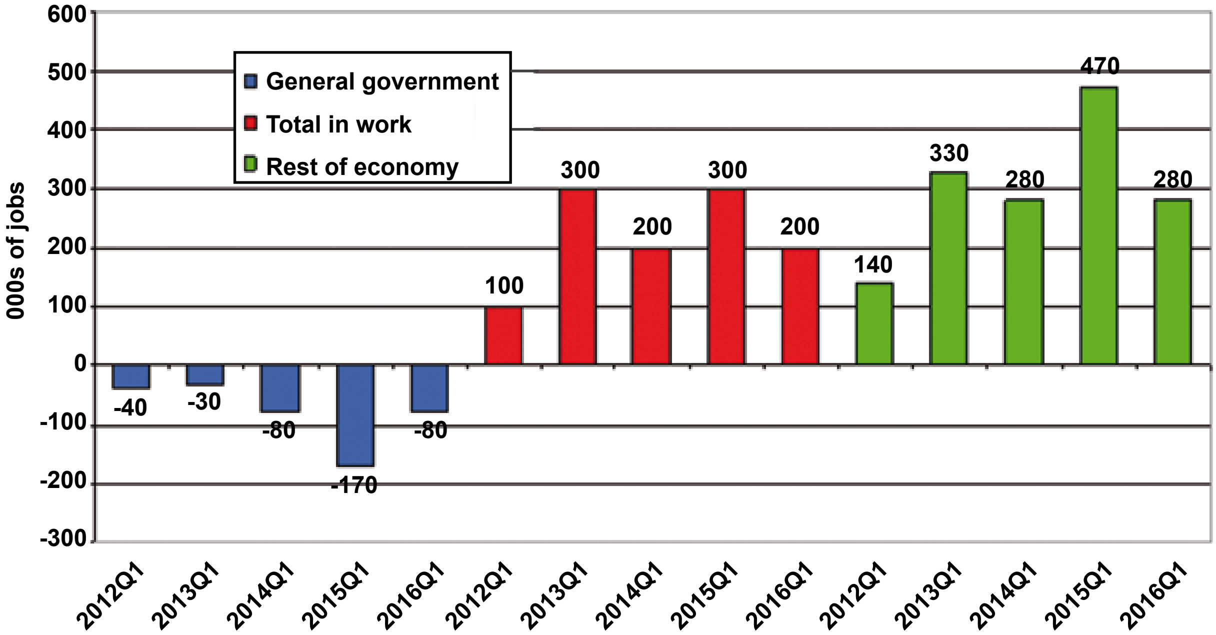
### 3.6 Jobs gaps and public sector job shedding

**The latest Office for Budget Responsibility (OBR) projections suggested that despite substantial job losses in the public sector and in private sector firms supplying the public sector, net employment would grow significantly between now and 2016.** The latest OBR forecasts, based on the forecast growth in the economy as a whole and the anticipated scale of job loss in the public sector, expects there to be a net increase in total employment of just over 1.1 million between Q1 2011 and Q1 2016. General government employment is expected to decrease by about 400,000 over the same period. This implies non-general government employment (private sector, public corporations and the nationalised banks) will see a net increase in jobs of 1.5 million.

The OBR forecasts show that most of the public sector job losses will come in the last three years of the forecast period from 2013 onwards, primarily through the public sector pay freeze imposed up to 2013. The OBR reasonably assumes the freeze will end and pay will increase at a more 'normal' rate, returning job losses to higher levels. The OBR has significantly reduced its forecasts for public sector job cuts since June because of bigger than expected planned cuts in welfare budgets which, it is assumed, will reduce the need for some job cuts across the public sector.

Figure 3.11 on the next page shows the fall in general government employment assumed by the OBR (the blue bars on the far left hand side). The OBR projection of total employment growth is shown in the red bars in the middle. The assumed growth in non-general government employment is shown in the green bars on the far right and is estimated by subtracting the fall in general government employment from total employment. This implies some fairly impressive net job growth in the rest of the economy, peaking at close to 500,000 net new jobs in the private sector in 2014-2015.

**Figure 3.11: OBR job forecasts, 2011 Q1 to 2016 Q1**




*Source: Office for Budget Responsibility, 2010*

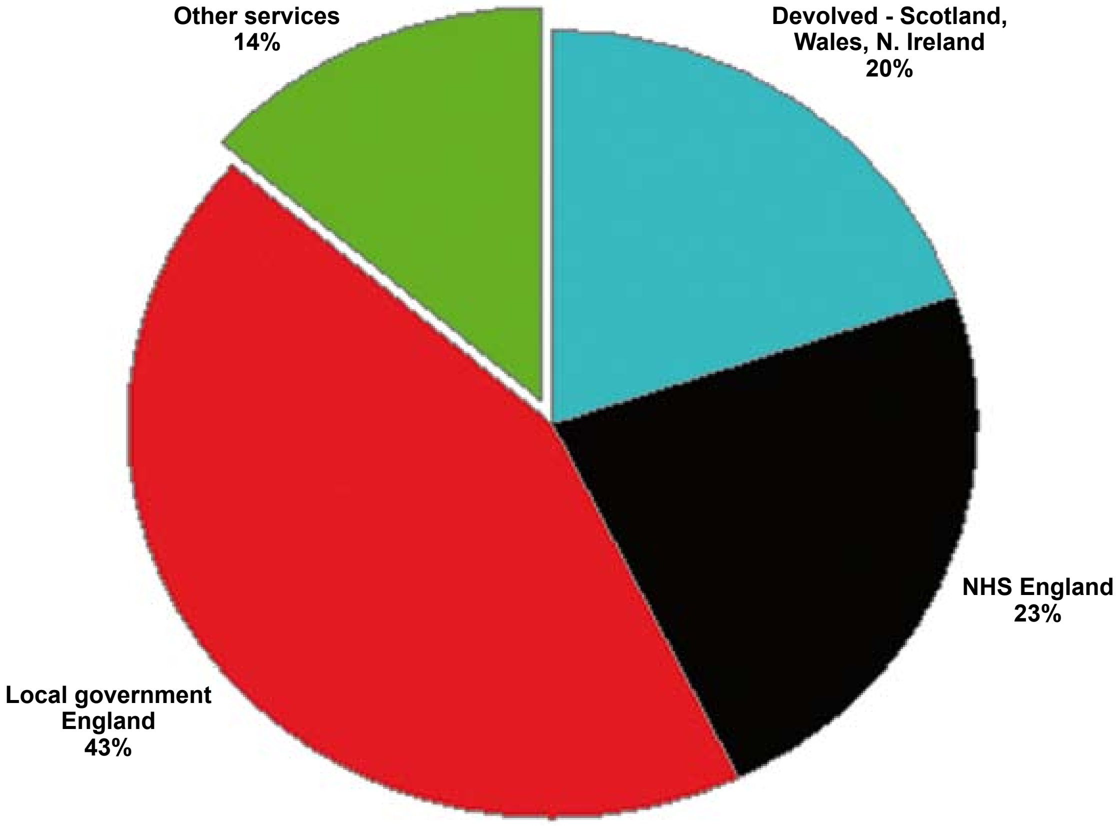
**Note:** all figures change year to Q1. Rest of the economy is total work minus general government.

**The projected falls in general government employment are far from certain.** They are based on top-down macro-economic assumptions. In reality, the decisions about the timing, scope, and severity of the cuts will be determined by a mass of public sector organisations at the local level and devolved administrations. In many cases ministers will have little control over the extent of job cuts. Over 40 per cent of general government jobs are in English local government and central government funding for local authorities in England is expected to fall by 28 per cent in real terms. At the same time, the Coalition is giving local authorities more freedom to manage their budgets (admitting this 'will require tough choices on how services are delivered'). In addition, nearly 20 per cent of jobs in general government are in Wales, Scotland and Northern Ireland where to different degrees there is devolved administration. About 23 per cent of jobs are in the NHS in England where decisions will be made by health service organisations.

**In addition, there are a number of publicly funded institutions excluded from the projections.** Most of the higher and further education sector is not officially included in the public sector definition used by the ONS and the OBR – for statistical purposes they are classified to the private sector. Any loss of jobs in the higher education sector is not therefore included in the general government job loss totals shown above. General government also excludes public corporations such as the Post Office[28], and the banks under public control. HM Forces are excluded from both the general government measure and the Labour Force Survey definition of total employment measure used by the OBR.

**One complicating factor is that some public organisations will transfer more functions to the non-public sector, either because they think this offers a more effective service or to save money (or both) or because the public sector no longer undertakes the service concerned.** For example, the abolition of the Audit Commission will mean that demand for private sector audit services will increase. When this happens the fall in general government employment will be at least partially matched by an automatic increase in private sector employment, especially where staff previously employed in the public sector are moved to private sector providers.

**Figure 3.12: Public sector jobs in 2010 – who decides where and when the cuts fall**




*Source: Office for National Statistics, 2010*

**Note:** all figures headcount, not seasonally adjusted, general government employment, 2010 Q1. Other services includes some jobs not classifiable to a region or country. Excludes public corporations and HM Forces. Excludes higher education – classified as private sector.

[28] But not the BBC which has been included in general government since 2006

### 3.7 Comparison with previous recoveries

**Public spending also experienced cut-backs in the recovery from the 1990s recession accompanied by significant falls in general government employment.** Between 1993Q1 and 1998 Q1 total employment went up nearly 1.4 million despite cuts in general government employment that may have been on a similar scale. However, comparisons over time of the public and private sector are fraught with difficulties. The 'general government' definition used by the OBR includes employment in central and local government, including the NHS and education and the police, but not the armed forces or public corporations such as the BBC or Post Office. From October 2008 the publicly controlled banks have counted as public corporations adding another 220,000 to the public sector total as at mid 2010. Universities have always been excluded from the public sector and they count towards private sector employment. The boundaries between public and private or between general government and the rest of the public sector have not remained constant. For example, in 1993 about 120,000 who worked in further education and sixth form colleges were reclassified to the private sector.[29] NHS Trusts were classified as public corporations between 1991 and 2001 and therefore outside general government and as part of central government and therefore included in the general government definition from 2002 onwards.[30]

**The real problem with the OBR forecasts is not that the economy is incapable of generating jobs on this scale at a time of public spending cuts, but the fact that the 1990s recovery was powered by much stronger economic growth.** Over the five years to 1998 GDP growth averaged over three per cent, and hit 4.3 per cent in 1994. The OBR forecasts assume growth over the next five years closer to 2.5 per cent, with growth peaking at less than 3 per cent. The OBR appears to be assuming a much more job rich recovery than happened in the 1990s.

**So far we have focused on some of the national challenges and the first stages of employment recovery in the national labour market but the regional challenge is however just as acute.** The UK's private sector knowledge economy is heavily concentrated in the Greater South East and a handful of cities across the UK. At the regional level, the geographical pattern of the recession looks much more like the 1980s than the 1990s. For ease of presentation, we have grouped regions and countries into Northern Britain (North West, North East, Yorkshire and Humberside, Scotland); the Midlands and Wales; and Southern England (South East, South West, London, East).

**Recessions, as we have seen, rarely have uniform effects across industry. Due to the uneven distribution of industry, the spatial impacts of recessions tend to be unequal.** The 1980s recession was characterised by enormous deindustrialisation (in both the manufacturing and mining industries) with permanent job losses in northern Britain.[31] The effects of the recession were far less evident in service

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[29] Labour Market Trends September 2003. ONS estimate. Full time equivalent measure. The headcount figure would have been higher

[30] In this recovery general government employment will be artificially boosted and private sector employment artificially depressed by moving some higher and further education institutions back to the public sector from March 2011, adding about 300,000 employees to the general government total

[31] Green, A. E., Owen, D. W. and Winnett, C. M. (1994) 'The Changing Geography of Recession: Analyses of Unemployment Time Series', Transactions of the Institute of British Geographers, Vol. 19, No. 2, pp. 142-162

based localities in the South. The industrial impact of the 1990s recession – a consequence of anti-inflationary policies and the collapse of the housing market – was far more widespread, and as a result the geographical impact was very different. Between 1990 and 1993 employment fell by far more in Southern England (down 7.5 per cent) than Northern Britain (average fall of just over 4 per cent) (Figure 3.13 on the next page ). Over the current recession we have seen the reverse pattern. Between 2008 and 2010 employment fell by much more in Northern Britain (down 5 per cent) and the Midlands and Wales (down 5.4 per cent) than in Southern England (down by just over 3 per cent).

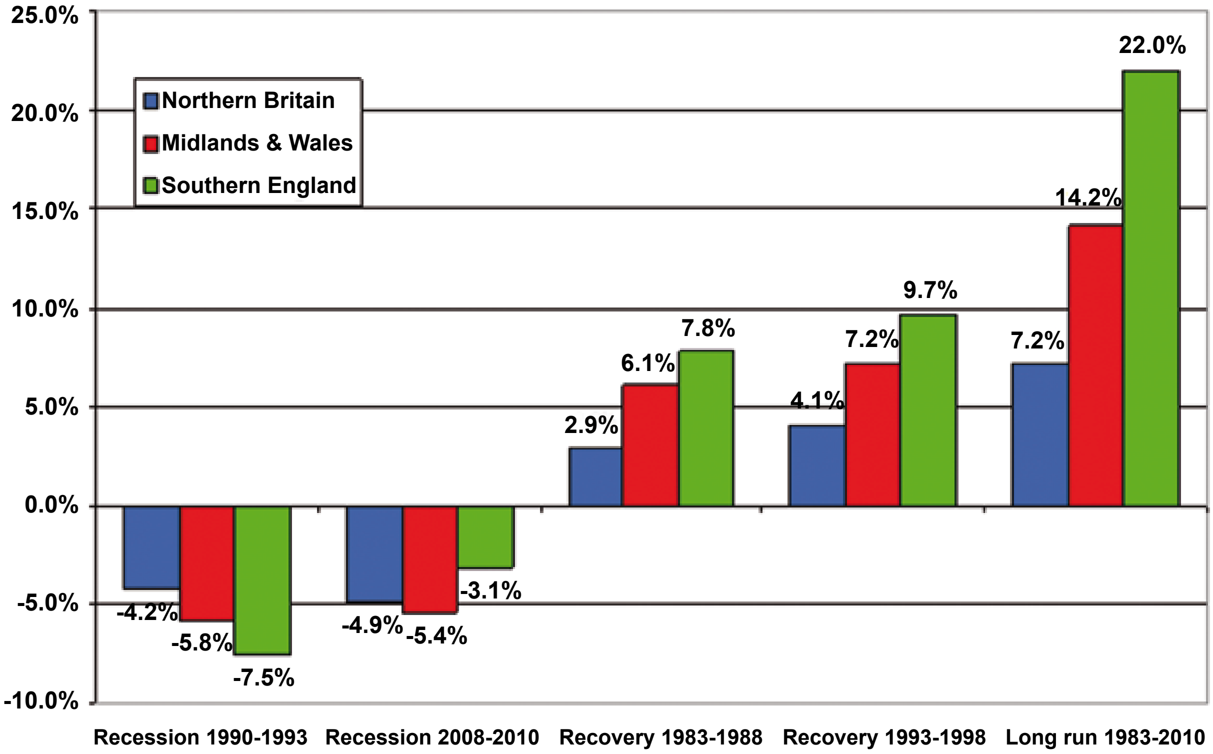
**Recoveries have followed a more consistent pattern, with employment recovering much faster in Southern England than in either Northern Britain or the Midlands and Wales.** In the first five years of the 1980s recovery (1983-1988) employment grew by just 3 per cent in Northern Britain, nearly 6 per cent in the Wales and the Midlands, and nearly 8 per cent in Southern England. In the first five years of the 1990s recovery (1993-1998) employment in Northern Britain grew by 4 per cent compared with just under 6 per cent in Wales and the Midlands and nearly 10 per cent in Southern England. So even though Southern England was much worse hit by the 1990s recession than Northern Britain, employment levels in the south bounced back much more strongly.

Over the whole period from June 1983 to June 2010, UK employment went up by 17 per cent. However, this growth was unevenly distributed. Total employment went up by 22 per cent across Southern England, by 14 per cent across the Midlands and Wales, and just 7 per cent across Northern Britain. Moreover, nearly half of the jobs generated in Northern Britain over this period came in the decade running up to the recession (June 1998 to June 2008) when public sector employment was growing strongly. With no net growth in public sector jobs over the next five years, the private sector in Northern Britain will have to have to grow much more strongly than in previous recoveries in order to restore pre-recession levels of employment.

**The regional pattern of job growth is less clear cut at the level of individual regions in the early stages of this recovery and the two official measures of employment (workforce jobs, partly based on employer payroll returns; and the household Labour Force Survey) are inconsistent.** So far however the biggest rises in employment have been in Southern England. The more timely but less reliable Labour Force Survey shows that in the year to September-November 2010 there was significant job growth in the North West, but employment fell in the North East, Yorkshire and Humberside and Scotland. Employment grew in Wales, but fell in the West and East Midlands. However, employment grew in all the regions of Southern England. Overall, employment went up by over 210,000 in Southern England fell by 8,000 across Northern Britain and fell by 18,000 across the Midlands and Wales. So far history seems to be repeating itself in this recovery.

Yet the pattern of recovery is much more complex than these aggregate analyses show, with all regions including areas of prosperity and growth and areas suffering severe long term structural problems. The next section looks at this sub-regional picture in more detail.

**Figure 3.13: Regional recessions and recoveries since 1983**




*Source: Office for National Statistics,*

**Note:** all figures workforce jobs, June each year.

**People and place-based factors combine to impact on both employment and earnings opportunities.** As Turok states, '[employment] *disparities are not completely unrelated to differences in skills, employability and aspirations, but such conditions are more of a reflection of the state of the labour market than a cause of it. Some people got discouraged from seeking work or from investing in their education and skills because they recognised that there were not enough jobs available and their prospects of getting work were poor*'. [32] Individuals' ability to enter into employment, and to retain work and progress, is affected by a complex interaction between a range of different factors. Some may be related to individual circumstances such as caring responsibilities while others to the socio-economic factors, such as the characteristics of the local labour market and the availability of jobs locally, as well as employer perception.

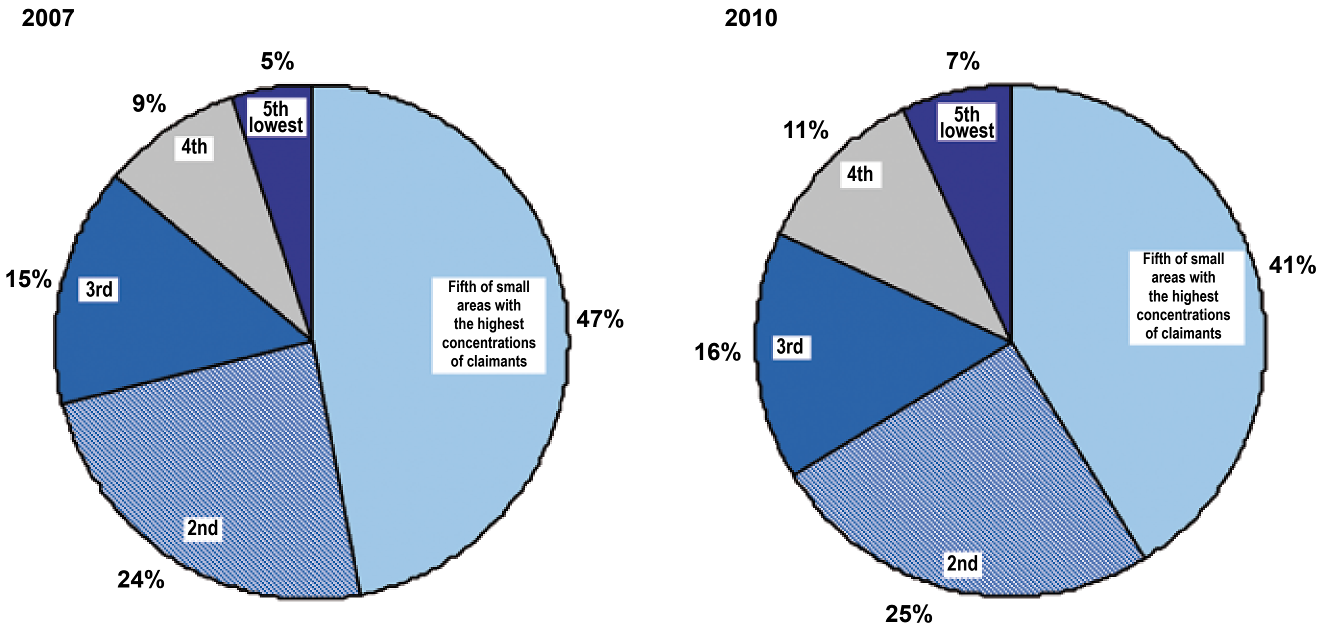
### 4.1 Geography of worklessness

Intra-regional disparities are much more marked than inter-regional disparities. The impact of the 1980s recession and recovery meant that by 1986 regional labour market disparities had reached there widest for 50 years[33] – a pattern commonly referred to as the north-south divide. The 1990s recession, primarily centred on the southern service industries, to some extent changed these trends and by the 2000s regional disparities were back almost to the level of the mid-1970s. Yet local disparities within regions had not only persisted but increased over this time. Demand and supply side processes interact to maintain high unemployment locally even when labour market buoyancy has improved at the aggregate level. As a result, there has been intensified concentration of unemployment within the worst areas of major cities since the 1980s.[34]

**At the local level there is a very clear spatial pattern to worklessness in the UK with a high number of claimants being concentrated in a small number of areas** (Figure 4.1). The latest figures show that 41 per cent of JSA claimants are located in just 20 per cent of Lower Super Output Areas (LSOAs). Breaking these figures down slightly differently, 66 per cent of claimants live in 40 per cent of LSOAs with the highest concentrations of claimants, whilst 34 per cent of claimants live in the remaining 60 per cent. Unemployment tends to be concentrated in older industrial and urban areas (West Midlands and parts of the North), rural areas (south Wales) and coastal towns, and boroughs within London (particularly east London) (Figure 4.2). Most low unemployment areas tend to be found in the Greater South East region; there are relatively few high concentrations of claimants in the South East, East of England and South West. As the recession hit areas of existing high unemployment hardest, the geography of claimants remains largely unchanged.

[32] Turok, I. (2007) 'The Role of Planning and Development in Spatial Labour Markets' in Dimitriou, H. and Thompson, R. (2007) *Strategic and Regional Planning in the UK*, Oxford: Routledge, pp. 154-173
[33] Martin, R. and Sunley, P. 1999, 'Unemployment flow regimes and regional unemployment disparities' Environment and Planning A 31(3) 523 – 550
[34] Gordon. I. (2003) 'Unemployment and spatial labour markets: Strong Adjustment and Persistent Concentration', in Martin, R. and Morrison, P. S. (2003) *Geographies of Labour Market Inequality*, London: Routledge

**Figure 4.1: Concentrations of worklessness, 2007 and 2010**




*Source: DWP, 2010*

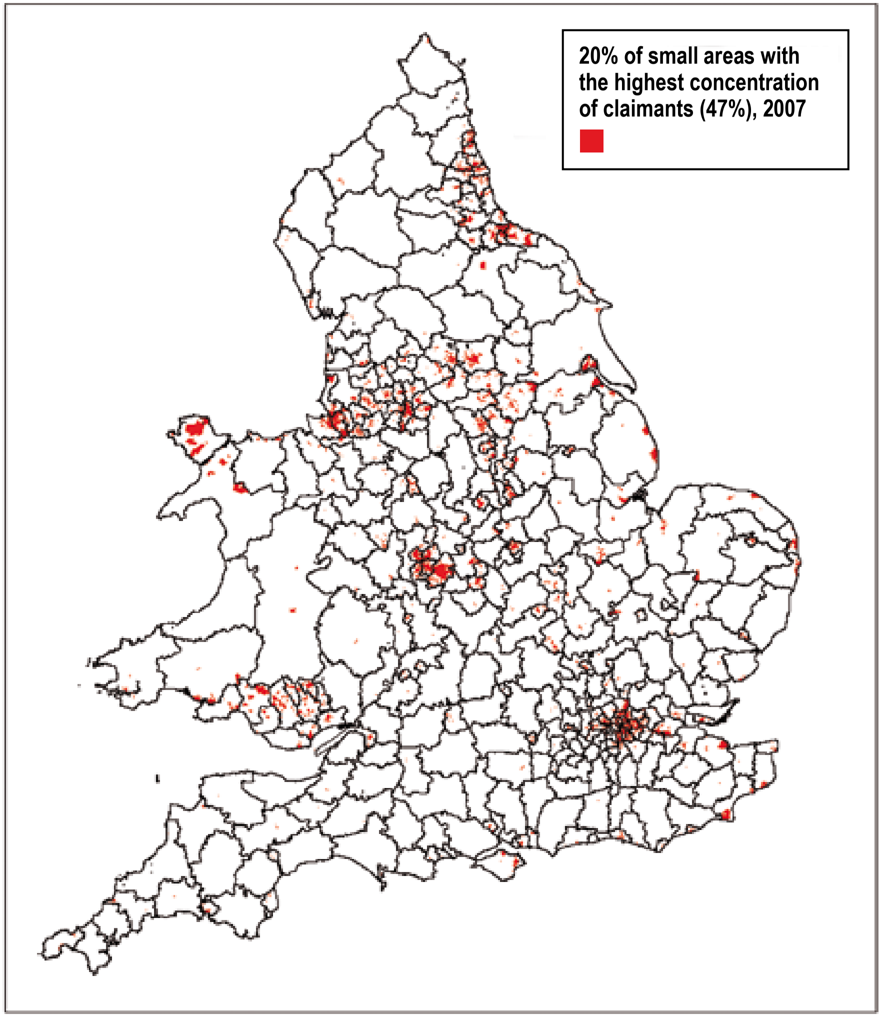
These figures are likely to seriously underestimate the level of *real* unemployment in an area. There will be a number of unemployed people in any given area who are not eligible for, or who chose not to claim, JSA. It is also argued that the official unemployment rate (ILO unemployment) seriously undercounts the true number of people who are denied work by the scarcity of jobs, as areas with high unemployment rates are likely to see a higher proportion of the working age population drop out of the labour market.[35] We include both JSA and Incapacity Benefit/Severe Disablement Allowance (IB) claimants in further analysis.

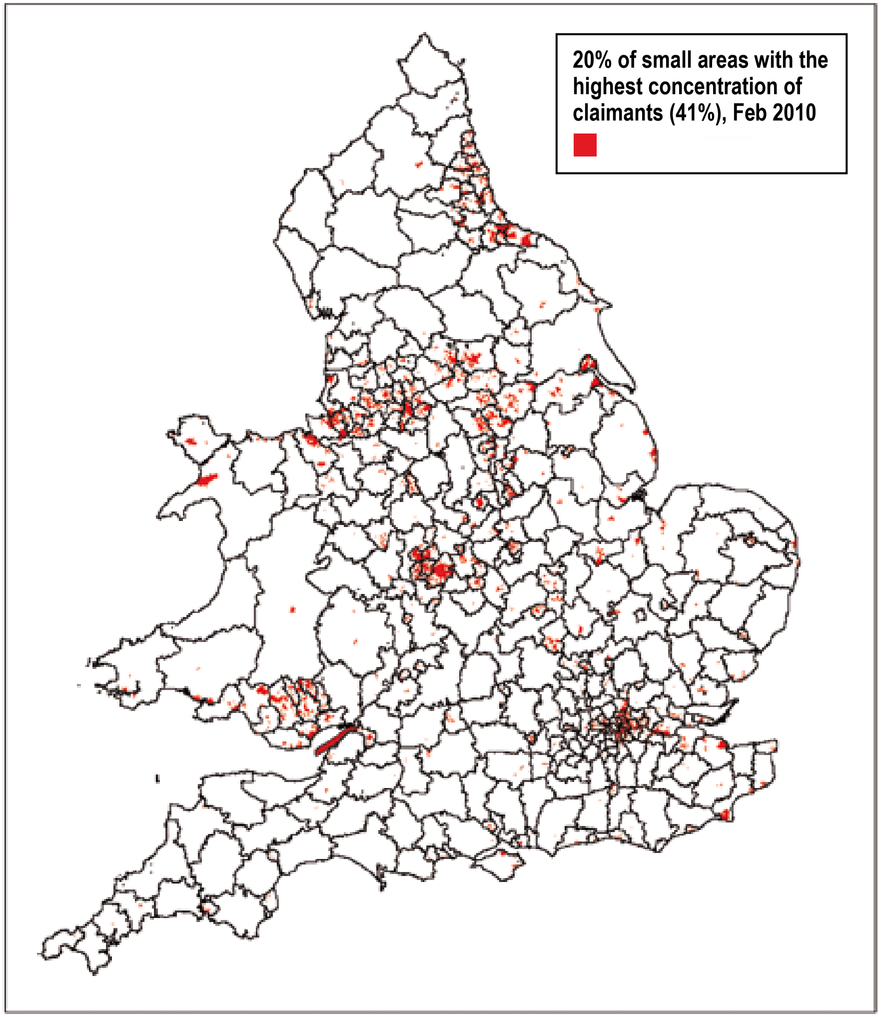
## 4.2 Why does the geography of demand matter?

**Individuals' economic status to a large extent will be influenced by the employment opportunities at the local and regional level, rather than the national.** In essence there is no such thing as a national labour market, but rather '*a complex geographical mosaic of overlapping local and sub-national labour markets defined, and linked variously together, by a myriad of spaces of labour recruitment by firms and the job search, travel-to-work and migration fields on the part of workers*.'[36] The quantity and quality of jobs available locally is likely to be of particular importance to welfare claimants and low paid workers, as their travel horizons are likely to be lower. Typically people only commute a short distance to work: on

[35] Beatty, C., Fothergill, S., Gore, T. and Powell, R. (2007) *The real level of unemployment 2007*. Sheffield: CRESR, Sheffield Hallam University
[36] Sunley, P., Martin, R. and Nativel, C. (2006) Putting workfare in place: local labour markets and the New Deal, Oxford, Blackwell

**Figure 4.2: Concentrations of worklessness (JSA claimants), February 2007 and February 2010**




*Source: DWP, 2010*

average travel times are limited to around 45 minutes in the UK.[37] Commuting journeys tend to be smaller for unskilled workers compared to those working in professional occupations. At the lower end of the labour market travel costs constitute a larger proportion of income, reducing the incentive to travel. Job searches are also likely to be less geographically extensive.[38]

**In addition to smaller travel-to-work areas, individuals at the lower end of the labour market are less likely to migrate for work.** In general, the better educated are far more likely to move in response to available job openings – a pattern long associated with the 'brain drain' in Britain. A number of factors restrict the internal migration of lower skilled workers. [39] Firstly, as recruitment to lower paid jobs is more likely to take place via word-of-mouth, window advertisements or local job centres, it is more difficult for low paid workers to secure employment prior to relocating meaning there is likely to be a higher element of uncertainly involved. The risks involved in speculative moves are likely to be heightened by the large differentials in regional housing costs and high cost housing as a share of income. In many cases, differential costs are also likely to make moves to secured jobs unaffordable anyway. There has been greater tendency for labour markets to adjust through commuting rather than migration over more recent years: *'inter-regional adjustment processes involving long-distance migration have recently been less effective than in the past, particularly for manual workers, but intra-regional mobility has remained strong, particularly through commuting'*.[40]

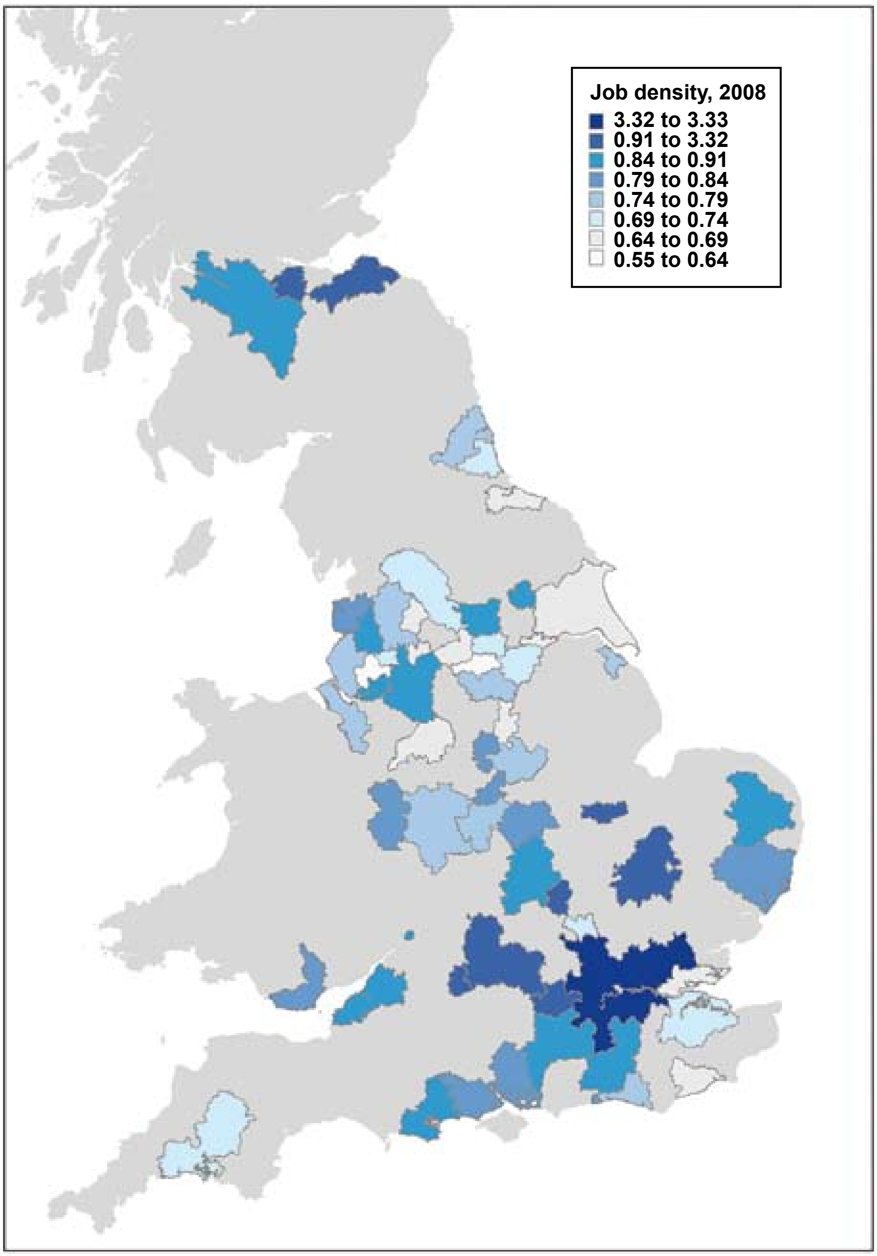
**There are also a number of additional barriers to spatial mobility, including family connections, cultural factors and social housing.** The rate of worklessness among those in social housing is double that of the general population and there is a high spatial correlation between the prevalence of worklessness and concentrations of social housing. John Hills' 2007 report on social housing found that, whilst nationally one in eight moves are associated with work, a much smaller proportion of social tenants move for job-related reasons.[41] Furthermore, a 2008 paper found confirmed persistent downward trends in mobility in the sector over the last ten years.[42]

### 4.3 Local labour market demand

**The geography of labour market demand (as measured by job density at the travel-to-work level) highlights the jobs gaps that exist at the local level** (Figure 4.3 on the next page). Job density across the travel-to-work areas (used to identify functional economic areas) is highly variable whilst in London the job density rate is 3.3 (three jobs for every one working age person living in London), in Barnsley it is 0.55 (two working age people for every job). Large intra-regional variations also exist; within the North

[37] Green. A. and Owen, O. (2006) *The geography of poor skills and access to employment*. York: Joseph Rowntree Foundation
[38] Green and Owen (2006) *ibid*
[39] Gibbons, S., Green, A., Gregg, P. and Machin. S. (2005) *Is Britain Pulling Apart?*, CMPO Working Paper No. 05/120, University of Bristol
[40] Sunley, P., Martin, R. and Nativel, C. (2006) *ibid*
[41] Hills (2007) *Ends and means: The future roles of social housing in England*, CASE report 34, LSE
[42] Clarke, A., Fenton, Markkanen, S., Monk, S. and Whitehead, C. (2008) *Understanding the Demographic, Spatial and Economic Impacts on Future Affordable Housing Demand*, Cambridge: Housing Corporation

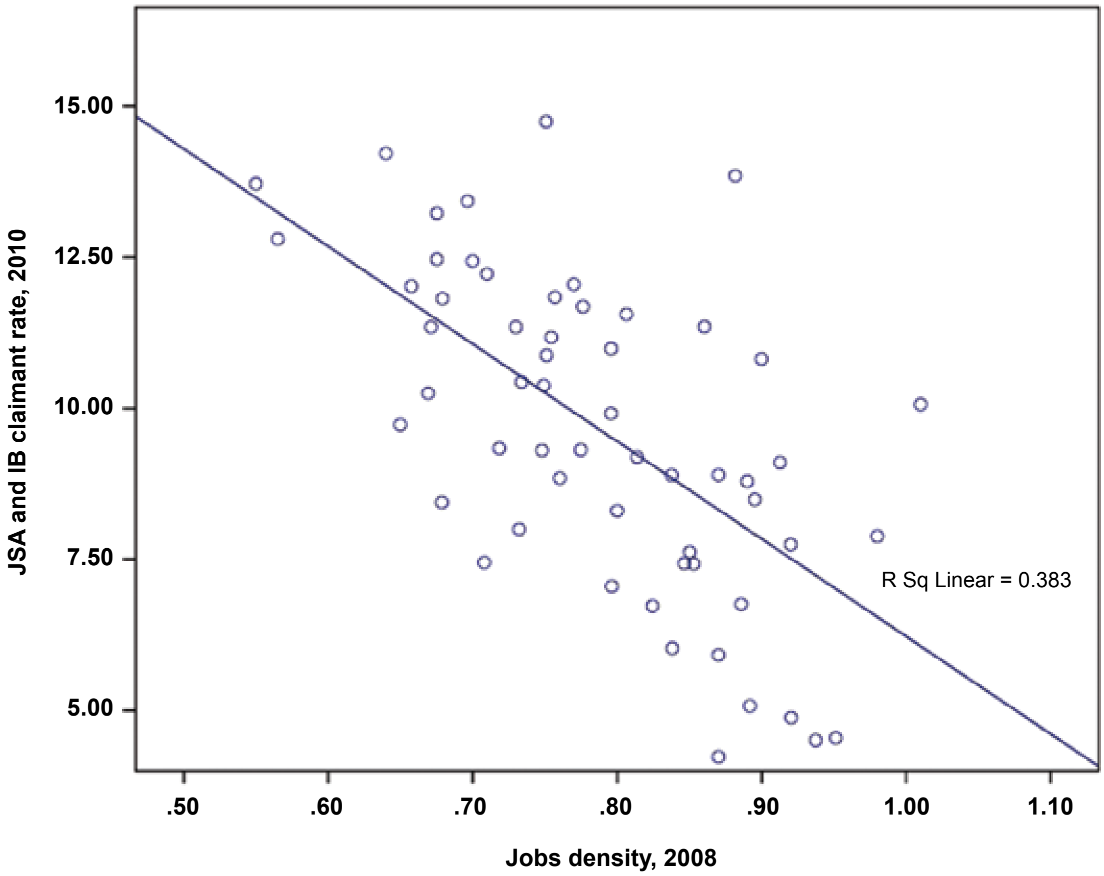
**Figure 4.3: Job density by travel-to-work area, 2008**




*Source: NOMIS, 2010*

West the job density rate in Warrington and Halton is 0.90 and in Wigan and St. Helens it is 0.57. There is a clear relationship between jobs density and the proportion of JSA and IB/ESA claimants at the functional economic level (Figure 4.4 on page 44). Whilst these statistics are to an extent logically circular, local labour market demand plays a major role in explaining the emergence of localised concentration of unemployment and the persistent nature of such concentrations. Labour market demand deficiencies will inevitably impact on the performance of future supply-side interventions.

**Figure 4.4: Relationship between job density and claimant rate[43]**




*Source: Claimant Count and NOMIS, 2010*

**Evidence on the relative success of active labour market policies at the local level highlights the importance of the nature of local labour market demand.** Studies into the geographic variation in the performance of the New Deal programme (introduced by the Labour government in 1998) – found it to be more effective in tighter local labour markets – added weight to the argument that workless populations are affected by local labour market conditions even in benign macro-economic conditions.[44] Martin *et al* found *'the limitations and imbalance of supply-side active labour market policies, focused on raising individual employability, are most apparent in distressed local labour where there is less opportunity to find rewarding and stable job opportunities'*.[45] A more recent study found that the '*dynamics of the wider functional area, the strength of its economy and the availability of suitable jobs*' have a significant impact on the reduction of worklessness at neighbourhood level.[46] Another recent study of Glasgow found that falling IB/ESA claims in the city were related to jobs growth rather than welfare to work interventions.[47]

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[43] Regression excludes London as it is a clear outlier
[44] Sunley, P., Martin, R. and Nativel, C. (2006) *ibid*
[45] *ibid*
[46] Cox *et al* (2010) *Rebalancing Local Economies: Widening economic opportunities for people in deprived communities*, Newcastle-upon-Tyne: The Northern Way
[47] Webster, D., Arnott, J., Brown, J., Turok, I., Mitchell, R. and Macdonald, E. (2010) 'Falling Incapacity Benefit claims in a former industrial city: policy impacts or labour market improvement?' Policy Studies 31(2): 163–185

**There is a very clear spatial pattern to low earnings.** Spatial wage disparities have been very persistent over time.[48] With a similar geography to job density, low earnings are highest in coastal towns and in parts of the north. A smaller proportion of workers earn less than £7 per hour in London and the South East.[49] In Grimsby and Blackpool nearly a third of workers earn less than £7 per hour. In contrast, just over a tenth of workers in London and Reading are low paid. Again large intra-regional disparities exist: in Leeds 20 per cent of workers are low paid, whereas this figure rises to 28 per cent in Hull. It is important to note that the analysis here uses nominal rather than real wages and so does not take account of differences in costs of living and in access to amenities across space. Evidence from the West Midlands shows that economic restructuring has led to a fall in real wages in some areas; in Birmingham the average real wage fell by 3.5 per cent between 2001 and 2008, compared to a fall of 0.5 per cent nationally.[50] Trends are more pronounced amongst the lowest paid: amongst the lowest paid workers average earnings fell by 4.5 per cent in Birmingham, compared to 0.3 per cent nationally.

There is a strong relationship between job quality, as measured by the proportion of the population earning less than £7 per hour, and the prevalence of worklessness (Figure 4.5 on the next page). The finding is not surprising given that tighter labour markets tend to offer higher average wages. Yet combining low jobs density with low earnings significantly increases the risk of worklessness, highlighting the importance of sustainable, quality jobs. The inclusion of the low earnings indicator into the regression model increases the r-squared by 0.14; in other words, a further 14 per cent in the variation in claimant rates (JSA and IB) can be explained by the quality of jobs available locally. Areas with a high proportion of low skill occupations[51], again with a similar geography to low earnings, are also likely to have a higher concentration of worklessness.

**Both finding and maintaining employment are likely to be more difficult in areas with a low density of poor quality jobs.** A recent JRF study explored the relationship between low-paid, insecure work and recurrent poverty in Teesside.[52] Nearly a third of workers in Teesside are low paid (28 per cent earn less than £7 per hour) and job density is low (0.67). Ongoing economic restructuring in the area has led to an increase in the proportion of ‘low-skilled, low-paid and insecure employment’. The predominant experience of work for the interviewees in the JRF study was one of moving between low paid work and unemployment, driven by the opportunities available in the local labour market. Progression opportunities are also likely to be limited in weaker labour markets. In general, tighter labour markets have proved more ‘human capital’ orientated with higher levels of employer commitment to the development and training of new recruits.[53]

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[48] Gibbons, S., Overman, H. G. and Pelkonen, P.(2010) *Wage Disparities in Britain: People or Place?* SERC Discussion Paper 60, LSE

[49] £7 per hour roughly corresponds to the minimum income standard. Estimation of proportion earning less than £7 per hour based on interpolation of Annual Survey of Hours and Earnings data (Source: The Poverty Site)

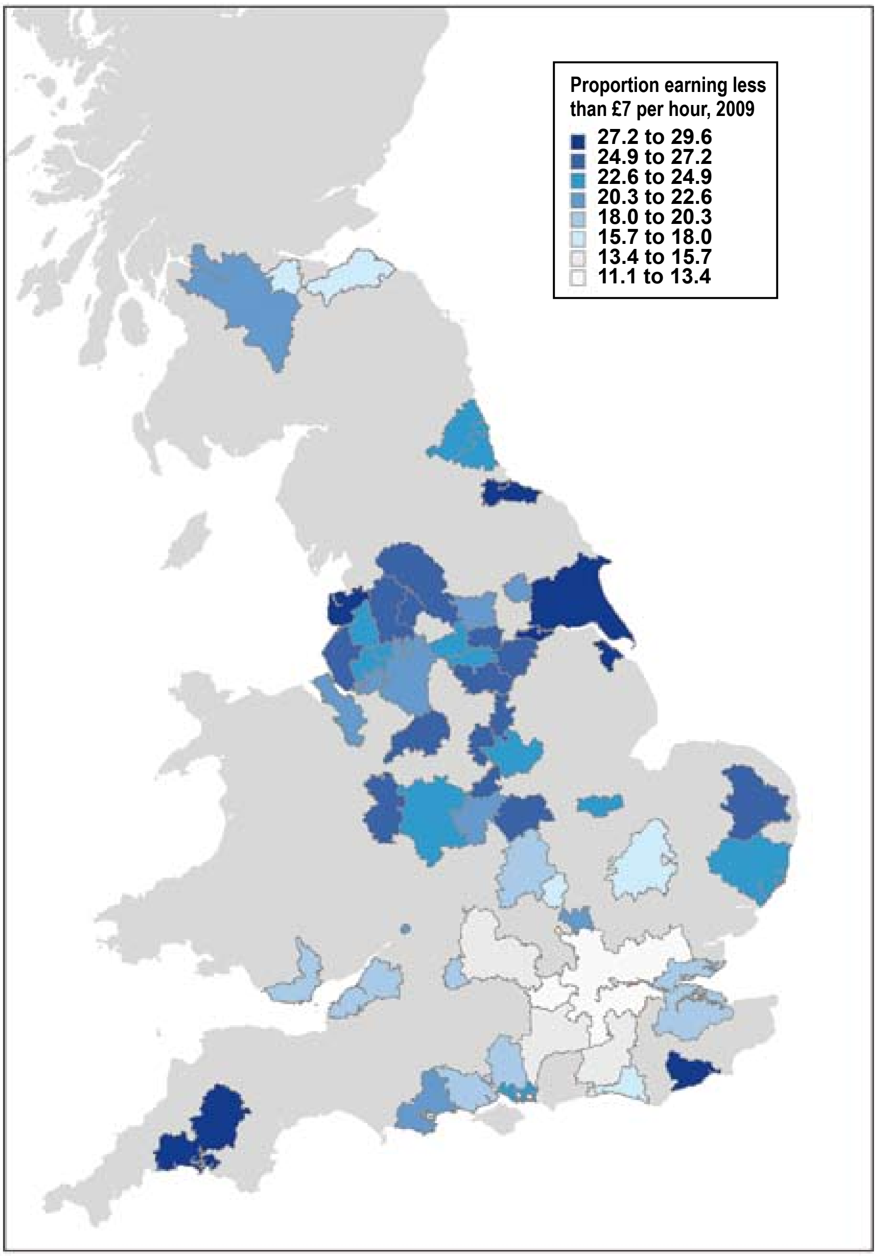
[50] Fenton, A., Tyler, P., Markkanen, S., Clarke, A. and Whitehead, C. (2010) *Why do Neighbourhoods Stay Poor? Deprivation, place and people in Birmingham*, Barrow Cadbury Trust

[51] Low skills occupations are defined using the Standard Occupational Classification system and refer to all non-knowledge worker occupations

[52] Shildrick, T. *et al* (2010) *The low-pay, no-pay cycle: Understanding recurrent poverty,* York: JRF

[53] Sunley, P., Martin, R. and Nativel, C. (2006) *ibid*

**Figure 4.5: Spatial pattern of low earnings, 2009**




*Source: The Poverty Site, 2010*

**Typically areas with low skills profiles are likely to have higher levels of worklessness, but the picture is more complicated at the individual level.** At the individual level, people with low level skills are less likely to be unemployed in areas with a large proportion of high skilled employment. Gibbons *et al* found that the employment gap between less skilled and the rest closed in tight labour markets or when employment rates reached 75 per cent.[54] This indicates that the full employment rate (80 per cent) will be needed in every region for the low skilled to start to disproportionately entering employment.

[54] Gibbons *et al* (2005) *ibid*

These findings are consistent with theories that the presence of highly educated, highly paid individuals boosts demand for low skill services within the local area. There is also some evidence that there is a wage premium for low paid occupations – cleaners, carers, personal service workers – in high skill areas.[55] Further research is warranted, however, to explore the extent to which the attraction of high skilled workers impacts on real wages of low-paid workers by driving up costs of amenities and housing within a local area.

**Local labour market conditions clearly have a bearing on individuals' employment and earnings prospects, but other important factors also come into play.** For example, a study of functional economic areas in the North found that Tees Valley showed strong performance in reducing economic deprivation (income and employment) despite weak economic growth (as measured by change in GVA per head) whilst Manchester showed a weaker performance in reducing economic deprivation despite strong growth.[56] Clearly, local economic growth is not sufficient in itself to improve individuals' job prospects. Berthoud identifies six types of disadvantage: family structure, disability, skill level, age, ethnic group and demand for labour (of the 0.5 million sample only 4 per cent with none of these disadvantages were non-employed).[57] A recent paper by Gibbons *et al*. explores the impacts of different types of labour market disadvantage further, looking specifically at the impact of individual characteristics (sorting) versus area effects on spatial disparities in wages.[58] In other words, 'whether outcomes for people working in London would be any different if they worked in Liverpool'. They find that area effects (the same types of workers in different areas) do not make a large contribution to spatial disparities: individual characteristics account for 90 per cent of spatial disparities, whilst areas effects account for 10 per cent. Yet area effects may have an indirect impact on spatial wage disparities as they drive the sorting of the workers. The authors also note several important caveats. Most importantly in relation to the focus of this paper, differences in the probability of earning a wage (or being employed) are not taken into account. Nevertheless, the study raises some important questions around policy that focuses on outcomes for places rather than people.

**London: Worklessness and in-work poverty**

In contrast to many other areas in the UK, whilst labour market demand pressures appear to be strong, rates of employment are relatively low in London. London has the third lowest employment rate amongst the English regions (68 per cent). Here it is important to see London in its wider labour market context. If the functional economic area – London and large parts of the Greater South East – is used as the unit of comparison, then patterns of worklessness in London (albeit on a much larger scale) are not dissimilar to those found in other UK cities, such as Manchester or Birmingham. Yet, given the strength of London's economy, employment rates for the wider Greater South East are not as high as might be expected (71.8 per cent compared to 73.7 per cent in the South West). A number of studies have

[55] Kaplanis, I. (2010) *Wages Effects from Changes in Local Human Capital in Britain,* SERC Discussion Paper 39, London: London School of Economics
[56] Cox *et al* (2010) *ibid*
[57] Berthoud, R. (2003) *Multiple disadvantage in employment,* York: Joseph Rowntree Foundation
[58] Gibbons *et al* (2010) *ibid*

concluded that the dominant explanation for the high levels of worklessness in the capital can be attributed to personal characteristics – population mix and a high proportion of individuals not currently seeking employment.[59]

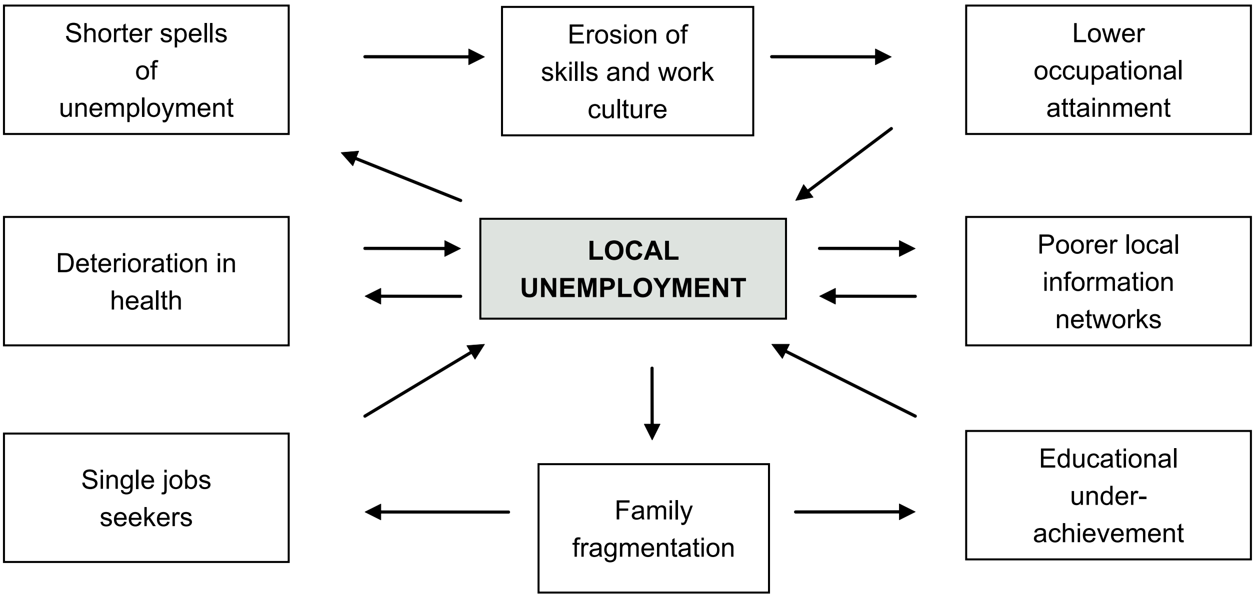
Alongside high levels of worklessness, in-work poverty has also been highlighted as a particular issue in London. Higher average earnings in the capital, in part, compensate for higher costs of living. Once housing costs are taken into account, London also has one of the highest levels of in-work poverty amongst UK regions. At the same time as being home to the majority of the UK's highest paid jobs, the earnings distribution is unequal with some evidence of labour market polarisation.[60] These inequalities are manifested in the spatial concentration of deprivation within London, with levels of worklessness and in-work poverty particularly high in parts of East London. For example, in Newham 21 per cent of residents earn less than £7 per hour compared to 4 per cent in Richmond.[61]

Linked to labour market polarisation are issues of social mobility amongst particular groups. The career progression opportunities London is perceived to offer attract a large number of migrants and workers to the capital. Yet the polarised nature of London's labour market means that for many aspirations of upward mobility are not realised.[62] Employment and earnings opportunities are far greater for those who have graduate level qualifications and who fall within the 20 to 40 years age bracket.

**Demand and supply side issues cannot be easily separated, however.** At the local level, lack of labour demand creates and reinforces problems on the supply side. Figure 4.7 on the next page demonstrates the interaction between demand and supply-side factors. There are a number of positive feed back loops (or vicious circles) linking local unemployment to local social outcomes that further reduce individuals' chance of getting back into employment in the short/long term.[63] As discussed earlier, in depressed local labour markets workers are likely to experience shorter employment spells, which can erode or militate against the development of skills. Unemployment can have significant psychological and health related impacts – a key finding of the 2010 study in Teesside[64] – and lead to a whole host of inter-generational social problems including the educational underachievement of young people.[65]

[59] Gordon, I. (2006) 'London's Economy and Employment' in Kochan, B (ed.) (2006) *London: Bigger and Better?*, LSE London
[60] Kaplanis, I. (2007) *The Geography of Employment Polarisation in Britain*, London: IPPR
[61] Poverty Site
[62] Buck, N., Gordon, I.R., Hall, P., Harloe, M. and Kleinman, M. (2002) Working Capital: life and labour in contemporary London, London: Routledge
[63] Gordon, I. (2003) 'Unemployment and spatial labour markets: Strong Adjustment and Persistent Concentration', in Martin, R. and Morrison, P. S. (2003) Geographies of Labour Market Inequality, London: Routledge
[64] Shildrick, T. *et al* (2010) The role of the low pay, no-pay cycle in recurrent poverty, York: Joseph Rowntree Foundation
[65] Sunley, P., Martin, R. and Nativel, C. (2006) *ibid*

**Figure 4.6: Casual links in the reproduction of concentrated unemployment**




*Source: Gordon, I.. (2003)*

## 4.4 Mind the gap: the changing geography of labour market demand

**Both the geography of the recovery and the public spending cuts are likely to widen spatial disparities and exacerbate the problems of labour market demand deficiency at the local level.**

The Work Foundation has previously highlighted that employment growth over the last decade was driven primarily by the expansion of the public sector, and that private sector growth in many places was weak or non-existent despite the benign macroeconomic conditions.[66] In the worst affected region by this measure the West Midlands, between 1998 and 2008 the private sector lost employment – employment change in the region was only positive because of increases in the public sector. Public sector spending cuts will inevitably have a proportionately greater impact on regions outside the Greater South East which tend to have higher than average levels of public sector employment and weak private sectors that showed slow rates of recovery from the previous recession. Spending cuts will have greater direct, indirect and induced impacts on cities: a) with weak private sectors that did not thrive during the economic boom and remain dependent on revenues from the public sector; b) that are heavily dependent on particular types of public sector employment and c) with higher proportions of welfare dependents. With the accelerating pace of job loss in the public sector and lack of overall growth in the private sector, initial signs of recovery in employment have been halted in some regions: over the last quarter to September-November 2010 employment fell by 69,000 in the West Midlands.

[66] Brinkley, I., Levy, C. and Morris, K. (2010) *The Jobs Gap: A statement from the Work Foundation*, London: The Work Foundation

Elsewhere we have also argued that the future key growth sectors – creative and culture industries, low carbon, advanced manufacturing and high tech services – and high growth businesses which will drive demand in the recovery are likely to locate in areas with strong private sectors, existing employment in the growth sectors and high skills.[67] Places with greatest growth potential include London, Cambridge and Reading. Conversely, high growth businesses are less likely to be found in those places with the lowest skills profiles, a lack representation in growth sectors and that tend to be reliant on the public sector as an employer. There is a real danger that cities predominantly in the north of England, such as Grimsby, Barnsley and Hull, will be bypassed by the recovery. Local policymakers have also struggled to attract low skill, low wage jobs to these areas. Much of the growth in low skill occupations in the UK has been in non-traded sectors, such as personal services, and most of these are in services directly related to consumption in the local area from more affluent residents.[68] If recovery takes hold first in the more prosperous and knowledge intensive parts of the economy, then we can expect widening divides as large scale public sector cuts take hold in all parts of the country.

[67] Lee, N., Morris, K., Wright, J., Clayton, N., Brinkley, I. and Jones, A. (2010) *No City Left Behind? The geography of the recovery – and the implications for the Coalition*, London: The Work Foundation
[68] Gibbons *et al* (2005) *ibid*

### 5.1 Macro-economic challenges

The Coalition inherited a benign labour market, fewer jobs were lost over the recession than expected, and we expect the labour market to recover to pre-recession levels of employment faster than in previous recoveries. Historical experience shows the private sector is perfectly capable of generating enough jobs to offset the expected loss of public sector jobs as projected by the OBR. But that experience was based on a much stronger recovery in GDP – over three per cent in the 1990s – than the OBR expects in this recovery. We are still concerned that the OBR's revised job predictions are over-optimistic.

However, a bigger concern than whether the OBR has got the numbers right is the absence of an overall growth strategy. The Coalition has instead initiated what it calls a 'Growth Review' focused on a number of potential growth sectors which will inform the 2011 Budget. There is much to be said for a more thoughtful, focused and sustained approach to policy making that engages business and other organisations on a more systematic basis. However, at the time of writing the review process feels vague, lacks substance, and relies too much on government reacting department by department.

### 5.2 Welfare to work

Some features of the welfare to work proposals can in broad terms be welcomed, but they may have been oversold in terms of their net impact on the labour market and on worklessness. It would be more reassuring if the reforms were focused on getting people into jobs with more than 16 hours of work a week. This would be much more in line with the grain of the labour market, and it would also have more impact on low income households.

We would also urge great caution in seeing self-employment as a viable option for the more disadvantaged – there is a great risk of swapping one form of precarious, low income existence for another with no long term benefit. The evidence suggests that up front grants, targeting of older workers, and steering individuals away from very high churn, marginal activity can all improve success rates.

### 5.3 Sustainable employment

Skills are one of the most important determinants of socio-economic outcomes. Those with low level skills were more vulnerable to job loss during the recession and emerging dominance of the knowledge economy. Skills are not only an important route out of poverty for individuals, but a key driver of economic prosperity. Disparities in skills levels are one of the main contributors to uneven development of the knowledge economy across the UK's cities and towns. All tiers of government – national and local – need to continue to invest in education and training provision working with employers to address skills mismatches.[69]

[69] Wright, J. (2010) *Employability and Skills in the UK: Redefining the debate Report for the London Commercial Education Trust*

However, unless the problem of under-utilisation of the skills and experience that people already have is addressed, supply-side interventions, such as skills development, will only have limited impact on improving individuals' employment prospects. Skill shortages only concern about 1 per cent of employees and skill gaps more than 10 per cent, however skills under-utilisation concerns between 35 and 45 per cent of the workforce.[70] In The Work Foundation's Knowledge Worker Survey, 36 per cent of knowledge workers reported that their jobs under-utilised their skills and experience.[71] This problem intensifies further down the spectrum with 44 per cent of those in jobs with some or little knowledge content reporting that their skills were underutilised. Increasing investment in skills, especially skills below degree level, and tackling the root causes of under-utilisation in the workplace has the combined potential to increase productivity in lower wage industries and businesses and open up more job opportunities for those on low incomes.

Job entry alone is insufficient to combat poverty. Yet, as our previous work has shown, successful policies, such as the NMW, are approaching the limit of their relative impact.[72] A wider range of measures, used in parallel with the NMW and working tax credits, need to be considered if the UK is to continue to combat in-work poverty. A key challenge is to seek to improve the performance of low wage businesses. Potential measures include: employment standard compliance in public sector contracts, including encouraging clients (particularly large multi-national companies) to adopt responsible procurement practices; business forums to identify best practice to boost productivity and improve organisational performance; and tailored support and advice about employment and skills development opportunities for low paid workers. Efforts to promote the upward mobility among those already in employment and to move businesses up the value chain may help to open up employment opportunities to which the unemployed can realistically gain access.

We have shown the rise of labour market intermediaries over the past 15 years and hypothesise that it has been one factor in helping reallocate labour more efficiently and hence improved overall labour market performance. We suspect their role is most developed for more skilled and specialist groups of labour and for moving people from unemployment and inactivity into work and least developed among those already in work in the 'Bottom Ten Million'. If we are right, this is a potential gap in the market that may require some further public support and encouragement if it is to be filled.

One area that deserves more attention is the potential role of local employers both in helping disadvantaged groups secure work and in giving them additional skills and experience so they can progress upwards. They can also have a positive role in helping low earners access financial advice and grants and benefits that many may be unaware they can claim.[73] A forthcoming evaluation of Tesco's Regeneration Partnership shows the benefits such initiatives can have, and sets out a number of

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[70] Wright, J. (2010) *ibid*
[71] Brinkley, I. *et al.* (2009) *Knowledge Workers and Work,* London: The Work Foundation
[72] Coats, D. (2007) *The National Minimum Wage: Retrospect and Prospect,* London: The Work Foundation
[73] Ashby, K. (2010) *Income Maximisation for Low Income Employees*, London: The Work Foundation

recommendations for ways local authorities and national government can do more to support, encourage, and develop them in the future.[74]

### 5.4 Spatial recovery

By international standards the UK's approach to welfare and employment support is highly centralised and there is an absence of the local dimension in the DWP's latest initiative, The Work Programme. Any policy to reduce poverty and worklessness needs to take account of how labour markets operate in different areas and recognise that labour market demand deficiency may be a significant barrier in many areas. Local authorities and their partnerships should be given the flexibility, including greater budgetary control, to shape labour market policy and customise interventions in a way that responds to local circumstances. It is simply not possible to dictate the detail of policy design from the centre and expect this to work in an undifferentiated way across the UK.

With 43 per cent of general government jobs in English local government, and budgeted 28 per cent cut in local authority expenditure in real terms, it is crucial that decision makers understand how to manage cuts at the same time as rising to other strategic challenges. The public sector has multiple impacts at the local level and publicly funded job creation has outweighed private job creation in large parts of the UK. As highlighted in our previous work[75], poorly managed public expenditure cuts at the local level have the potential to result in additional spending due to higher levels of unemployment in the public and private sectors. It is important that decision makers prioritise and take decisions about where costs will be reduced with a clear vision of the desired outcomes for service delivery across public service providers. Local decision makers also need to reorganise work and think innovatively about how to make best use of skills, focus on the ways in which intelligent procurement can help create innovative local economies, provide economic development support for those made redundant and maximise resources through collaborative working.

Cities will be vital to the recovery and the Coalition envisages LEPs playing a key role in creating the conditions to enable private sector growth. Here partners need to take a holistic, joined up approach and consider the wider barriers to innovation and business growth including skills housing and transport. In addition, rather than expensive blanket SME policies with a high deadweight cost, policymakers need to focus on identifying and supporting firms with the potential to create employment growth in the future. We are developing more detailed proposals in this area through our sister programme *Cities 2020.*

It is very clear that some people are placed at a severe disadvantage because of where they live. Policies have historically focused on bringing jobs to people rather than people to jobs. However, the history of bringing jobs to disadvantaged communities is mixed, especially where the economic rationale for a town or city has diminished. As a result, spatial concentrations of worklessness and low quality employment have persisted.

[74] Mahdon *et al* (forthcoming) *Regeneration Through Partnership,* London: The Work Foundation
[75] Jones, A. and Morris, K. (2010) *Managing Change: Responding to Reduced Public Expenditure in Yorkshire and Humber*, London: The Work Foundation

It may be appropriate for policy makers to focus on people-based initiatives to remove barriers to work, including reform to social housing, and to connect people to areas of economic opportunity. However, this approach has dangers. Voluntary migration tends to be self-selective, with the better educated in owner-occupied housing most likely to move away, further reducing the potential economic base for sustained regeneration. Further reinforcement of mobility may accelerate the downward spiral. In practice, a balance must be struck, based on a realistic assessment of job opportunities and the pace of regeneration in local areas, between increasing individual mobility so as to widen access to job opportunities, while seeking to rebuild the economic base to provide more and better jobs locally.

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