



The unemployment challenge

Labour market policies for the recession

About NZIER

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Key points

Over the next year another 50,000 people will become unemployed. The number of unemployed will surpass that of the last recession of 1997-98.

To address the unemployment challenge New Zealand needs to supplement existing job search assistance with investment in training and business capital to push long term productivity growth. Subsidies to prop up jobs and firms should be avoided.

The April 2009 QSBO found that a net 36% of firms intend to cut staff numbers in the next three months. Unemployment will be the worst we have faced since the 1991 global recession.

With the peak in unemployment approaching, attention needs to shift now to the challenge of getting the unemployed into work. The temptation will be to artificially protect jobs. But this is short-sighted. The economic imperative should be to ensure New Zealand has the right human capital to prosper when the economy picks up.

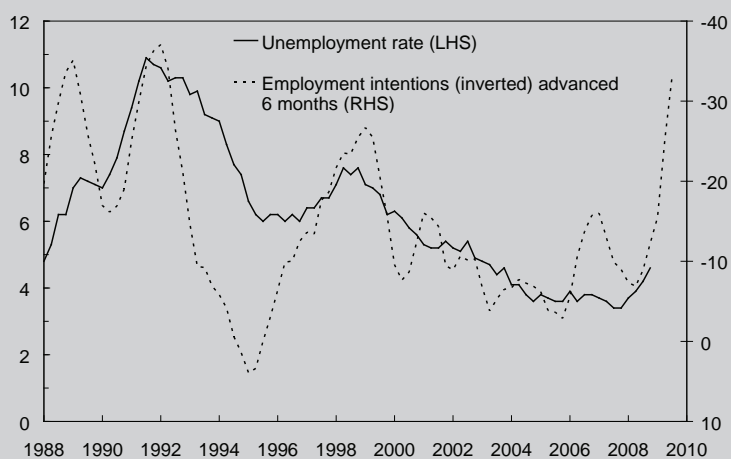
At first glance, recent initiatives (temporary top-up support for those made redundant and the 9 day fortnight) appear sensible. But they have downsides and should be removed after the crisis has passed.

Also, because they are tightly targeted they will have little impact, and do not cater well for many of the 50,000 or so extra unemployed. These will be new entrants to the labour market or those employed by small firms.

This policy gap needs to be filled to avoid high and long-term unemployment.

Figure 1 Employment intentions and unemployment

Percent of labour force, seasonally adjusted (LH scale); Net percent of respondents, 4 quarter moving average (RH scale)



Source: NZIER's Quarterly Survey of Business Opinion, Statistics New Zealand

Job subsidies should be avoided. They are a very expensive way of getting only a small reduction in unemployment. That is because it is hard to accurately work out which jobs are genuinely created, and which jobs would have been filled or created anyway. That means a huge potential for tax-payers' money being wasted. Worse, job subsidies might prop up the 'wrong' jobs. That would undermine necessary structural change and long-term job and income growth.

The most cost-effective of initiatives is job search assistance. Work & Income New Zealand has a well-honed routine of getting unemployed people into work before they even get to draw the unemployment benefit. This routine works well when there are job vacancies waiting to be filled. But right now it will not be enough because of a sheer lack of jobs.

Furthermore, there will be a mismatch between the skills and location of the unemployed and where job growth occurs. For example, there may not be the same amount of jobs in manufacturing or housing construction, or in the locations that people live now. Whatever the outcome, labour demand is unlikely to be the same as before the recession.

Training programmes have potential to deliver long-term benefits. But they are expensive and should thus be targeted carefully. They should meet the specific needs of the individual and the local labour market.

Training initiatives must also have in sight the longer-term objective of raising productivity. The 2009 OECD review calls raising productivity growth "the greatest medium-term challenge". In our view investment in training needs to go hand-in-hand with promoting business investment if productivity growth is to be achieved.

Reducing the cost of employment must be another area for attention, in addition to addressing skill mismatches. One reason unemployment persists is that wages and conditions do not adjust quickly enough to the new market environment.

New Zealand's employment relations policy scores high on international benchmarks. But there is scope for targeted changes to the Employment Relations Act, beyond the 90 day trial period for small firms. One idea is to remove the bias toward multi-employer collective agreements, as these create impediments to firms adjusting to local circumstances.

Another way is to reduce the cost of employing labour. Areas that especially small employers raise as issues are the Holidays Act, health and safety legislation, and ACC levies.

All in all, the following principles should guide proposed employment initiatives:

- use the opportunity to position New Zealand to benefit from the inevitable upturn
- target initiatives to raise their effectiveness and minimise the negatives
- don't attempt to slow structural change.

The unemployment challenge

Over the next year another 50,000 people will become unemployed. The number of unemployed will surpass that of the last recession of 1997-98. This comes after a decade of economic growth with unemployment hitting a low of 3.4% in 2007.

Some even suggest that unemployment may reach 1991 levels when unemployment peaked at 185,000 or 11%. We do not yet think it will get that bad – circumstances were vastly different: tight fiscal and monetary policy reinforced restructuring-induced unemployment in New Zealand on top of the effects of the 1991 global recession.

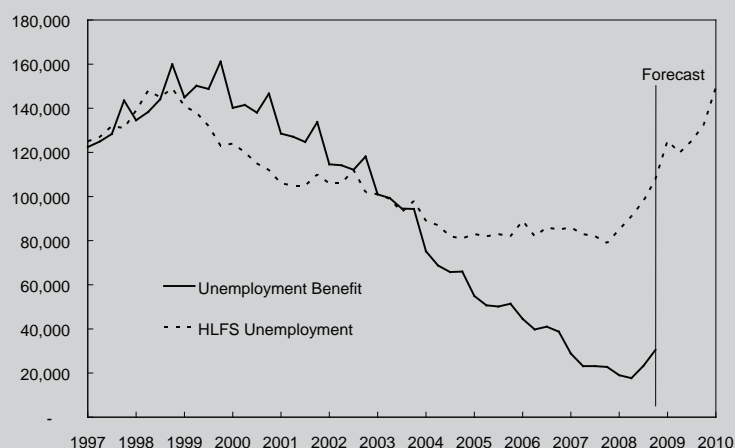
We may not be able to passively rely on economic growth to soak up unemployment as quickly as it is now being created. This is because of two factors:

- the outlook is for a long period of subdued growth after we come out of this recession
- growth may come in sectors that require different skills and experiences than unemployed labour has.

A long period of high unemployment and high levels of long-term unemployed people would be very damaging, both for the individuals concerned and New Zealand's longer term economic prospects.

An early policy change put in place a financial shock absorber for people made redundant – 'ReStart', a time-limited Unemployment Benefit top-up. The Job Summit generated interesting ideas, but most of these are yet to be turned into practical initiatives. As we near the unemployment peak, attention must shift to the challenge of getting the unemployed into work. So what are our options, and what works?

Figure 2 Unemployment numbers



Source: Statistics New Zealand, Ministry of Social Development



Employment initiatives: what works?

A look around the world shows that there are three types of active employment policy¹ targeted at the unemployed and other people not in work (Katz 1994):

- job creation
- training
- job search assistance.

Most New Zealand research evidence on the effectiveness of such initiatives dates to the experience from the 1990s and tends to be consistent with international findings.

¹ The jargon for these types of programmes is Active Labour Market Policies – “active” in the sense that they involve measures to move people into work, in contrast with “passive” income support.

Job creation

Job creation initiatives involve directly subsidising specific jobs in the private or public sectors. This is different from Government temporarily increasing its spending, for example on infrastructure, to indirectly stimulate general employment or avoid job losses.

Although job creation measures will appear to create jobs, the net job effect is usually small. Calmfors (1994) describes three negative effects:

- displacement – when firms that benefit from the wage subsidies increase their production at the expense of firms with unsubsidised workers
- substitution – when firms replace unsubsidised with subsidised workers
- deadweight losses – when firms employ subsidised workers who would have been employed anyway in the absence of the subsidy.

A range of evaluation studies of job creation programmes suggest that the negative effects are usually large. Maré's 2005 survey of international studies found that deadweight effects are in the order of 60 percent, substitution effects of around 25 percent and displacement effects of around 5 percent of jobs 'created'. That is, for every 20 jobs that are 'created' after the subsidy is in place, twelve would have happened anyway, five are just replacing unsubsidised workers, and one is due to displacement. Only two are genuinely "new" jobs.

However, job subsidies can reduce the number of weeks of assistance or contact that jobseekers subsequently have with the employment service. But these favourable impacts are not evident until at least a year after the subsidy starts (Maré 2002). These interventions also appear to be more effective for males than for females and, to a lesser extent, more effective for younger than for older jobseekers.

Overall, given their problems, it is difficult to see these types of direct subsidy programmes truly offering value for money, given they do not lead to many additional jobs.²

The Job Support Scheme acts in a less direct way. It provides government subsidies for employees who agree to reduce work hours to a nine-day fortnight, as an alternative to redundancies. On the face of it, this is one of the employment initiatives that should be avoided. It risks giving support to marginal firms in declining industries.

But a number of features of the scheme mitigate the worst potential effects. Cost-sharing between firms, employees and the government, should reduce the behaviours that result in deadweight, substitution and displacement effects. This is reinforced by the fact that it is time-limited for a maximum of six months. It is also limited to firms with more than 50

² They act to share the burden of unemployment. This may reduce the number of people who become long-term unemployed, but is it an efficient and equitable way to do so?

employees, which represent a little over half of total employment.³

In practice, the effect of the Job Support Scheme may be to smooth the adjustment process of downsizing. Even in a recession there is staff turnover, and the support will facilitate downsizing through attrition rather than rapid job loss through redundancies. The scheme therefore has some merit, but is unlikely to have any noticeable impact on economy-wide unemployment.

Training programmes

Training and retraining programmes can directly address missing or obsolete human capital, and provide structure and routine to mitigate some of the lifestyle effects of unemployment.

The types of training can range from basic literacy and numeracy to vocational courses, but also “life skills” (including drug and alcohol rehabilitation) and support for self-employment.

The evidence of the effect of training on solving unemployment is mixed. Training can have negative effects for the first one or two years if participants are kept away from the labour market for the duration of the training. However, this lock-in effect may be offset by large positive impact in the long run (OECD, 2005).

New Zealand experience also shows benefits from capacity-building programmes – training, confidence building, and work experience (Johri et al, 2004). The lock-in effect tends to reduce participants’ short-term chances to find work, but the experience is that, when combined with wage subsidies, the impact on the chance of finding employment was better.

Training programmes tend to benefit adult women, have mixed effects for men, and have no benefit for out-of-school youths. The latter group must be a target of any employment interventions given the linkages between recessions, youth unemployment and the ‘one-way trap door’ into crime and poverty.

Training programmes are probably more effective than job creation schemes (Calmfors, 1994), but their effectiveness is patchy, and training is among the most expensive of measures (Martin and Grubb, 2001). So this intervention should be used carefully.

Job search assistance

Job search assistance takes several forms, including initial interviews and job search seminars at the employment service, job-matching services, in-depth counselling, and re-employment bonuses.

Job search assistance does not directly reduce unemployment. The number of people seeking work, and their success at finding it, is primarily a function of the economy-wide demand for labour. But job search

³ 56 percent of the employee count in March 2008, according to the Statistics New Zealand Longitudinal Business Frame.

assistance does reduce the duration of unemployment, which may in turn reduce the number of unemployed people at any given point in time.

New Zealand experience shows that the programme with the highest impact at one and at three years, if measured as becoming independent of Work & Income assistance, is helping job seekers into self-employment (Johri et al, 2004). But participants in these type of programmes are probably more motivated than others.

Job search assistance seems the most effective and least expensive of interventions, according to most of the evidence. To be successful, it must be combined with monitoring of the job search behaviour and enforcement of work tests. In New Zealand it is already at the core of all programmes of employment assistance.

No silver bullet: customised packages are best

Pulling it all together, the evidence shows that there is no silver bullet. No matter how good their intention, all interventions can have negative effects. But this especially true for wage subsidies.

A package of measures may be the best way forward. Well-targeted design and delivery can reduce many of the negatives of all three types of intervention (Chapple, 1999). That is of course more easily said than done. A targeted package would fit around the circumstances of individual job seekers and the local labour market – training in forestry is unlikely to be a good option for urban unemployed.

Job search assistance is usually most effective for people with short durations of unemployment who are work-ready. Training or other interventions can help where unemployment duration is already lengthening and there are barriers to employment, such as poor skills or health. Training might then be reinforced by focused job search assistance on completion.

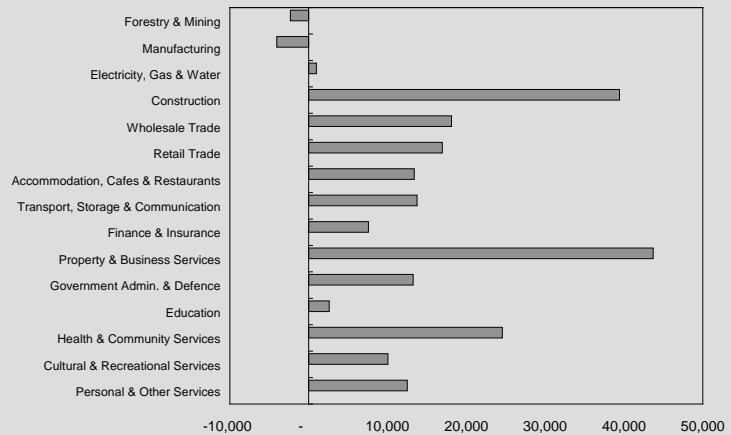
At this juncture in New Zealand, an emphasis on training seems warranted. Unemployment is usually most concentrated among people with limited human capital. But this time around, even skilled people may need assistance, if they have specialist skills that are ill-suited to those that are going to be in demand in the recovery.

For example, there may not be the same amount of jobs in manufacturing or housing construction, or in the locations that people live now. It is as yet unclear whether the same amount of job growth can be expected in residential construction and finance, for example. And manufacturing jobs had been contracting regardless. Whatever the outcome, labour demand growth is unlikely to be in the same sectors and places as before the recession.

Furthermore, research on the productivity challenge suggest training cannot be the only story: it needs to go hand-in-hand with a deepening of physical capital if New Zealand's long-term economic performance is to improve (Treasury, 2008; Hall and Scobie, 2005).

Figure 3 Job growth by industry 2003-2008

Change in annual average number of jobs in the years to December



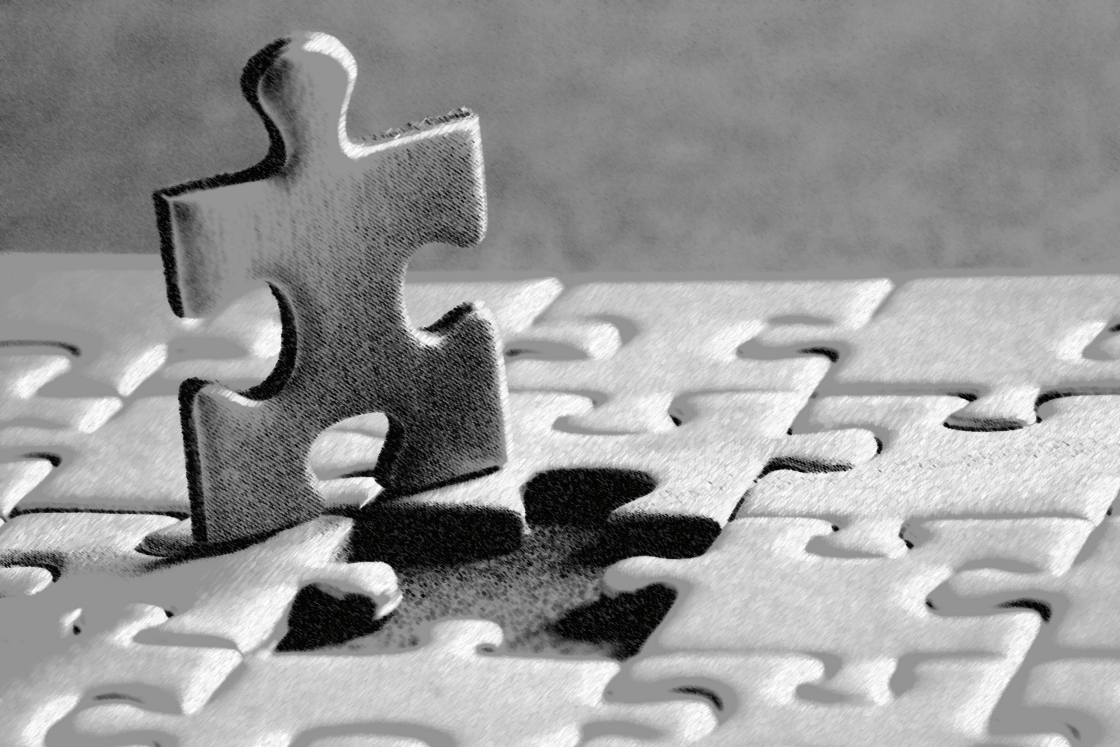
Source: Statistics New Zealand

Job creation projects should be avoided. At best they are a very expensive way of getting a small reduction in unemployment, and their main effect is in reshuffling unemployment. At worst, they may undermine long-term job growth by propping up employment in declining sectors. This may seem politically attractive in the short-term. But it undermines any necessary structural changes and thus the prospects of industries with strong growth potential.

The main questions in picking the best mix of interventions are thus how long the downturn might last and how can we best identify the specific training needs of individuals. The latter is a specialist task, and a short-term boost to skilled case managers in Work & Income New Zealand may be a good investment for the tax-payer and the economy.

If the downturn is relatively short, an emphasis on job search assistance, reinforced by short-term training for targeted unemployed people, would be an appropriate mix. But if the downturn and the resulting increase in unemployment proves to be longer lasting, a larger share of training of all forms would be required.

Regardless, employment policies will deliver only modest improvements while the labour market is in a slump. The timing of the interventions is important "with all interventions being less effective when employment growth is small" (Maré, 2002). In other words, pushing water uphill makes for hard work right now, but it could pay to open the floodgates when economic conditions start to improve.



Other policies must play their part too

The labour market does not function in isolation from other markets. No policies can deliver job growth when output growth is stagnant. Sound macroeconomic and microeconomic policies are essential.

Policies need to support entrepreneurship and business growth to lead to increased job opportunities. They also need to support and encourage people to attain the right skills, adapt to changes in the market, and offer their labour.

Currently New Zealand is ranked 22 out of 30 in the OECD productivity league table – an hour worked here generates 30% less output than an hour worked in Australia. This seems to be due to a combination of:

- a low capital intensity, as New Zealand's capital to labour ratio is less than two-thirds of that of Australia by one measure (Treasury, 2008)
- poor performance on technological diffusion, or the efficiency in combining capital and labour (OECD, 2009).

Both seem to be best explained by New Zealand's small size and distance to markets. It is telling that the share of business to total investment has been consistently below the OECD median for decades, with investment concentrated in residential property. That type of investment does not make the boat go faster.

One of the things New Zealand must do to compensate for its natural disadvantages is to have a super-efficient business regulatory environment, to raise the rewards to investment, and reduce the premium on the cost of capital.

The welfare safety net

Putting aside the quality of the wider regulatory environment, employment interventions cannot be expected to succeed when other labour market and social insurance policies heap costs on employers hiring and firing labour, or weaken work incentives.

Income support, such as through unemployment benefits, provides a safety net against the social and economic impacts of job losses. Working for Families and other tax credits give a buffer against a fall in income when still in employment.

At the same time as insulating households from the worst of income losses, this safety net also supports consumption (one of the so-called 'automatic stabilisers').

The level of income support has to be pitched right. It should provide sufficient protection against income shocks – without absolving households' responsibilities to protect themselves, if they can, in the form of precautionary savings. The optimal level may well need to be different in a protracted recession if time between jobs becomes considerably longer than normal.

The recently introduced ReStart does exactly that by temporarily providing extra income support over the standard unemployment benefit for those who have recently been made redundant. But it will need close monitoring as overseas evidence shows that time-limited support may actually extend the spell of unemployment, by reducing incentives for people to take early job offers. Policy-makers should also consider the need to withdraw the policy (and signal this policy change in advance) when the economy pulls out of the recession. Offering this extra 'free' insurance is bound to lead to households winding down taking their own precautions – a so-called moral hazard.

The floor on income support should protect people against poverty. But if income support is too generous compared to expected income from labour it will discourage people from taking on jobs.

Another setting to get right is abatement – the claw-back of the tax credit or income support against additional incomes. When this claw-back is combined with the ordinary tax on income the effective marginal tax rate can be very high. Rates of over 50% and even exceeding 100% are not unknown.

Such high rates will discourage people to take up work or increase their hours. The evidence suggests this is especially an issue for secondary earners and sole parents.

Designing tax and benefits systems with "suitable" abatement regimes is one of the most intractable policy tasks internationally. New Zealand deals with this through a complex morass of top-ups and tax credits, even drawing in households on relatively high incomes. But this solution imposes a higher than necessary tax burden on employment, and as such is not pro-growth. It requires a close re-examination.

Employment relations

A flexible labour market is important, especially to allow the necessary structural adjustments to occur. Labour and capital resources need to be able to flow to new ventures and sectors, out of the marginal firms and industries that were propped up by strong demand that was fuelled by easy credit. The quicker the better.

A regulatory environment that promotes investment into skills and capital is one part of the creative destruction story. The other part has to be an enabling industrial relations framework.

New Zealand's industrial relations framework is reasonably flexible, ranking 14/181 in the World Bank's Ease of Employing Workers indicator in its 2009 Doing Business index.

New Zealand ranks behind Australia (8th) and the United States and Singapore (1st equal) on the employment indicator. That reflects the relatively high ratio of minimum wage to average value added per worker, rather than market rigidities. On the Firing Costs subindex, New Zealand ranks 1st equal with the US.¹

So a major revamp of the employment law is probably not needed to speed up the structural adjustment. But there may be gains in targeted modifications to the current law to address specific problems. A recent example is the 90 day trial period for new employees in small firms that promotes more risk-taking in hiring decisions, by reducing costs if the relationship does not work out. This could be expanded to larger firms, for example.

Another area ripe for review is the bias in law for multi-employer collective agreements (MECAs). MECAs make the labour market more rigid. It is obvious that blanket conditions in collective agreements are a barrier to employers and employees finding solutions that suit local conditions – a clear rationale for enterprise based bargaining. Past and recent sector stoppage data for the health and education sectors suggest MECAs may be associated with poorer, rather than better, employment relations.

Similarly, there is scope to review other regulation that raise the cost of doing business and especially those that raise the cost of employment, such as the Holidays Act, health and safety legislation, and ACC levies. This is particularly important for smaller firms (Business NZ-KPMG 2008)

Minimum wage

Minimum wages raise the costs of and thus reduce employment at the lower end of the labour market. They encourage firms to replace low-wage jobs with capital or higher skilled labour. But they also encourage more people to participate in the workforce.

Another school of thought is that minimum wages raise productivity by 'forcing' employers to invest in strategies and training to offset increased

¹ New Zealand was ranked 4th lowest on Employment Protection Legislation among the 28 member nations of the OECD in 2003 (OECD, 2004).

wage costs. Some of this logic seems odd (why not raise productivity anyway?) and the evidence points to low waged workers receiving little on-the-job training compared to other staff.

The empirical evidence on the minimum wage is not conclusive. Both small negative and small positive employment effects have been reported. When Hyslop and Stillman (2004) analysed the effects of raising the minimum wage for youth workers in New Zealand from 2001 they found:

- no robust evidence of adverse effects on youth employment or hours worked
- stronger evidence of positive employment responses to the changes
- significant increases in income of teenagers relative to young adults
- inconclusive evidence of fewer educational enrolments and higher unemployment.

The minimum wage impacts are most pronounced at the bottom end of the labour market among those most at risk of unemployment (Department of Labour, 2007).

This inconclusive evidence does not make a strong case for either raising or lowering the minimum wage. But in a market where margins are being squeezed, risks are clearly on the downside. Employers are more likely to respond to increases in the minimum wage by reducing employment than by investing in training to raise productivity. A policy stance of aggressively raising the minimum wage is thus not to be recommended at this stage of the economic cycle.



Lessons for the unemployment challenge

A key objective must be to position New Zealand on a strong growth path once the inevitable upturn starts.¹ The 2009 OECD review calls raising productivity growth “the greatest medium-term challenge”. We think that any employment initiative now should be aligned to that objective.

Our review shows that a mix of employment programmes will be required, with solutions customised around the needs of individuals and local labour markets.

At first glance the recent employment initiatives (temporary top-up support for those made redundant and the 9 day fortnight) might appear sensible. But the potential for deadweight losses and moral hazard mean that they should be removed after the crisis has passed. Also, because they are tightly targeted, they will have little impact, and will not capture many of the 50,000 or so extra unemployed who will be new entrants to the labour market or employed by small and medium sized firms.

We find that job search assistance has to be central to the mix. This is very cost-effective at the early stages of unemployment – it can even avoid people going on the unemployment benefit.

But it will need to be reinforced by training where there are barriers to employment, such as poor skills. Training programmes have the potential to deliver long-term benefits, if they help speed up structural mismatches between existing skills and those that will be demanded once the economy picks up again. The 9 day fortnight policy missed the opportunity to link support to training.

¹ A forthcoming NZIER public discussion paper will examine New Zealand’s challenge in more detail.

Training is expensive and should thus be targeted carefully. It should meet the specific needs of the individual and the local labour market. It must also have in mind the longer game of developing a skilled, adaptable workforce aimed at raising productivity. And any training initiative needs to go hand-in-hand with promoting business investment if productivity growth is to be achieved.

One reason unemployment persists is that wages and conditions do not adjust quickly enough to the new market environment. So reducing the cost of employment must be another area for attention, in addition to addressing skill mismatches.

As such, a flexible labour market is of critical importance. New Zealand's industrial relations policy still scores high on international benchmarks. But there is scope for targeted changes to the Employment Relations Act, beyond the 90 day trial period for small firms, such as extending it to all firms, and removing the bias toward MECAs. MECAs create impediments to firms adjusting to local circumstances.

Reducing the cost of employing labour would assist too. Policy changes that would reduce employment related compliance costs include the ACC employer levy, the Holidays Act, and health and safety legislation – all areas frequently mentioned by small and medium sized enterprises in particular.

Employment interventions should not undermine the process of structural adjustment. Creative destruction is an uncomfortable but necessary fact. Job subsidies should therefore be avoided, or at best regarded as a last resort option. At best these job creation schemes are a very expensive way of getting a small reduction in unemployment; at worst they may undermine long-term job growth by undermining necessary structural change.

All in all, the following principles should guide proposed employment initiatives:

- use the opportunity to position New Zealand to benefit from the inevitable upturn
- target and customise to raise effectiveness and minimise the negative effects
- don't attempt to slow structural change.

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Looking at unemployment

Who is unemployed?

Unemployment tends to be concentrated among groups with lowest human capital, and hence lower productivity in the workplace.

In the year to December 2008, the unemployment rate averaged 4.1 percent across the labour force as a whole.

But significantly higher unemployment was found among:

- people with no qualifications, or no more than secondary qualifications
- young people – those under 30, and especially those under 20
- people of any ethnicity other than European.

The links between human capital and lower qualifications, and human capital and younger ages (limited work-related experience), are obvious. The link between unemployment and ethnicity is less obvious, but much can be explained by:

- the relative youth and lower qualifications of Maori and Pacific Peoples
- unfamiliarity with the local labour market and culture by, and lack of English language proficiency of, recent immigrants.¹

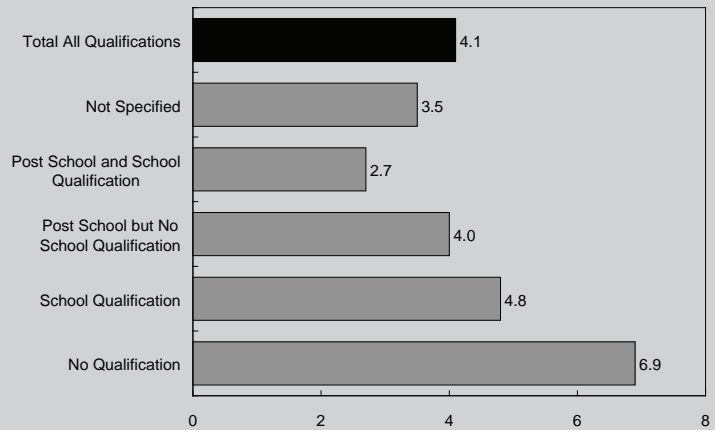
While the common measure of unemployment is not the same as people on the dole (see Figure 2), and is in fact much higher than that, at the same time it understates the number of people who might be employed in a stronger labour market. This is because “unemployment” relates to people who are not in paid employment and are actively taking steps to seek work.

A broader definition of joblessness refers to all persons who are without a job but want one. This is approximately double the number of official unemployed.

¹ Winkelmann and Winkelmann (1998) show that immigrants’ initial labour market outcomes were generally below those of similar New Zealand-born people. However, with more time in the country, migrants can expect their labour market disadvantage to decrease and even disappear.

Figure 4 Unemployment by highest qualification

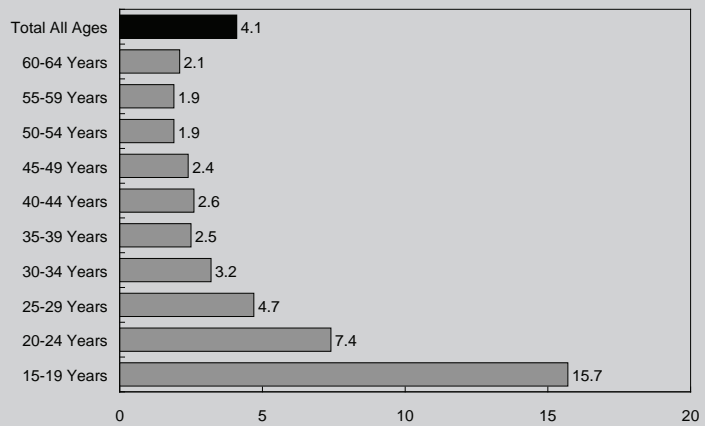
Percent of the labour force: year ended December 2008



Source: Statistics New Zealand

Figure 5 Unemployment by age group

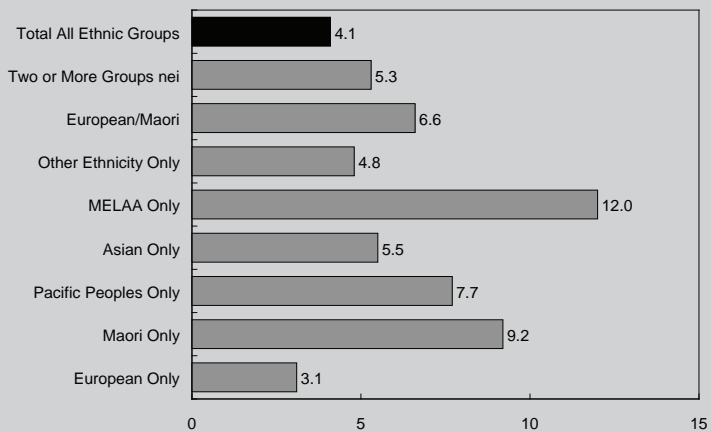
Percent of the labour force: year ended December 2008



Source: Statistics New Zealand

Figure 6 Unemployment by single/combined ethnicity

Percent of the labour force: year ended December 2008



Notes: NEI=not elsewhere indicated, MELAA=Middle Eastern/ Latin American/African

Source: Statistics New Zealand

The dynamics of unemployment

During the strong labour market of the current decade the participation rate – the share of persons of working age either employed or seeking work – has increased to record levels, through a combination of relatively stable male participation rates, and female participation rates on an upward trend.

There is no sign of participation rates falling yet – in fact, female participation was increasing throughout 2008. But a weaker labour market will lead to large number of people remaining outside the labour market, or leaving it for example, students, or people with family responsibilities.

Focusing purely on unemployment figures and trends overlooks the dynamics of the labour market, with a continual movement of people between employment, unemployment and non labour market activity, as well as changing jobs.

Table 2 shows average transition probabilities - i.e. the likelihood that people in any given labour force status will be in the same or a different status between one quarter and the next, during the year to March 2008.

In that period, which was when unemployment at a low point, 95 percent of people employed in one quarter were still employed in the following quarter (although not necessarily in the same job), and 89 percent of people not in the labour force remained outside it a quarter later. Also:

- only 1 percent of employed people were unemployed a quarter later – five times as many leaving employment left the labour force altogether
- most people initially outside the labour force found work when they sought it
- 24 percent of people who were unemployed in any quarter were still unemployed three months later.

These numbers were recorded during a very strong labour market, so may not be representative of what we can expect during a weaker one. Transition probabilities for people employed and not in the labour force tend to be relatively stable. But this picture is different for the unemployed. In the early 1990s – the tail end of the highest post-War level of unemployment – unemployed people had a roughly 50 percent chance of remaining unemployed over successive quarters.

Table 1 Joblessness

000s of persons; December 2008 quarter

Official unemployed	99.4
Available for but not actively seeking work:	
Seeking through newspaper only	9.2
Discouraged	3.2
Other	58.0
Actively seeking but not available for work	27.4
Total jobless people	197.3

Source: Statistics New Zealand

Table 2 Labour force transition probabilities 2007/08

Proportion of persons in labour force states over two successive quarters

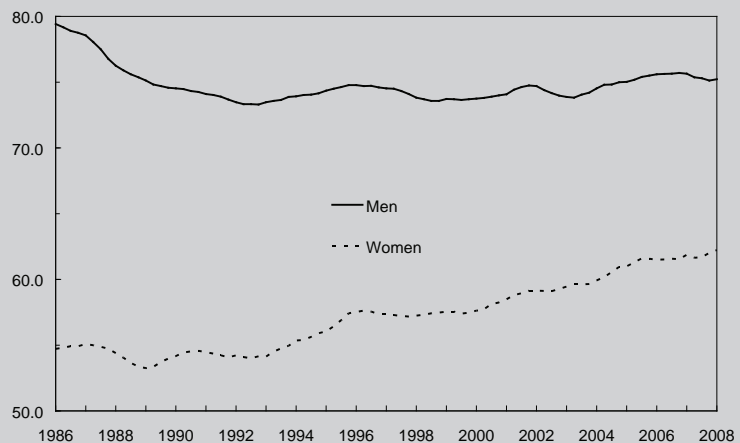
		Last Period		
		Employed	Not in LF	Unemployed
Current period	Employed	0.95	0.08	0.4
	Not in LF	0.05	0.89	0.36
	Unemployed	0.01	0.03	0.24

Notes: (1) Average, four quarters to March 2008
 (2) Not LF = Not in the Labour Force

Source: Statistics New Zealand

Figure 7 Labour force participation rates

Percent of the working age population: moving annual average



Source: Statistics New Zealand

Duration of unemployment

The fact that in recent times, most unemployed people have moved into jobs, or out of the labour force, means that most people are not unemployed for long periods. This is confirmed when we look at the duration of spells of unemployment.

Short duration unemployment - four weeks or less – represents people who are between jobs. It is sometimes known as frictional unemployment. This has been relatively stable (relative to total employment) for most of the last two decades. However it has been increasing over the last year, which is likely a precursor to longer spells of unemployment.

Long duration unemployment – over 26 weeks – increased markedly during the recessions of the early and late 1990s, and proved slow to recover. The tail of long duration unemployment from the 1990s only declined after sustained job growth in the current decade.

This type of unemployment represents the greatest potential problem, as people with long spells of unemployment find it difficult to move back into work, even when jobs are plentiful. There are a number of reasons.

Budd et al (1988) refer to the combination of “a reduction in the intensity of job search and ... a reluctance of employers to hire the long-term unemployed”. The latter is a signalling effect – employers tend not to offer jobs to apparently suitable long-term unemployed people, as they take long duration as suggesting some unobserved negative characteristic.

The only substantial New Zealand research on this issue is a survey undertaken in the late 1990s (Parker, 1997). This showed that very long-term job seekers (continuously registered with the then New Zealand Employment Service for over 52 weeks) faced four common and important barriers to securing work:

- limited mobility – typically rural Māori without a driving license and/or lacking access to car or public transport. But 31 percent indicated a willingness to move to a new town or city to take up a job opportunity
- perceived age discrimination – both among people aged under 20 and over 40 years of age
- lack of educational qualifications (including weaknesses in literacy and mathematics) – especially among Māori and Pacific Islanders
- poor English language skills - among Pacific Islanders and people of other ethnicities.

Other barriers identified included: lack of qualifications; lack of appropriate skills or work experience; lack of available or appropriate jobs in the local area; and health, disability, or physical incapacity.

In addition, long-duration unemployment may lead to lifestyle effects. As people become disengaged from work and the associated routines and social connections, certain lifestyle factors become more pronounced to

the point that they constitute barriers to re-employment – e.g. loss of work habits, increased drug and alcohol consumption, social disengagement,² health problems.

The combination of these factors can mean that long-duration unemployed people move to the back of the queue for job vacancies – behind people already in employment, with short histories of unemployment and entering the labour force.

Intermediate duration unemployment represents the at-risk group – unemployed people who have not quickly found jobs, and are at risk of remaining unemployed for long periods.

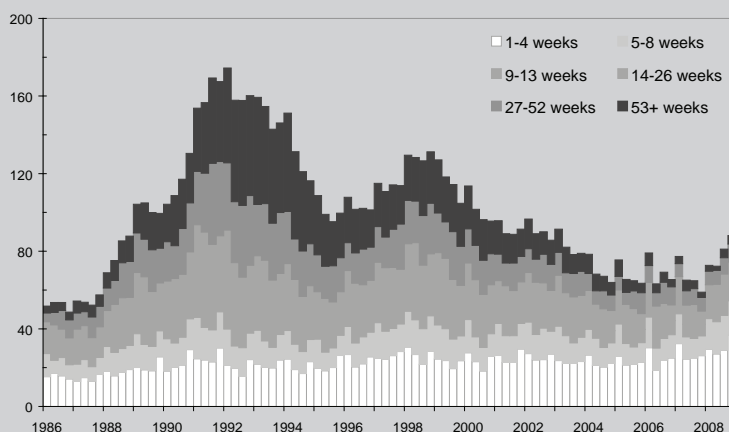
The above issues occur independently of the circumstances under which individuals become unemployed. Additional concerns are generated when the cause of unemployment is structural change, i.e. a decline in some industries and expansion in others.

Typically, the normal dynamics of the labour market can accommodate structural change, though people changing jobs, entering and leaving the labour force, allied with in-firm training processes. This adjustment generally passes unnoticed when declines are gradual with job loss through attrition. It is more problematic when job loss is through redundancies in a softening labour market.

For example, Fletcher (1995) and Humphris and Chapple (2002) point to the decline in manufacturing and reduced demand for workers with low or no educational qualifications, and for production and related workers, as causes of the decline in participation and employment rates among Pacific peoples.

² Informal contacts and word of mouth are an important source of job opportunities.

Figure 8 Duration of unemployment
Number of persons (excluding no duration specified)



Source: Statistics New Zealand

Implications

Given that unemployment tends to be concentrated among people with low human capital, this means that the bulk of the costs of the recession will fall disproportionately on a relatively small number of people.

Even if the effect is that people are unemployed for longer than would be the case in a strong labour market, these costs are not trivial. Unemployment almost invariably results in a loss of income, which the unemployment benefit can only partially compensate for, and extended spells of unemployment can have pronounced lifestyle effects, loss of savings etc.

The risk of any period of prolonged unemployment is that people drop out of the labour market, or become long-duration unemployed. This means that it can become very difficult to get them into work again, even when job growth resumes. Personal consequences of being unemployed become barriers to re-employment (i.e. self-reinforcing cycles). Such people wind up at the back of the queue for jobs, behind people already in work, recent unemployed, and new entrants to the labour market.

There are the obvious costs to the people themselves. But there also are costs to society through social and fiscal costs arising from effects of unemployment, such as healthcare, crime, drugs,³ and potential output losses when employment growth resumes, if long duration unemployed people cannot be re-integrated into the labour market – i.e. the possibility that there are unfilled jobs side-by-side with a pool of unemployment.

This points to a very strong argument to minimise long-duration unemployment within the total pool of unemployment.

³ Although it is difficult to estimate what proportion of these costs can be attributed to higher unemployment, and what proportion would have occurred regardless.



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