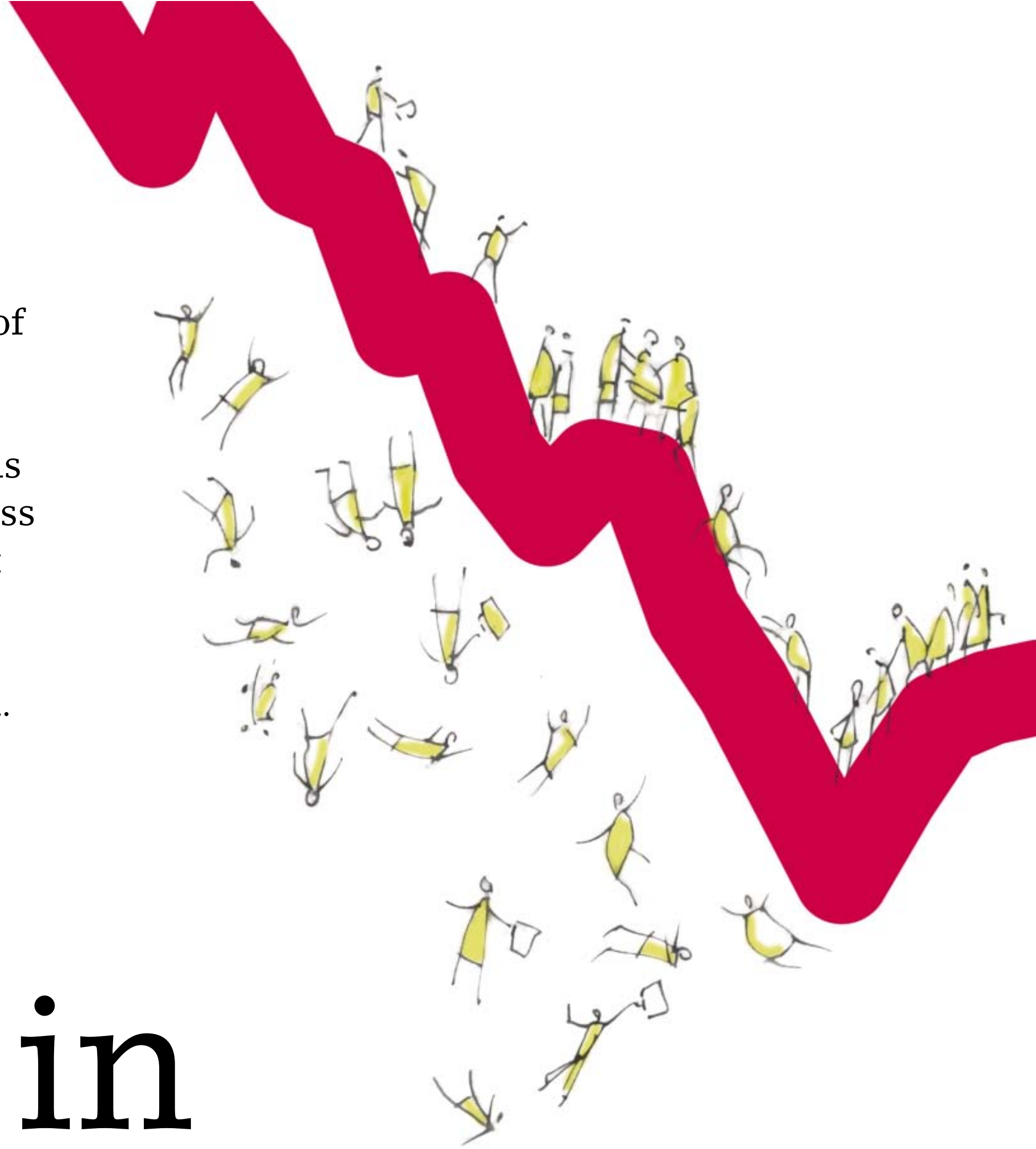


The recession of 2008-09 inflicted a larger cumulative loss of UK output than any of the previous post-war recessions, yet there has been a relatively low loss of employment, at least so far. **Paul Gregg** and **Jonathan Wadsworth** look for an explanation.

Jobs in the recession

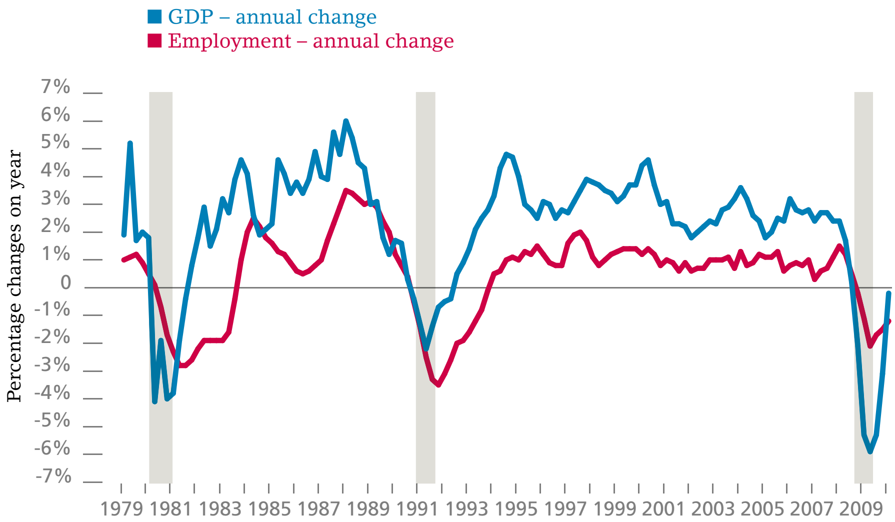
After 15 years of near continuous job growth, the UK's employment rate in the middle of 2008 stood at around 75% of the working age population, a rate broadly in line with previous employment peaks in 1968, 1978 and 1989. The UK had also experienced 12 years of near continuous decline in unemployment after 1993, following the double digit rates of the early 1980s and the early 1990s.

Despite the predictions of some, the introduction of the minimum wage in 1999 appears to have had little effect on employment over the last decade. In 2005, the unemployment rate fell below 5% for the first time since the 1970s and hovered around this rate for the next three years. Then in 2008, the UK entered what was to be its worst recession since the Second World War in terms of lost output.

During the latest recession, GDP fell by

Figure 1:

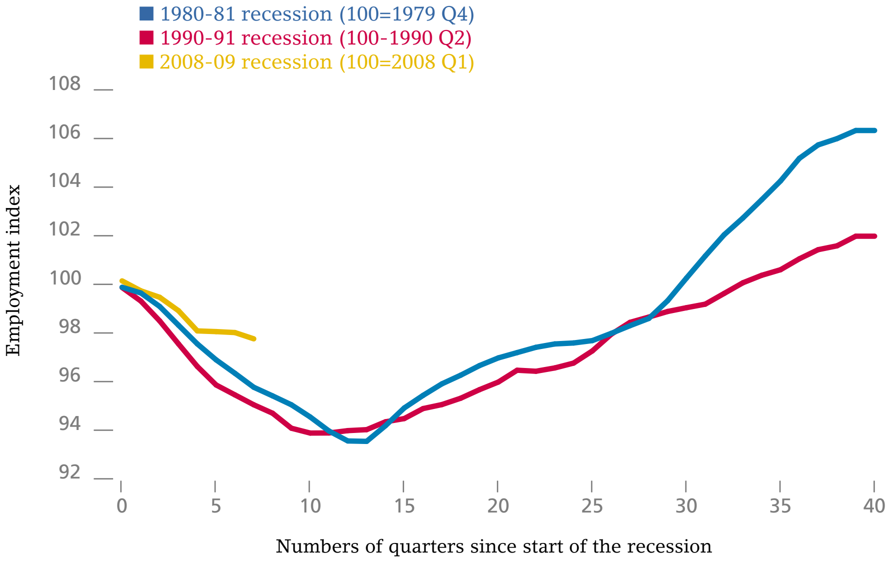
Annual change in UK employment and GDP, 1979-2009



Source: Labour Force Survey, Office for National Statistics.

Figure 2:

Employment levels from the start of the recession for the 1980s, 1990s and 2008-09 recessions



Source: Office for National Statistics.
Index at start of recession = 100 for 1979 Q4, 1990 Q2 and 2008 Q1 respectively.

This recession represents the first serious test of the UK's active labour market policies

over 6%, which is worse than in the recessions of the 1980s or 1990s (see Figure 1). What's more, with six quarters of falling output, this recession was both longer and deeper than the previous two. In the 1980s recession, the percentage decline in employment was broadly in line with the percentage fall in GDP. In the 1990s recession, the relative fall in the employment rate was somewhat larger than the percentage decline in GDP.

Moreover, in the previous two recessions, the fall in employment was only halted 12 to 14 quarters after the onset of recession (see Figure 2). Employment then also remained below its pre-recession levels for 18 months or so after the recovery in output started. Typically GDP growth of 2% or higher seems to be needed before employment starts to rise again (or unemployment starts to fall).

But the latest recession was strikingly different. While the fall in GDP was markedly worse than in past recessions, the loss of employment was much smaller – roughly 3% of the initial level – and the period over which employment fell was much shorter than in the past.

The number of UK jobs saved so far relative to what might be expected by the drop in GDP amounts to roughly one million. How has this happened? The first point to consider is how widespread this pattern has been across countries and whether it is related to their institutional differences.

Table 1 shows that France and Canada have escaped relatively lightly from the recession with around a 3% fall in GDP and a similar rise in unemployment, in line with past norms. In the United States, Spain and Ireland, the rise in unemployment exceeded the fall in output.

But there are a large number of countries with smaller than expected employment falls. Some of them adopted a deliberate strategy to encourage short-time working rather than lose jobs. In Germany, the government has supported a policy of short-time working, and similar employment subsidy schemes are operating in Italy, the Netherlands and

Table 1:

The percentage change in GDP and unemployment across selected countries over the recession

	Percentage change in GDP **2008 Q1-2009 Q2**	Percentage point change in unemployment **2008 Q1-2009 Q4**
Countries with small unemployment rise relative to fall in GDP		
UK	-5.9%	2.7
Sweden	-6.1%	2.9
Countries with small unemployment rise relative to GDP and with employment subsidies		
Italy	-6.5%	1.8
Germany	-6.3%	-0.1
Netherlands	-5.85%	1.2
Japan	-7.1%	1.3
Countries with similar sized unemployment rise and GDP falls		
France	-3.1%	2.4
Countries with larger unemployment rises than GDP falls		
United States	-3.5%	5.0
Spain	-4.3%	9.7
Ireland	-9.6%	8.2
Countries with little or no GDP fall		
Australia	+1.5%	1.5

Japan. The UK is one of a smaller number of countries to have experienced relatively small employment losses without a deliberate government-funded strategy of fewer working hours.

Does this mean that employment in the UK has benefited from its putative flexible labour market? The evidence does not support this view. The countries with low employment loss are not those regarded as having flexible labour markets. The United States is held to be the prime example of the flexible model and Ireland is also a relatively less regulated country, and both countries experienced large falls in employment. Spain has strong labour protection but also has a large share of temporary jobs, which are weakly protected and have proved to be vulnerable in the downturn.

In contrast, Sweden, Italy, Germany and the Netherlands have relatively high levels of employment protection and relatively good employment records over the recession. In short, there appears to be little relationship between a country's supposed degree of labour market flexibility and employment losses in this recession.

So what explains the UK outcome? It seems that the answer consists of several elements. First, policy-makers were better prepared this time round. After all, there had been two severe recessions well within the memory of most adults over the age of 30. The understandings that were gained undoubtedly helped frame a policy response in the latest downturn, allied with a greater willingness to intervene than in the past.

This recession was notable in that, unlike the previous two recessions, it was not exacerbated by a deliberate policy of fiscal and monetary tightening to squeeze demand out of the system to get inflation down. Instead, unemployment rose because of an old-fashioned collapse in demand following the bursting of a financial bubble.

Moreover, this time round there has been a deliberate larger and more rapid loosening of fiscal and monetary policy to try to offset the fall in demand. Policy-makers did the right thing in saving the banks, cutting interest rates and inducing fiscal and monetary stimuli, which have all helped to maintain demand and firms' cash flow.

Workers also did the right thing in accepting lower nominal wage growth which kept firms' costs down and reduced the need to cut costs through layoffs. At the same time, real take-home pay was sustained by cuts in interest rates and VAT and this may have maintained consumer demand. And firms did the right thing in, wherever possible, holding onto valuable labour in the face of the pressure on profits and the severe nature of the crisis.

There is no relationship between a country's degree of labour market flexibility and employment losses in this recession

Employers entered the recession in good financial shape and this has also helped avoid the level of job shedding that occurs when firms get into deep financial trouble. But the recession means that firms have under-used labour at the moment and this will allow them to grow without the need to hire much in the short to medium term. And if demand continues to be weak, then job shedding is likely to continue on a slow but sustained basis.

This recession represents the first serious test of the active labour market policies that have been put in place since 1996. Increased conditionality on welfare claimants to take active steps to secure work, packages of support services for job search available to those claiming benefits and use of outside providers to deliver these services rather than Job Centres are all innovations aimed at keeping individuals in the labour market and maintaining search effectiveness.

Reforms that increased the financial returns to working relative to not working – the minimum wage and in-work tax credits – should also help continue to make work pay through a downturn, when job prospects may not be as good as when the economy is doing well.

The signs are that unemployment also has not risen as much as many expected. This is to be welcomed, though the ability of the new policies to withstand a build up of long-term unemployment that has in the past followed in the wake of a recession is still to be tested.

The cost has been huge for the public finances and in terms of productivity and this will affect cost competitiveness going forward. There are also serious jobless concentrations among more marginal groups that 15 years of sustained growth did little to remedy. For some groups, there has been a ratchet upwards in joblessness from the 1980s onwards and this will need to be addressed when the economy recovers.

Yet overall, it seems that the labour market has performed better than expected. Whether this generally good news will be sustained as the focus shifts to cuts in public spending and employers begin to assess their longer-term employment needs is less clear. Employment took eight to nine years to get back to pre-recession levels after the last two recessions. This time it might be less if a second wave of job shedding is avoided.

This article summarises 'The UK Labour Market and the 2008-2009 Recession' by Paul Gregg and Jonathan Wadsworth, CEP Discussion Paper No. 950 (http://cep.lse.ac.uk/pubs/download/occasional/op025.pdf). An extended version of the paper will appear in *The Labour Market in Winter: The State of Working Britain*, a book to be published by Oxford University Press later this year.

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