

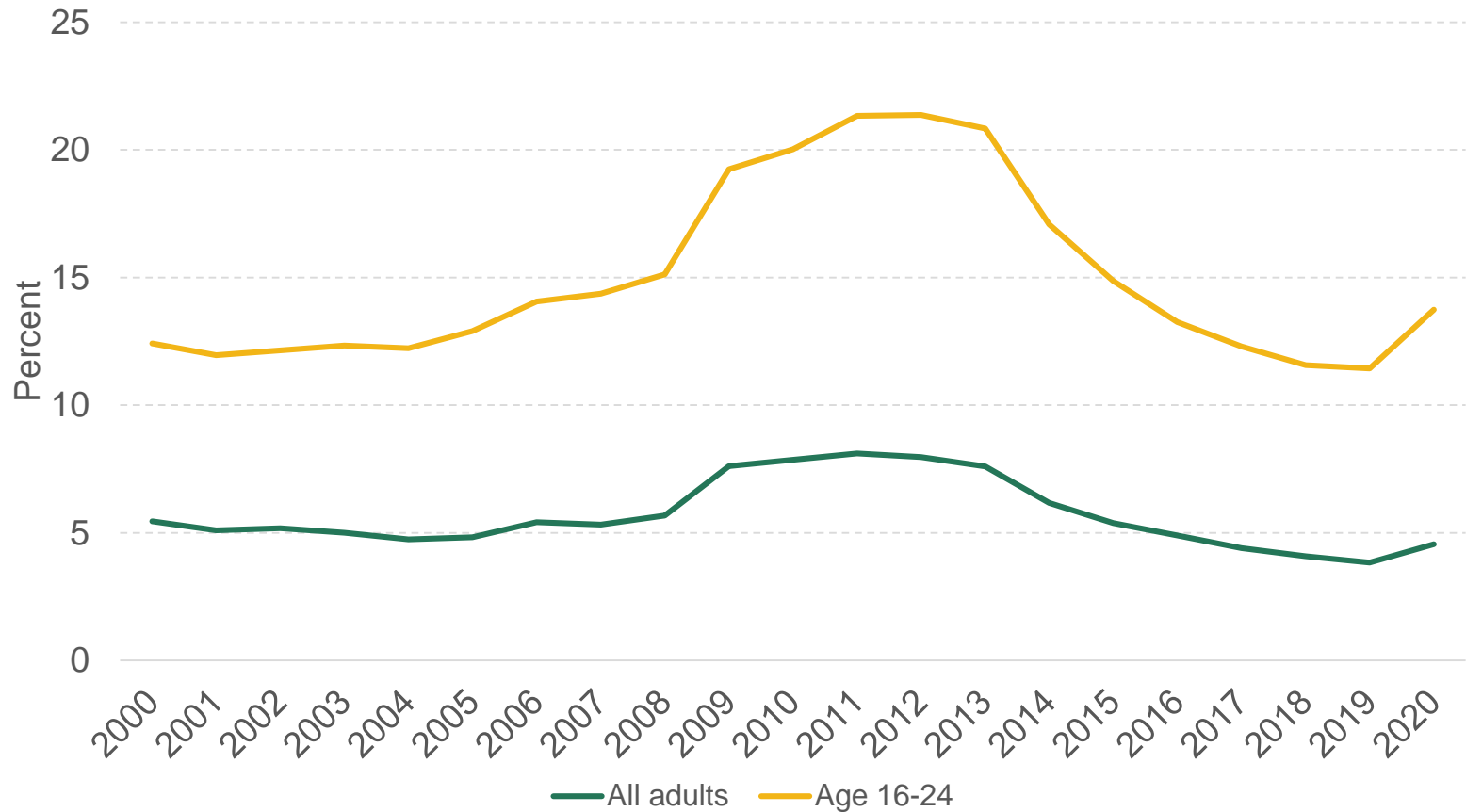
The Curse of graduating during a recession

Monday 15th November
16:00 - 17:00



Young people are more likely to be unemployed

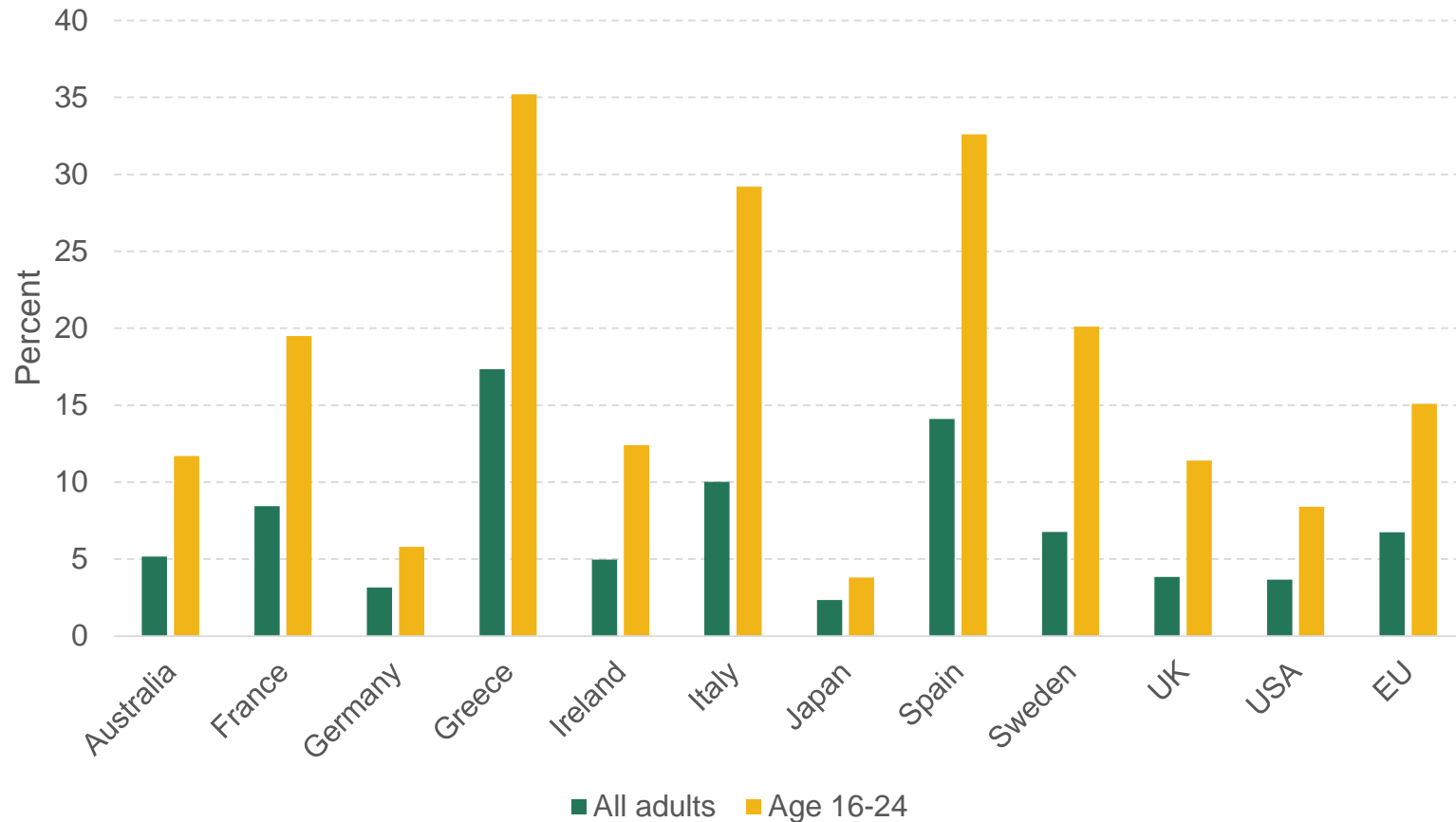
UK unemployment rate since 2000



Source: OECD Labour Market Statistics

High youth unemployment is not just a UK phenomenon

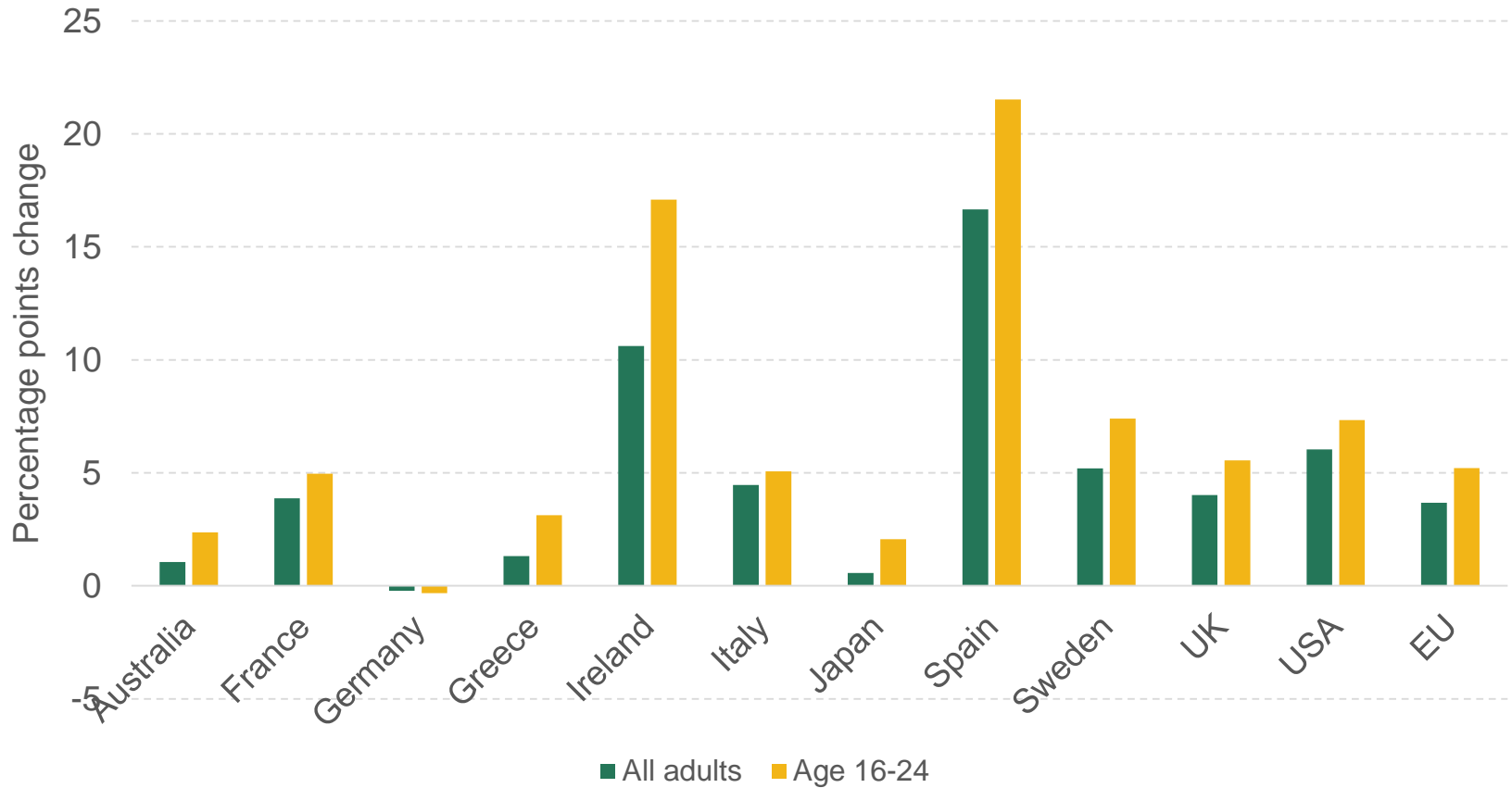
Unemployment rates by age group, 2019



Source: OECD Labour Market Statistics

Young people are especially impacted by recessions

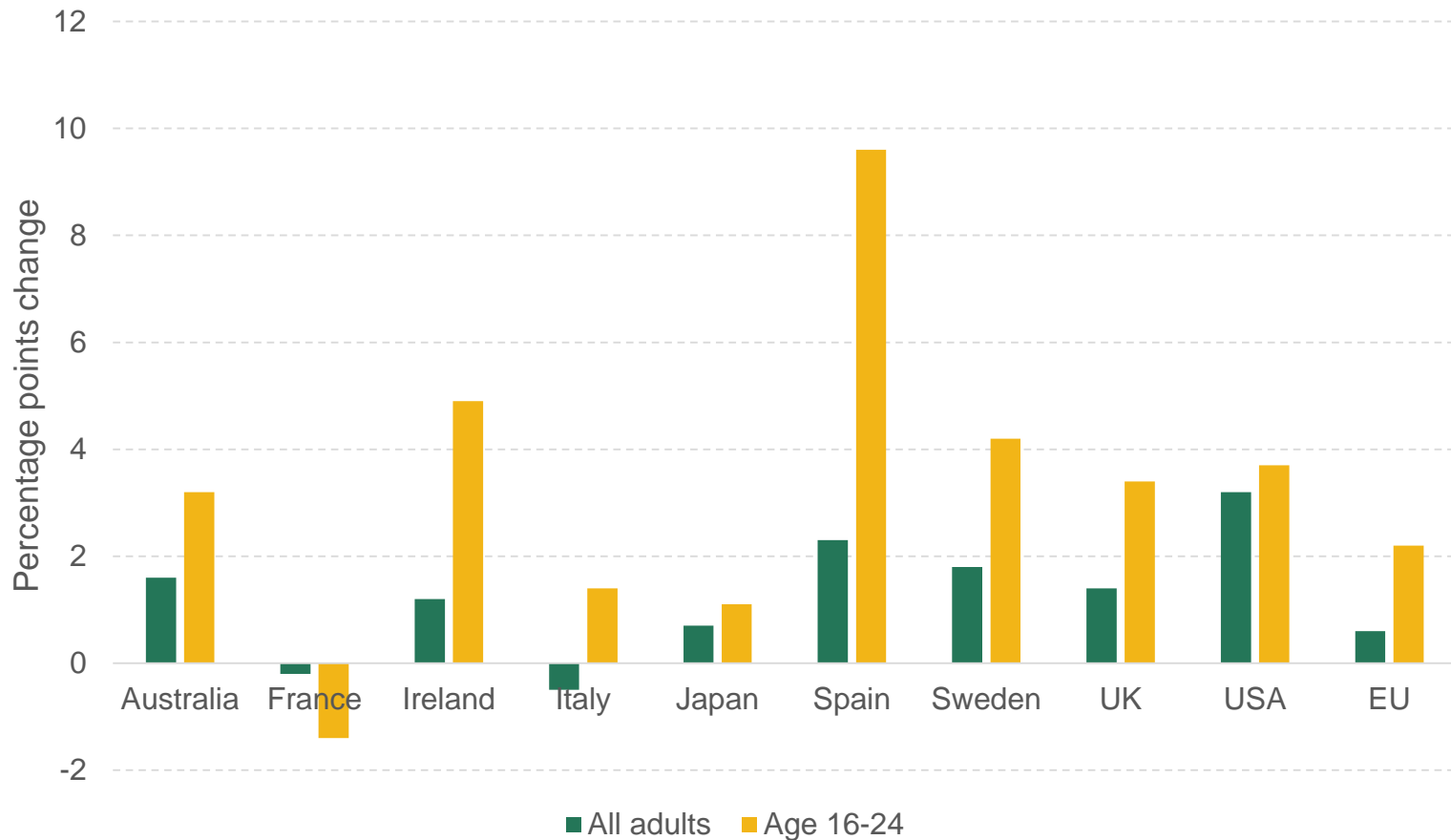
Change in unemployment rate between Q3 2007 and Q3 2009



Source: OECD Labour Market Statistics

The pandemic has hit young workers hard

Change in unemployment rate between Q4 2019 and Q4 2020



Source: OECD Labour Market Statistics

Why is this so concerning?

- Unemployment rates among young people are higher and recessions seem to be more damaging for the young
- This is concerning because youth unemployment leads to long term economic ‘scars’
- Cohorts who graduate during a recession are more likely to be unemployed and so experience long term damage

Why is graduating during recession so harmful?

- Unemployment spells have long term impacts on life chances

Why are the effects of unemployment on earnings so persistent?

- Explaining career development and earnings growth

Why and how does the government intervene?

- There are a number of potential underlying market failures
- Active labour market policies



Why is youth unemployment so harmful?

Economic scarring

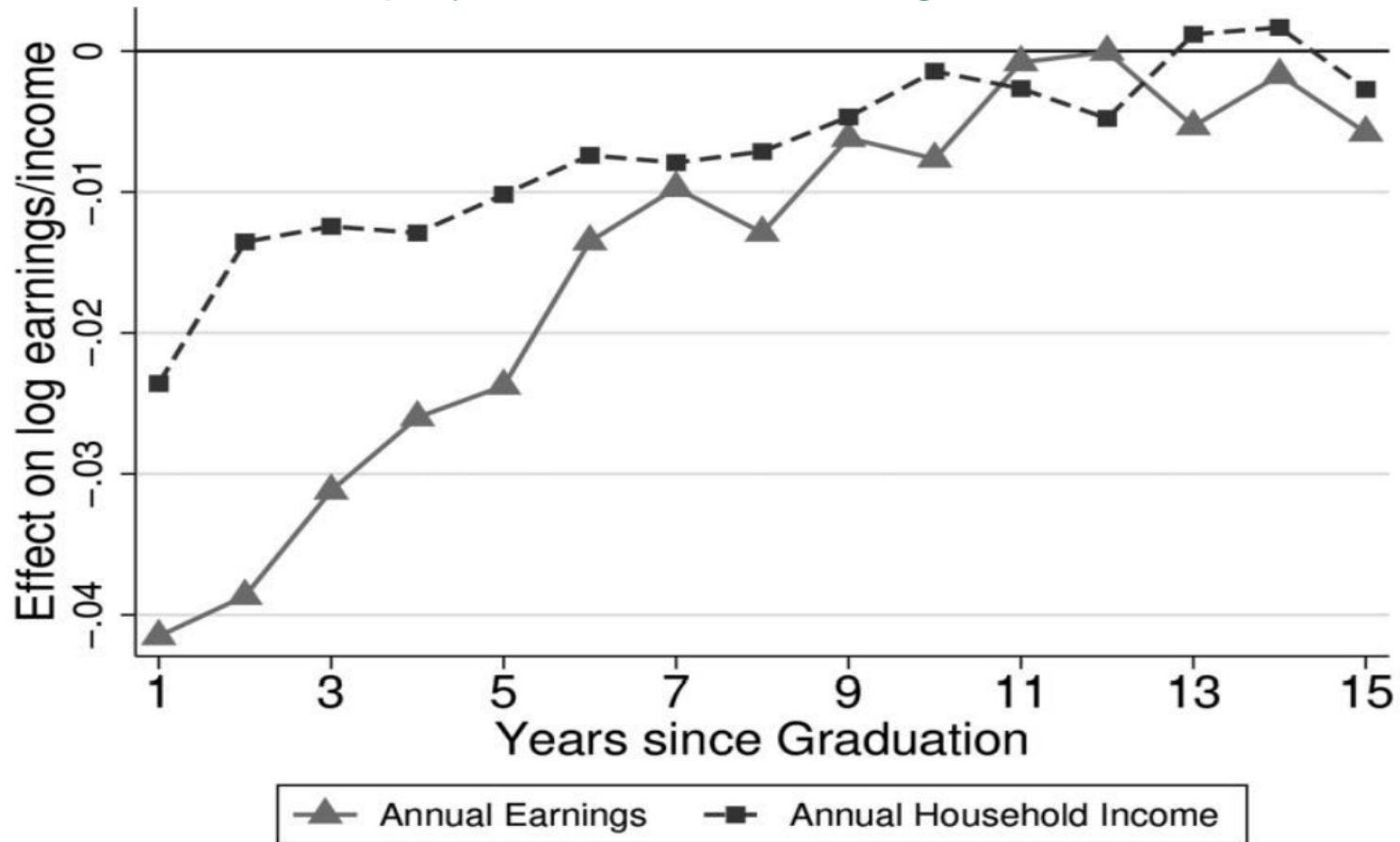
- Recessions lead to economic scarring – long-lasting damage to individuals' economic situations and the economy more broadly
- While recessions are often short-term periods of negative economic growth, they can lead to falls in long-term productivity and cause long-term harm to individuals life chances
- Why are young people so susceptible to scarring?
 - As we have seen, they are more likely to be unemployed
 - They are in the formative stage of their careers
 - There is longer time horizon for them to be impacted

Unemployment scars

- Youth unemployment harms future labour market prospects
- In the UK, De Fraja and Lemos (2019) find that:
 - “An additional month of unemployment between ages 18 and 20 permanently lowers earnings by around 1.2% per year”
- In the US, Schwandt and von Wachter (2019) show that:
 - “Labor market entrants experience persistent reductions in earnings, employment, and wages from entering the labor market in a recession that last at least 10 years”

The persistent effect on earnings and income

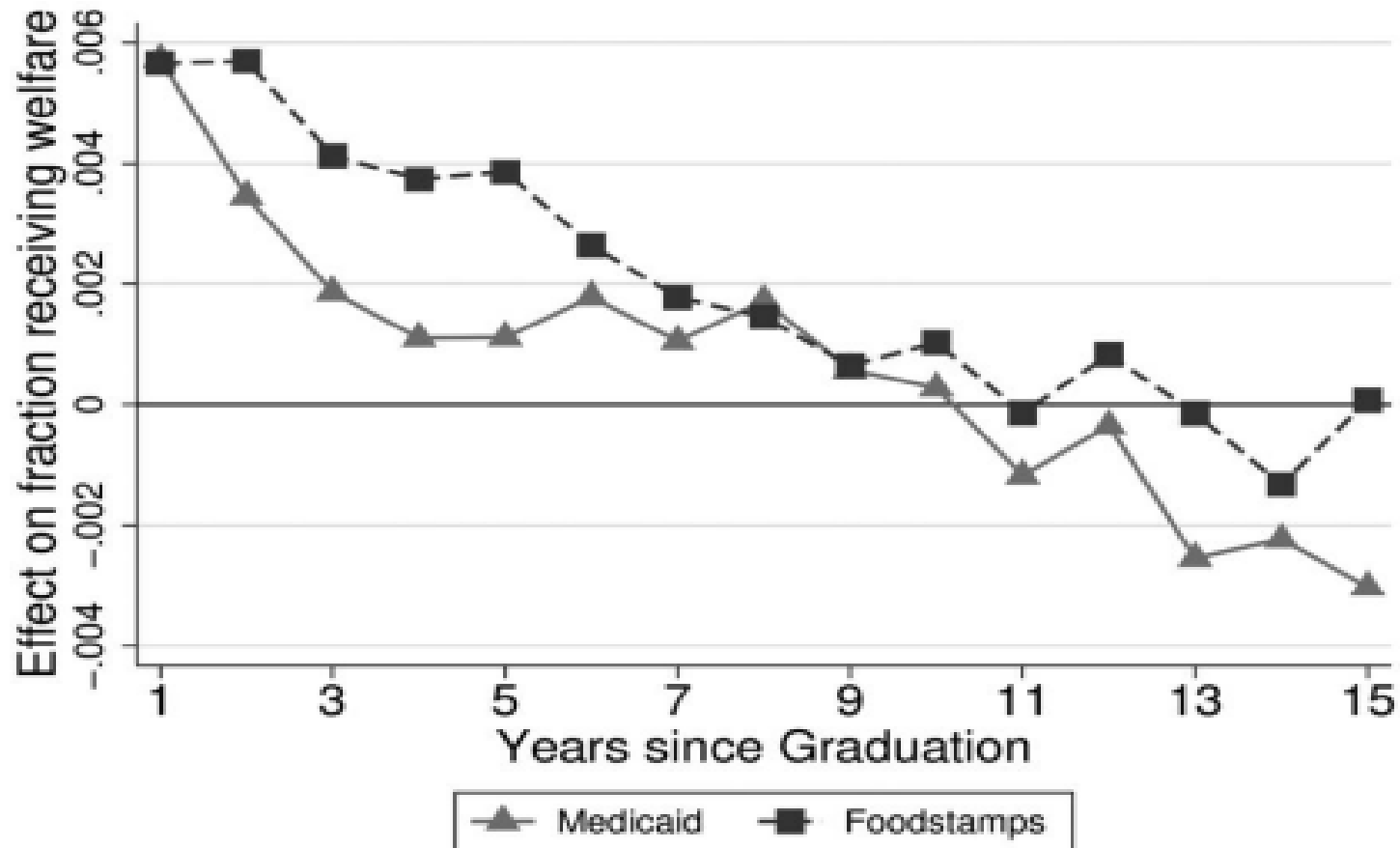
Effect of state unemployment rate on earnings and income



Source: Figure 2 from Schwandt and von Wachter (2019)

The persistent impact on claiming benefits

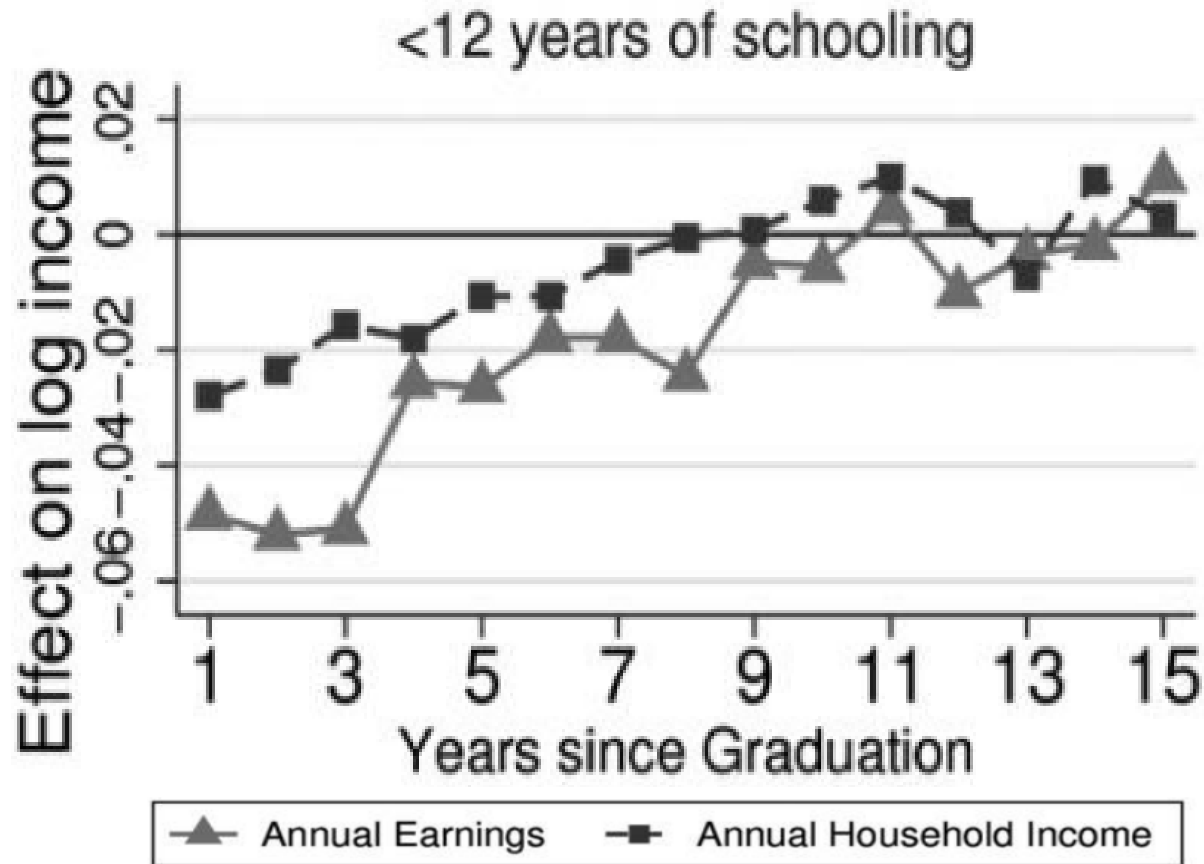
Effect of state unemployment rate on social assistance claims



Source: Figure 6 from Schwandt and von Wachter (2019)

The effects are especially high for the least-educated

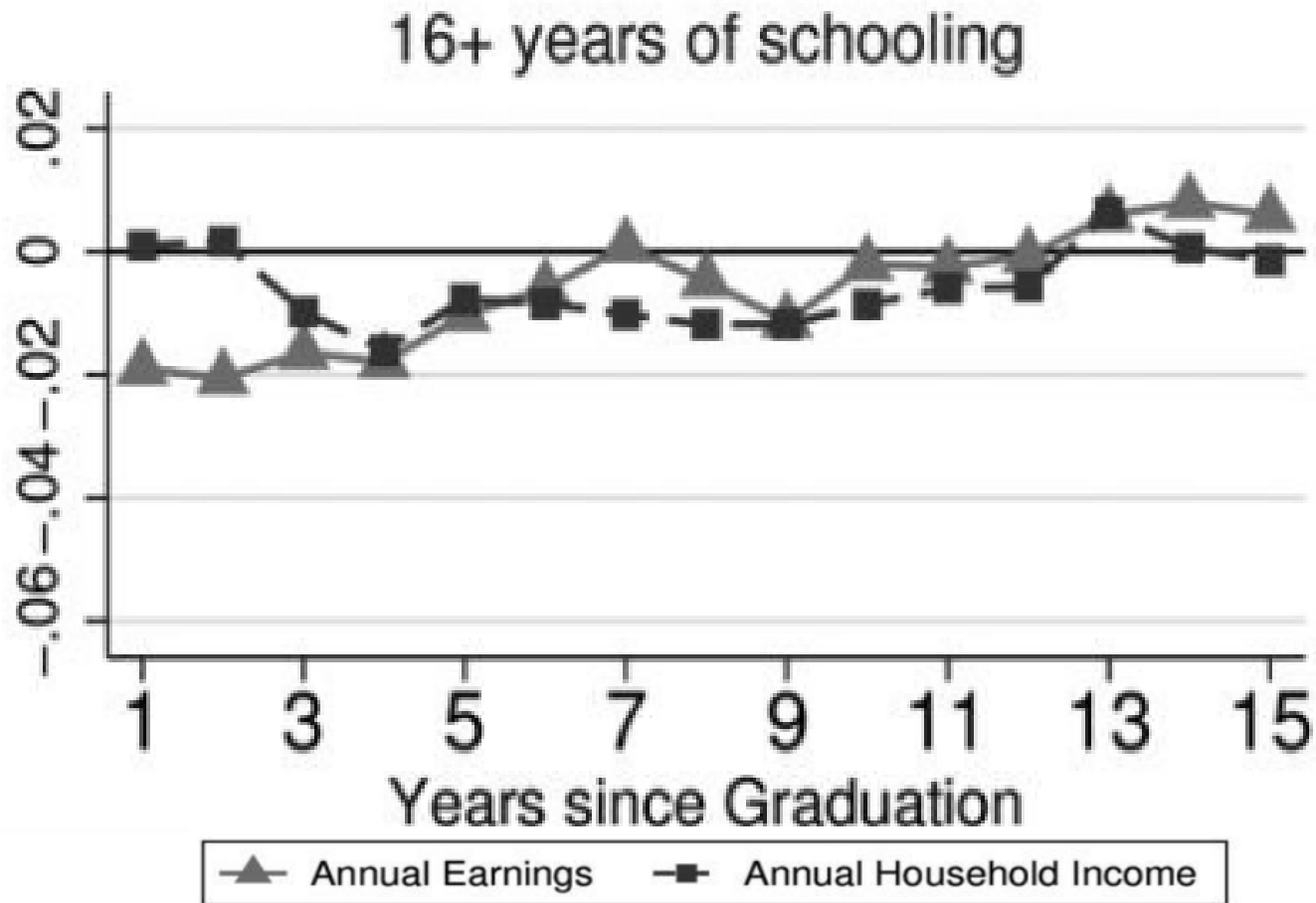
Effect of state unemployment rate on earnings and income



Source: Figure 8 from Schwandt and von Wachter (2019)

Graduates do not fare as badly

Effect of state unemployment rate on earnings and income



Source: Figure 8 from Schwandt and von Wachter (2019)

The scars are not just limited to labour market outcomes

- Lost earnings are not the only issue, there are negative effects on a range of other life outcomes

- There is evidence that people who enter the labour market during a recession fare worse in the future:
 - Higher rates of divorce and childlessness (Schwandt and von Wachter, 2020)
 - Worse physical health (ibid)
 - Worse mental health (Strandh et al, 2014)
 - More likely to commit a crime (Bell et al, 2018)
 - In general, their life chances are harmed

Why is youth unemployment so harmful?

- Periods of youth unemployment (or leaving education during a recession) have long term negative impacts
- Not only on future earnings and unemployment but on many other outcomes – ultimately it affects individuals life chances
- But why can a period of unemployment in your teens or early 20s still affect you so many years later?



Why are the effects of unemployment so persistent?

The persistent impacts of unemployment

- We have seen that there are long term negative effects, but why do the effects of early unemployment persist?

- This is a more tricky question because it requires us to uncover the underlying mechanisms

- Here we focus on the impact of unemployment on future earnings, which requires us to answer two questions:
 - 1) What explains earnings growth?
 - 2) Why does a spell of unemployment persistently harm future earnings?

How do we explain earnings growth?

- Economists use models to tell stories about what is happening in the real world

- What we need here is a model that explains earnings growth and how this is impacted by a spell of unemployment

- Two standard labour market models that could offer an explanation:
 - 1) Human capital accumulation model
 - 2) Sequential job search model

1. The human capital story

What is human capital?

- Economists use the term human capital to refer to “the knowledge and skills of workers” which contribute to their productivity
- This is a term that can encompass a lot of different things:
 - Intelligence
 - IT skills
 - Soft skills
 - Resilience
 - Charisma

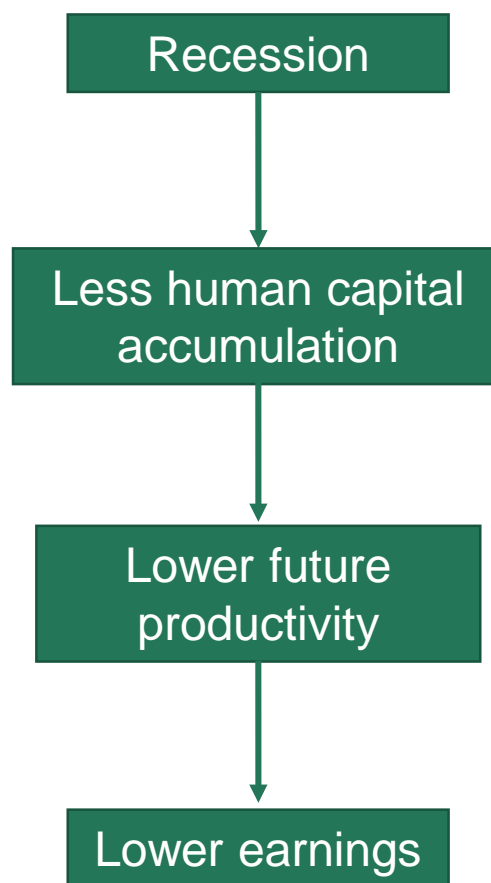
1. The human capital story

How does human capital explain earnings growth?

- We ‘build’ human capital through education, from our family, and importantly at work
- Workers - especially young workers - accumulate skills through learning-by-doing or in their job
- Over the course of your (working) life you ‘build’ more human capital, which leads to you being more productive
- This higher productivity is rewarded by higher earnings

1. The human capital story

Why does unemployment harm earnings growth?



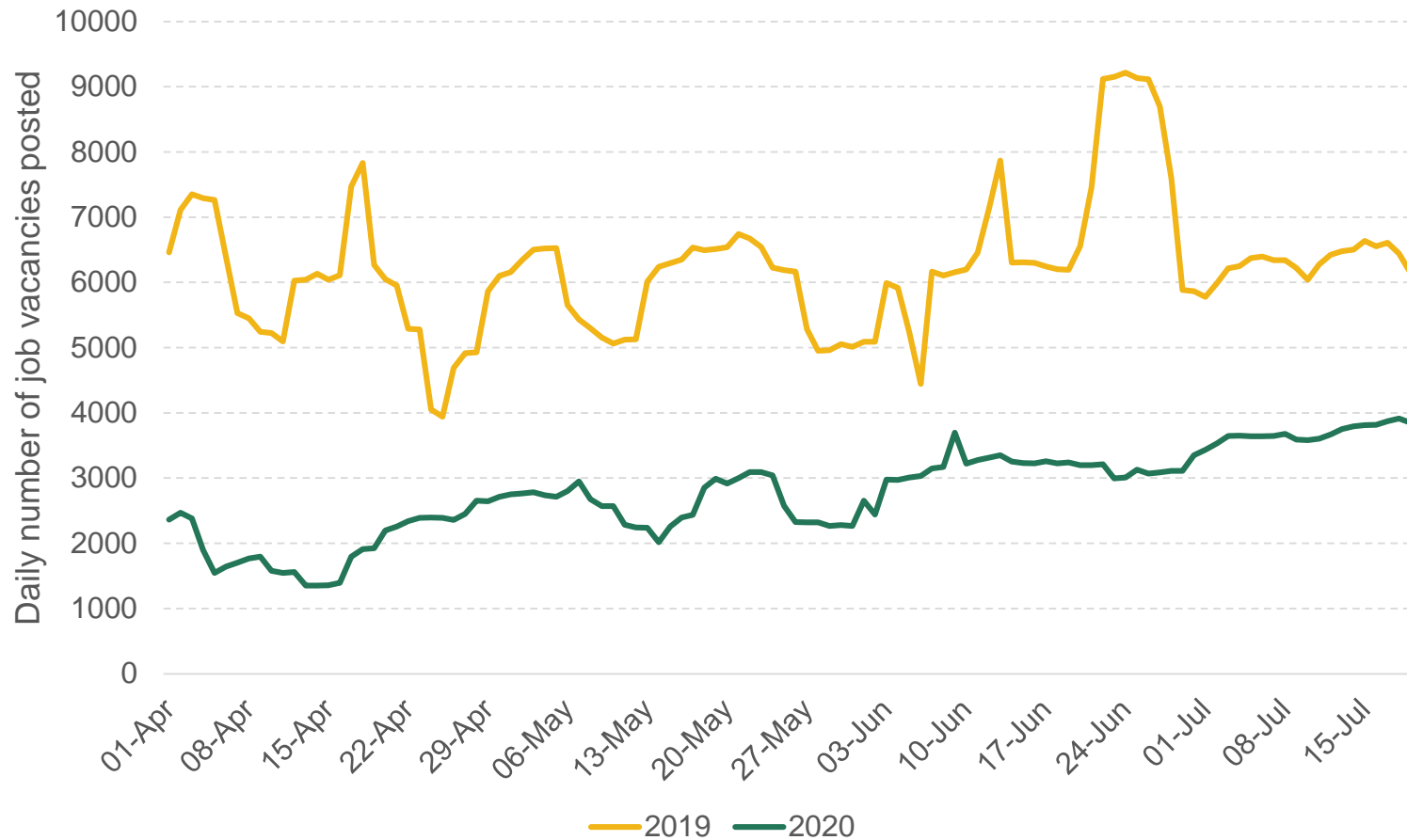
2. The job search story

How can 'job search' explain earnings growth?

- An alternative story of earnings growth is the job search model, which suggests that job search is a key driver of earnings growth
- Workers receive job offers and move jobs (especially early on in their careers)
- They move from job to job in search of higher earnings, and so earnings growth is driven by job switches

2. The job search story

Total new job vacancy postings April – July, 2019 and 2020



Source: <https://ifs.org.uk/realtimejobvacancytracker>

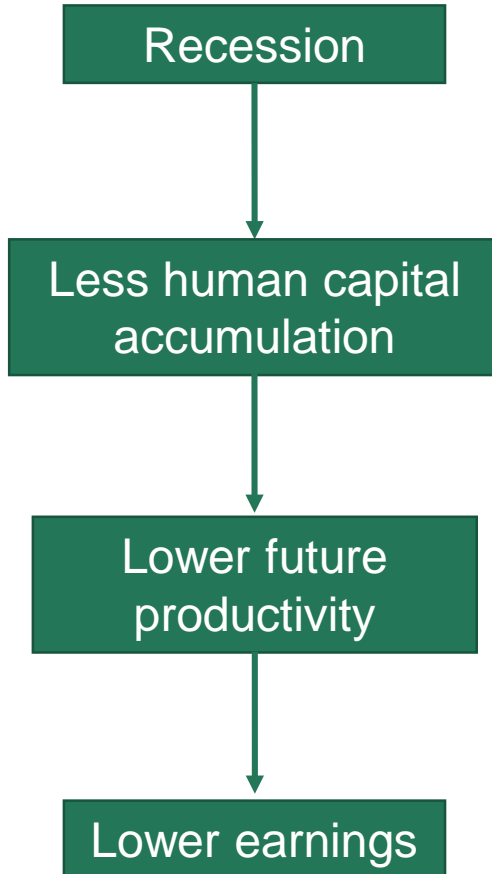
2. The job search story

Why does unemployment harm earnings growth?



The two models together

Human capital model



Job search model



Assessing the two models

- Both models seem to offer plausible explanations of why unemployment effects persist
- However, Von Wachter (2020) finds that neither model can completely explain what we see in the real world
 - The human capital model fails to explain why “even short-term exposure to adverse labor market conditions can lead to long-term effects”
 - While using the search model, “typical estimates ... [are] recovery patterns that only take three to four years”

Moving beyond these models

- Economists have not given up on trying to explain the persistent impacts of unemployment and job loss
- One approach is to combine both the human capital and search model, while others have looked at different factors, e.g. skills match
- What this highlights is that there are still important questions that economists need to answer!

Why are the effects of unemployment so persistent?

- This is a more challenging question to answer and as of yet there is no definitive answer
- Lost human capital and a decline in the ability to move to better paying jobs are part of the story but they do not provide a complete explanation
- There is still more research that needs to be done!



Why and how does the government intervene?

Is there a case for government intervention?

- Youth unemployment clearly has negative consequences but this does not necessarily mean that the government should intervene
 - Labour market interventions are often costly
 - There is the risk that government intervention could have unintended consequences

- We need to identify market failures that can be addressed

Why does the government intervene?

- There are a range of market failures related to youth unemployment:
 - Frictions in the labour market
 - Negative externalities
 - Future tax revenue
 - Crime
 - Macroeconomic concerns
 - Mitigate potential inequalities
 - Both within cohorts (educated vs less-educated) and between cohorts

How do governments intervene?

- Employment is something that is influenced by a range of factors
 - Labour market policy
 - Taxation and benefits
 - Education

- All of these factors need to be considered together by governments

- One key tool used to tackle unemployment are active labour market policies

Active labour market policies

- Active labour market policies (ALMPs) are government programmes that intervene in the labour market to help the unemployed find work
- Traditionally they have been associated with the Scandinavian vision of the welfare state (flexicurity)
 - A generous welfare state needs a pro-active labour market policy
- However, they are now common in countries across the world

Recent UK ALMPs to address unemployment

- There are three main types of ALMP, all of which have been used by the UK government in the wake of the pandemic

Type of ALMP	UK government policy
1. Public employment services, e.g. job centres	Job Entry Targeted Support (JETs)
2. Training and skills development	£3.8bn additional spending on skills
3. Employment subsidies	Kickstart scheme

The impact of active labour market policies

- In part, the different types of ALMP address the two different causes of persistent effects we highlighted
 - Human capital accumulation - Training and skills development
 - Job search - Public employment services
- While it is too early to evaluate the impact of the current set of ALMPs, effective ALMPs are well designed and targeted
- The key to their success is the extent to which they boost human capital and ease job search



Conclusion

Conclusion



- Young people are more likely to be unemployed and are especially hit hard by recessions
- This matters because unemployment has long-term impacts – not just on an individual’s career but a range of other life outcomes
- Explaining why youth unemployment has such persistent effects is a really important question that we still need to answer
- Tackling youth unemployment is a key policy priority
- Governments across the world now use ALMPs but crucially the success of these programmes depends on whether they boost human capital

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