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The UK Labour Market and the 2008 – 2009 Recession

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Abstract
The recession of 2008-2009 inflicted a larger cumulative loss of UK output than any of the other post-war recessions. Nevertheless, employment rates remained higher than might have been expected given the experience of previous recessions. The main reasons for this appear to be a combination of high firm profitability levels going into the recession, supportive monetary and fiscal policies during the recession, reductions in real producer wages and relatively buoyant real consumer wages. Unemployment had reached its lowest levels for thirty years going in to the latest recession and has also remained relatively subdued through the downturn, certainly compared to previous recessions. A combination of lower inflow rates into unemployment, allied with a relatively higher outflow rate into employment, underlie this. As government support for the economy is scaled back and productivity growth remains low, it may be that it will take a long time for employment to return to levels last seen before the recession.

JEL classification: J0 J2 J3 J6
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Introduction

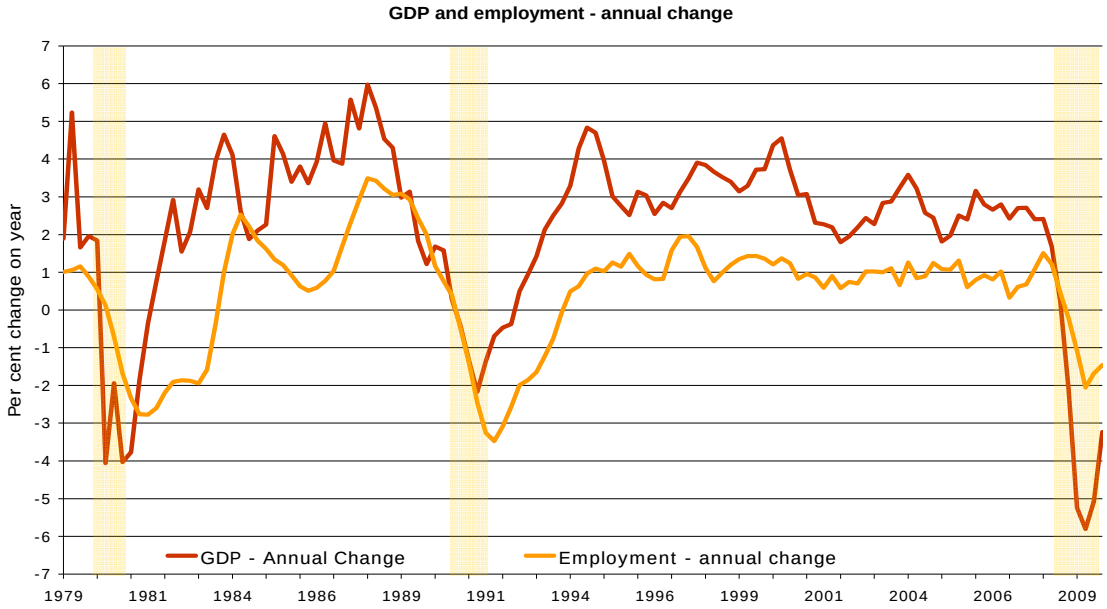
After some 15 years of near continuous job growth, the UK employment rate in the middle of 2008 stood at around 75% of the working age population, a rate broadly in line with previous employment peaks observed in 1968, 1978 or 1989. The UK had also experienced twelve years of near continuous decline in unemployment after 1993, following the double digit rates of the early 1990s and in the first half of the 1980s. Despite the predictions of some, the introduction of the National Minimum Wage in 1999 had little effect on employment over the latter half of this period. In 2005, the (OECD-based) 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 World War 2, in terms of output lost. This latest recession was notable in that it was not, unlike the previous two recessions, exacerbated by a deliberate policy of fiscal and monetary tightening to squeeze demand out of the system in order to get inflation on track. Instead, unemployment rose because of an old-fashioned collapse in demand following the bursting of a speculative financial sector bubble. Moreover, this time round there has been a deliberate larger and more rapid loosening of fiscal and monetary policy to try and offset the fall in demand. In some ways, policy makers were better prepared this time round. There had been, after all, two severe recessions well within memory of most adults over the age of thirty. The understandings that were gained under these periods undoubtedly helped frame a policy response in the latest downturn, allied with a greater willingness to intervene than in the past. This was also the first recession in which there was a raft of interventionist policies introduced by the Labour government in place, centred around the various New Deals, designed to help deal with job search effectiveness and address the problems associated with long-term unemployment and inactivity. The real test of these policies is yet to come, as long-term unemployment starts to build, typically one year after the initial shock. In what follows we focus on the immediate labour market consequences of the recession compared to previous downturns in the UK.

So was UK labour market performance during this latest recession any different? In what follows, we chart the performance of UK employment and unemployment over the recession. We then offer some explanations for the results that indicate that the impact on the UK labour market has been much less severe than many expected, given the pattern over previous recessions and the contemporaneous experience of other industrialised countries. We then assess the prospects for UK labour market over the next few years.

Employment in the Recession

During the latest recession beginning in 2008 Q2, GDP fell by over 6%, far worse than in the recessions of the 1980s or 1990s (see Figure 1), and with six quarters of falling output, it was both longer and deeper than the previous two. In the 1980 recession, the percentage fall in employment was broadly in line with the percentage fall in GDP. In the 1990s, the relative fall in the employment rate fall in the 1990s was somewhat larger than the percentage decline in GDP, (see Figure 1). Moreover, in the previous two recessions (see Figure 2), the fall in employment was only halted some 12 to 14 quarters after the onset of recession. Employment also remained below its before-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.

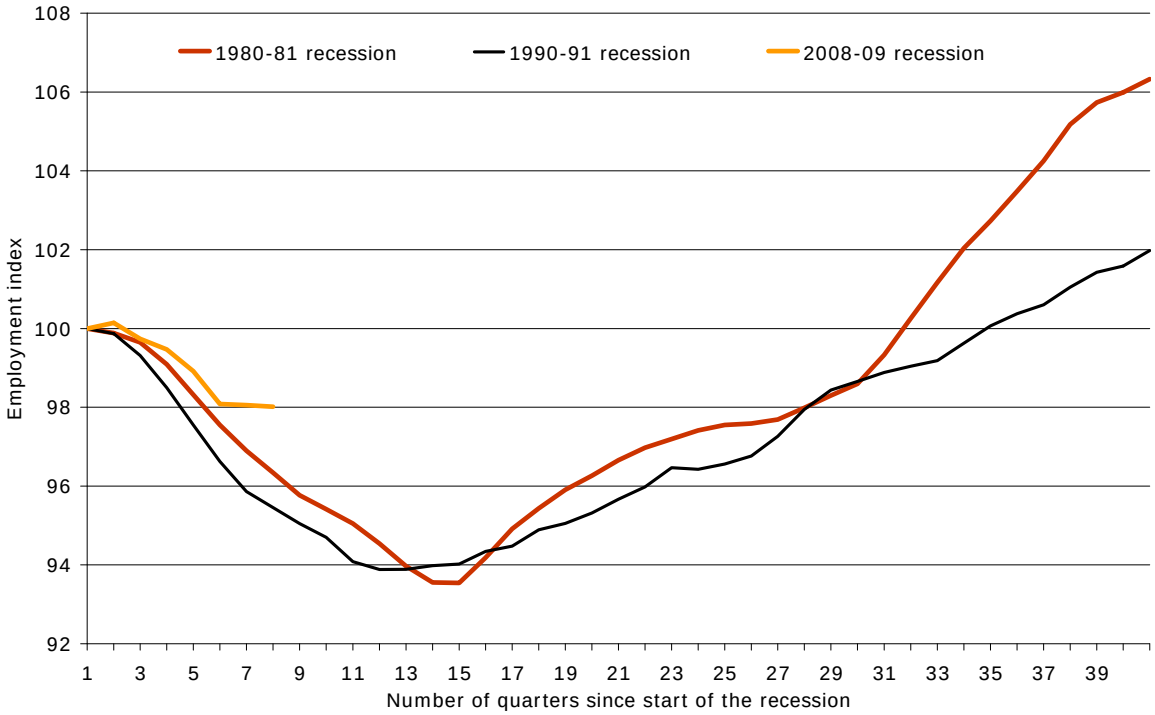
Figure 1: Annual Change in Employment and GDP 1979-2009



Source: LFS, ONS. http://www.statistics.gov.uk/pdfdir/gdp0410.pdf

However, the latest recession was strikingly different. Whilst fall in GDP fall was markedly worse than in past recessions, the loss of employment was much smaller, some 3% of the initial level and the period over which employment fell was much shorter than in the past (Figure 2). This is notable, but could it be misleading?

Figure 2: Employment levels from the Start of Recession



Source: ONS. Index at Start of Recession = 100 for 1979Q4, 1990 Q2 and 2008 Q1 respectively

To understand the factors that have influenced the preservation of jobs through the recession it is worth considering what we know about firms' workforce strategies. Experienced staff are valuable to firms, they have firm-specific knowledge. Losing valuable staff knowledge is costly, particularly if it will be needed again in the near future (see Geroski and Gregg, 1997, on the evidence for this over the 1990s recession). So firms will hold labour where possible through a recession, preferring instead to take short-term hits on profitability. However, if a firm is in deep financial trouble such longer-term planning is discounted and the firm will take emergency measures to cut costs and improve cash flow. This means job cuts, as equivalent cost reductions made through dramatic wage cuts are difficult to implement quickly. So a large part of the story of employment through the recession is shaped by the extent to which firms are in a battle for survival rather than adjusting to, temporarily, lower demand.

One potential problem with the estimates of numbers in employment concerns recent immigrants, particularly migrants from the accession countries of Eastern Europe, (the A8). Migrants from the A8 are not covered by the government's recently introduced points-based immigration system and hence not monitored in the same way. This lead some commentators to suggest that A8 workers were underestimated in the official employment numbers. So if unmeasured A8 migrants returned home in large numbers in response to the recession, this could, conceivably, generate a smaller decline in employment in the official data than would be the case if all those in employment were measured in the official statistics. The employment numbers in Figure 1 are derived from the Labour Force Survey, (LFS), a survey of households. It is possible that recent migrants living in temporary accommodation, on building sites or farms may not be sampled by the LFS. However there are a number of reasons to think that emigration is not a major factor behind the moderate fall in employment.

First, an alternative data source on employment, the workforce job series, which derives employment data based on surveys of firms, shows a similar pattern to that given by the LFS. Second, whilst the numbers of new migrants did fall back after 2006, until recently the stock of migrants in the workforce was still rising until 2009, suggesting that the duration of stay was also rising. It is also not obvious why immigrants to the UK would return to the source country if relative job prospects in the source country are worse, as they currently appear to be in many A8 countries. Rising unemployment rates and depreciating home currencies in 2009, relative to the pound, combined to reduce the relative returns to returning. Thirdly there is a question of scale. The number of jobs saved so far relative to what might be expected by the drop in GDP, amounts to some 1 million, (3.5% of employment). If however 1 million jobs had been lost but obscured by immigration, the scale of hidden migration would have to be huge and this is highly unlikely. (For example a 10% job loss centred exclusively on immigrants would require 10 million hidden immigrants to generate a 1 million fall in employment). Moreover the recession would have to be centred on sectors that employ migrants and there is little evidence that this is the case. In short, it is unlikely that mis-measurement of immigration underlies the smaller than expected fall in employment.

Accounting for the Behaviour of Employment

So if an estimated net 1 million jobs appear to have been preserved, how has this happened? The first point to consider is how widespread across countries this pattern has been and whether it is related to institutional differences across countries. Table 1 shows that countries like 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. Whilst in the US,

Spain and Ireland, the rise in unemployment exceeded the fall in output. However there are a large number of countries with smaller than expected employment falls. Some of these countries 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. Similar employment subsidy schemes are operating in Italy, the Netherlands and Japan.

Table 1: The Percentage Change in GDP and Unemployment Across Selected Countries Over the Recession

	% Change in GDP 2008 Q1-2009 Q2	% 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	-5.8	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		
US	-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

Source: OECD.

The UK is one of a smaller number of countries to have experienced relatively small employment losses without a deliberate government funded strategy of short hours working. Does this mean then that the putative flexible labour market in the UK helped by facilitating adjustment in hours or wages instead of jobs? It is important to note that the low employment loss countries are not those regarded as having flexible labour markets. The US 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 employment protection levels and relatively good employment records over their recessions. In short, there is no relationship between a country's degree of labour market flexibility and employment losses in this recession.

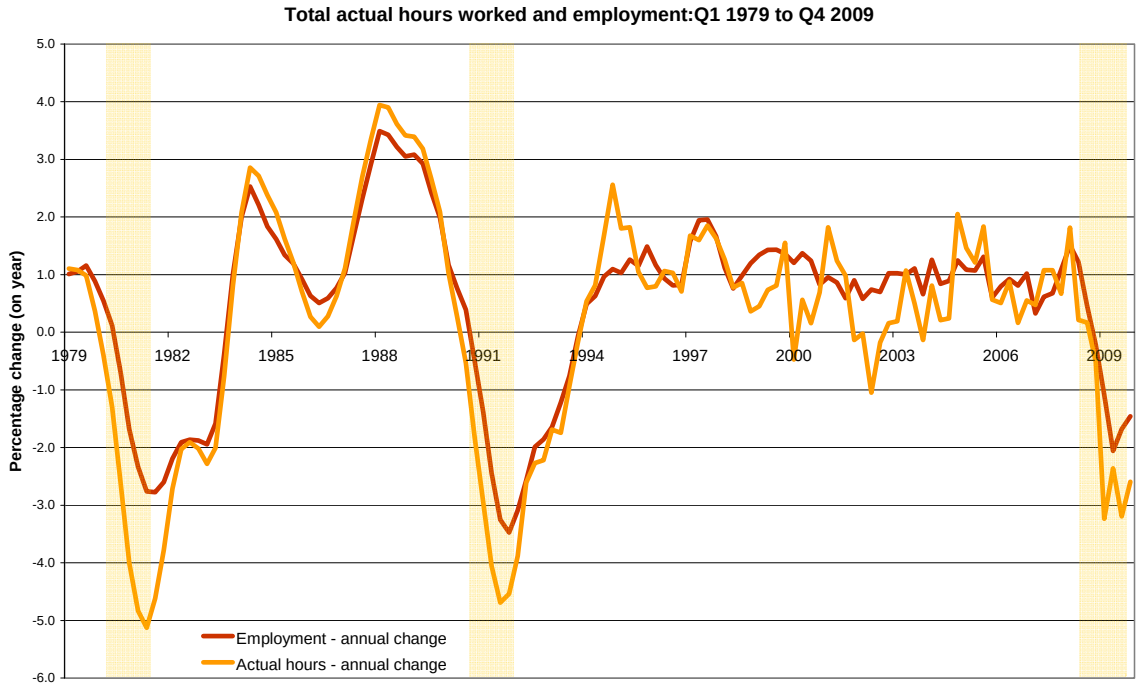
One broad accounting identity, which goes back to Okun, attributes changes in output to changes in output per worker (productivity), average hours, the employment rate and the

participation rate.[1] While this takes no direct account of the role of changes in wages or prices, it is useful to look at each of these components in turn.

Hours of work

It is typical in recessions for total hours to fall faster than employment. Overtime working is often cut first, some workers are placed on short time working and others move into part-time work when they struggle to find full-time jobs. Figure 3 gives the annual change in employment across the last three recessions (as in Figure 1) and adds the change in total hours worked. The difference between the fall in total hours and employment then reflects what is happening to average hours. Hours did fall in this recession, by around 2%, but less so than in the last two recessions, especially during the 1980s when the government did subsidise short-time working in many major manufacturing plants and hours fell by around 4%.

Figure 3: Annual Percentage Change in Employment and Hours 1979-2009



Source: LFS, ONS.

Part-time working rose from around 16% of employment in 1980 (excluding students) to 22% in 1995, after which it has been broadly stable. The share of part-time working has

[1] One variant of Okun's Law is that $Y = \frac{Y}{H} * \frac{H}{E} * \frac{E}{L} * \frac{L}{N} * N$ where Y is output, Y/H is output per hour worked, H/E = average hours per worker, E/L is the employment rate (as a fraction of the labour force, L) and L/N is the participation rate. In principle this accounting identity could be amended to incorporate wages. The decomposition suggests that much of the output fall can be accounted for almost equally by falling productivity, average hours and the employment rate.

risen during this recession, consistent with the fall in hours above. However this pattern is not unique to this recession. Similar or sharper rises in the share of part-time work can be found during the last two recessions. The part-time job share tends to stabilise when employment recovers to before-recession levels.

One explanation for differential employment performance across countries over the recession, is that the shock of the recession hit sectors with different capital intensities or productivity differentials by differing amounts across countries. A high productivity, high capital intensity sector, subject to a negative shock is likely to experience a sharper fall in output than employment. Figure 4, which shows employment indexed for the beginning of the recession across major industry groupings and Table 2 indicate that, in the UK, the manufacturing sector, once again experienced the sharpest percentage fall in employment over the latest recession, as in previous recessions, (in contrast to the financial sector, the source of the recession). Manufacturing and construction have been hardest hit with 8 to 10% of employment lost compared to services at under 2%. Since high productivity manufacturing experienced the largest employment loss, it is unlikely that the simple shock to a high productivity story explains much of what we have observed in the UK. However, within the service sector there is considerable variation. In the public services of education, health and administration employment has grown by 4%, and employment has fallen by around 4% in finance retail (and transport). While these rates are well below construction and manufacturing as proportionate declines, because these latter sectors are larger, they account for around half of the total jobs lost.

Table 2: Sectoral Trends in Employment

	1979-83	1983-90	1990-93	1993-2007	2008Q2-2009Q4
% Δ Employment	-7.3	+15.0	-6.3	+15.6	-2.9
% Δ Manufacturing	-21.5	-5.6	-16.7	-27.8	-9.7
% Δ Finance	+3.7	+45.4	-1.5	+51.7	-4.3
% Δ Construction	-9.2	+35.2	-20.6	+18.9	-8.2
% Δ Retail, Hospitality	-3.9	+20.7	-3.6	+12.8	-3.9
% Δ Public Admin.	0	+13.8	+1.5	+21.9	+3.5

Source: Workforce jobs series ONS. Authors' calculations.

Figure 4a: Employment Index from 2008q1 for Major Industry Groupings

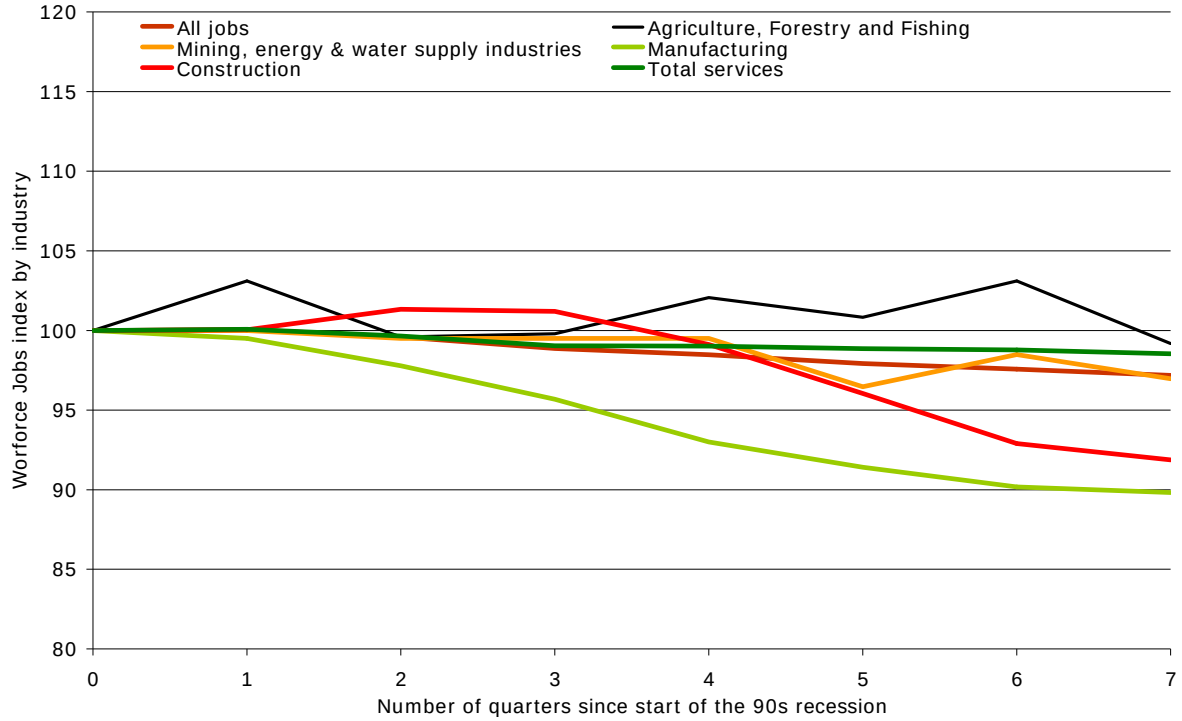
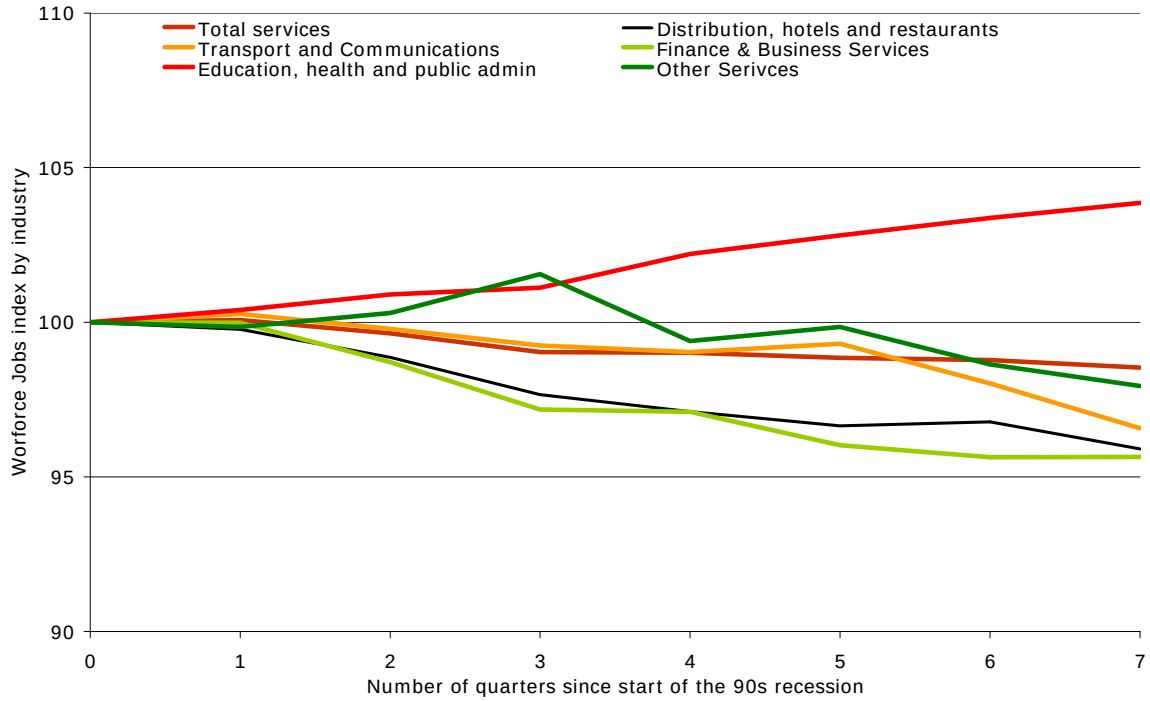
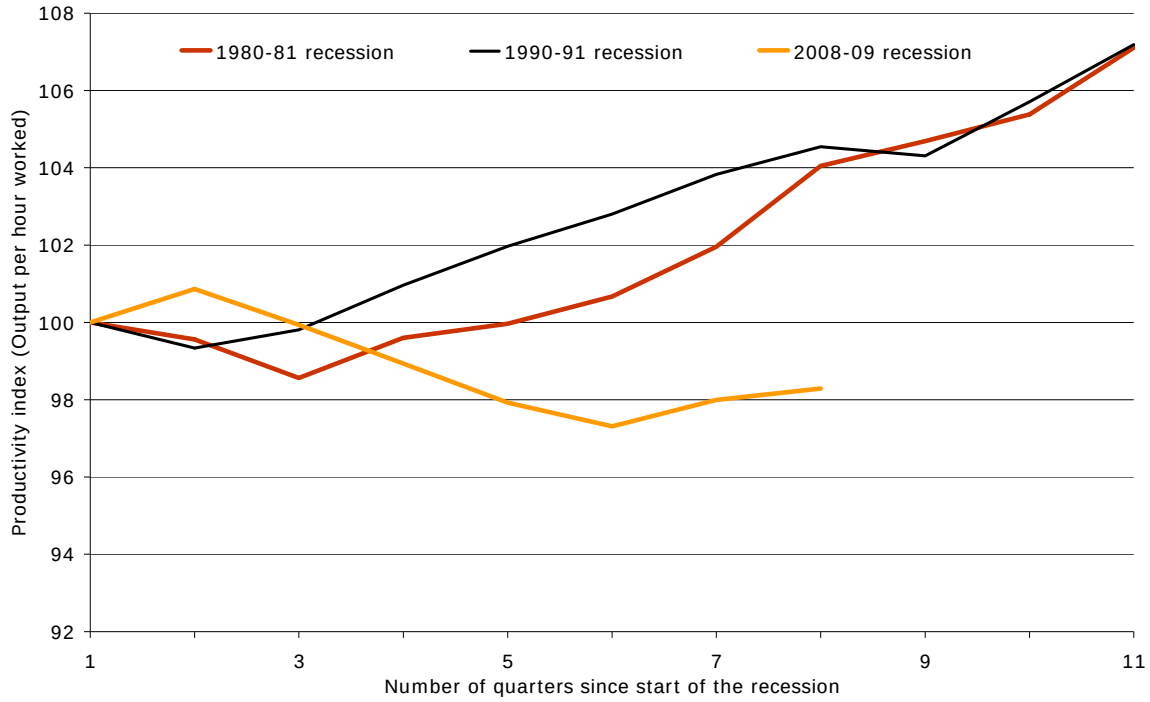


Figure 4b: Employment Index from 2008q1 for Major Service Sector Groupings



Since UK output fell much faster than employment or hours worked, then productivity also fell sharply. Figure 5 shows that productivity fell by around 2% during 2008-2009, further and more protracted than in previous downturns.

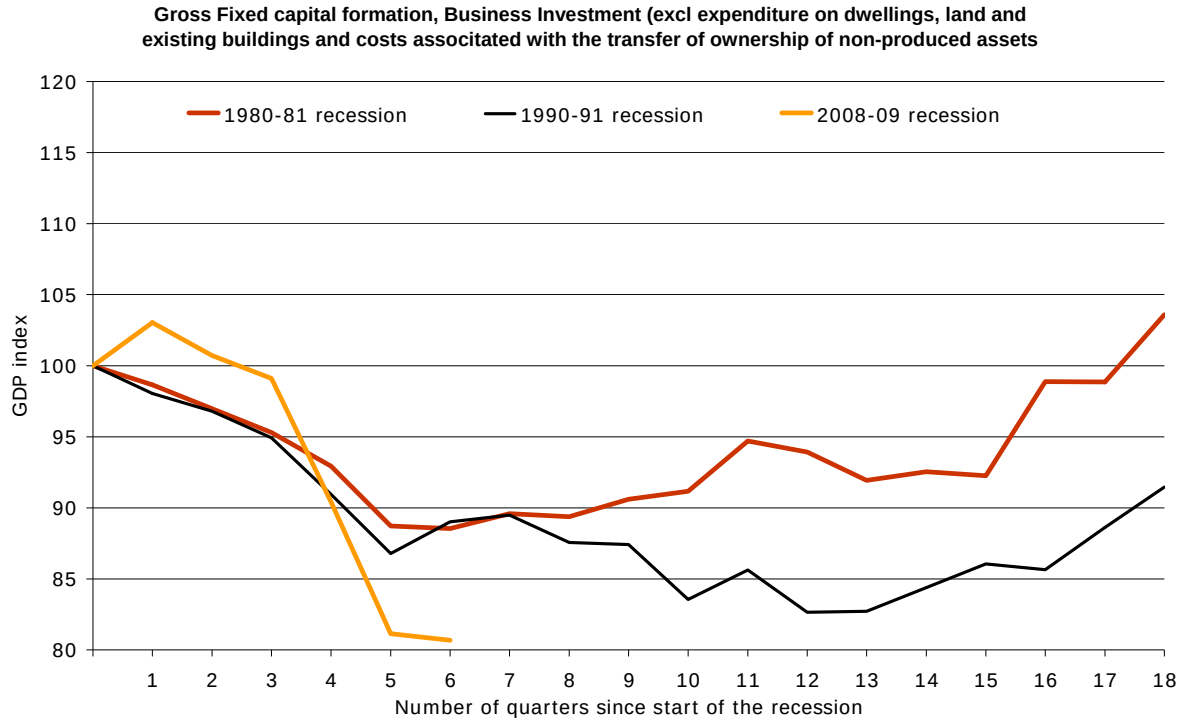
Figure 5: Productivity Levels from the Start of Recession for the 1980s, 1990s and 2008/09 recessions.



Source: ONS. Index at Start of Recession = 100 for 1979Q4, 1990 Q2 and 2008 Q1 respectively.

This fall in productivity was supported by a sharper collapse in business investment in the latest recession compared to earlier downturns, perhaps reflecting the shortage of capital available from banks in the credit crunch (see Figure 6). The collapse of investment will undoubtedly have contributed to the depth of the recession and to lower productivity growth.

Figure 6: Investment Levels from the Start of Recession for the 1980s, 1990s and 2008/09 recessions.

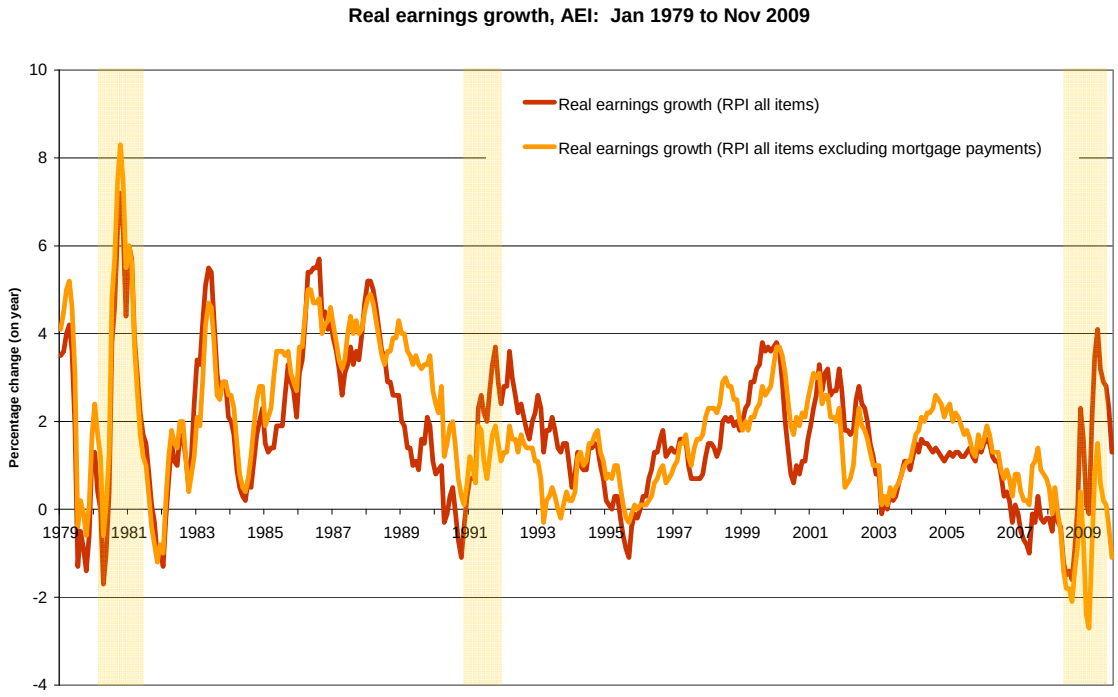


Source: ONS. Index at Start of Recession = 100 for 1979Q4, 1990 Q2 and 2008 Q1 respectively.

Real wages

Over the last fifty years, productivity growth has allowed real wages to grow by around 2% a year, on average but falling productivity puts downward pressure on wages. Squeezing *real* wage costs during a recession is not as straightforward as it seems, as pointed out by Keynes. Price inflation also tends to fall during downturns so offsetting any moderation in nominal wage growth. Furthermore, wages are a major driver of consumer spending and squeezing the earnings of consumers and hence demand makes stabilising output harder. While real wage estimates over the cycle will be affected by composition effects – more low paid workers are likely to lose jobs in a recession – Figure 7 shows the patterns for real wage growth including and excluding the impact of mortgage interest rates. It thus captures the growth of real wages from the perspective of firms (excluding mortgage rates) and consumers (including mortgage rates). In all three recessions, both prices and nominal wage growth slowed sharply. In the latest recession real consumer wages rose quite markedly, as mortgage rates were cut following the slackening of monetary policy to accommodate the fallout from the crisis in the financial sector and Vat was temporarily reduced to 15%. However, real wage growth *to firms* fell to around 3%. This gap between consumer wage growth and that faced by producers will have undoubtedly helped firms cope, while sustaining demand.

Figure 7: Real Wage Growth (with and without mortgage interest rates)



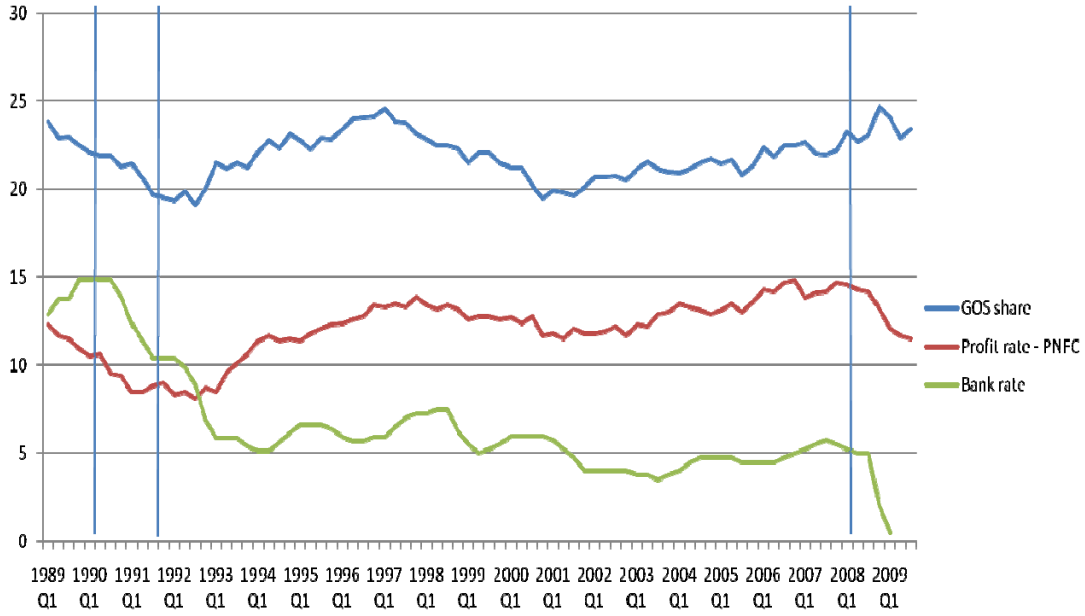
Source: Labour Force Survey, ONS.

Profits

In the 1990s recession, profitability was already being squeezed ahead of the recession proper, as interest rates were set high to bear down on inflation, (Figure 8). By contrast this time, profits were much higher immediately prior to the recession. This means that the immediate pressure on firms to cuts jobs in order to survive was reduced. Since then, profitability held up well through the recession. Indeed profits as a share of GDP rose during the recession. This is in part due to lower interest rates making financing debt easier; partly due to the fall in the exchange rate, unlike in the 1990s when membership of the ERM precluded devaluation; partly due to rapid falls in real wages and partly due to the maintenance of spending in the economy. The fall in the wage share over the recession means that real (producer) wages were falling faster than productivity over this period.[2]

[2] Since the wage share is given by $\frac{wE}{PY} = \frac{w/P}{Y/E}$ where w is the nominal wage, E employment, P pries and Y (nominal) output then falling wage share suggests that real wages are falling faster than productivity.

Figure 8: Rate of Return on Capital (Profit Rate), Profits as a Share of GDP and Bank of England Base Interest Rate, 1989-2009

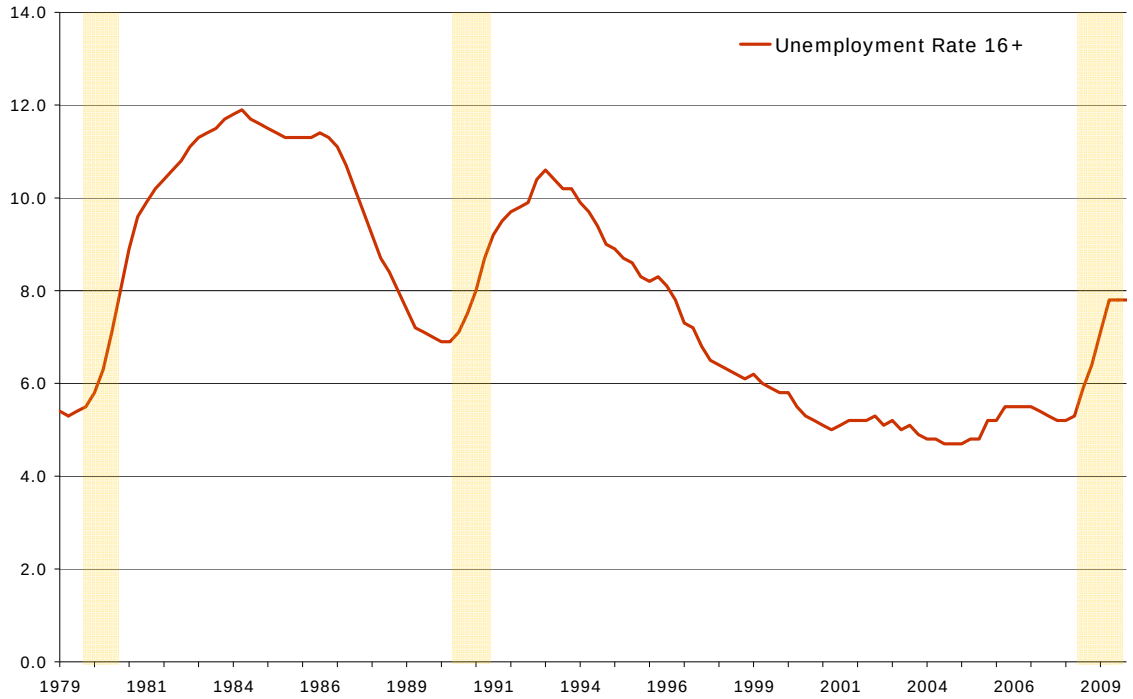


Source: ONS. Note: GOS=Gross Operating Surplus (the profit share).

Unemployment and the Recession

As with employment, the rise in (ILO/OECD) unemployment this time around has been small relative to the fall in GDP. Following the 1980 recession, unemployment rose for some 5 years after the recession end, reaching a peak of 12% in 1986, (Figure 9). In the 1990s, unemployment took three years to reach its height following the 1990 recession and while still in excess of 10% was lower than in the 1980s. In this recession the rise in unemployment was sharp, but, significantly, appears to have stabilised much earlier, even before the recession had ended.

Figure 9: The ILO Unemployment Rate for UK 1979-2009

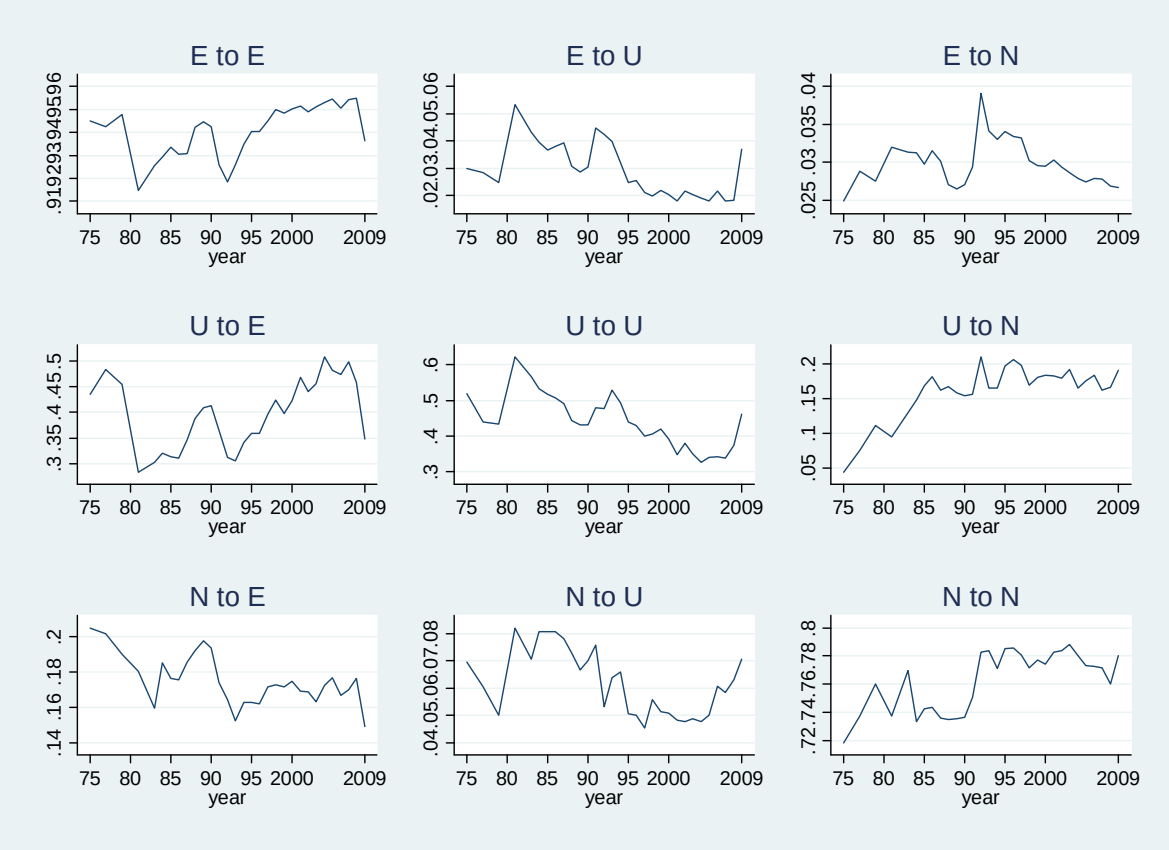


Source: ONS.

Figure 10 documents the flows that shape the stocks of unemployment, employment and inactivity, all measured on the ILO/OECD definition. The top left row gives the flow out of employment. It is clear that the employment outflows in this recession were lower than in previous recessions, with 96% of those in work staying in work through the year compared to 92% in the last two recessions. Similarly the outflow from unemployment into employment remained higher this time round than in the past downturns, with 35% of those unemployed getting work compared to 30% in previous recessions. As a result, the duration of unemployment, captured by the U-to-U flow, in row 2 of Figure 10, remained lower than in previous downturns. The numbers flowing into economic inactivity, E to N and U to N, have been falling or stable in recent years. Outflows from inactivity into unemployment have risen in recent years, perhaps as a result of schemes like the New Deals for Lone Parents, Disabled People and 50+, which are all aimed at bringing groups with high rates of economic inactivity back into the labour force. The Working Tax Credit schemes expanded and augmented under Labour, aimed at making hitherto low paid jobs more attractive to the unemployed, may also have helped maintain flows into employment. However outflows from inactivity into employment are as low in this recession as in previous ones.

The net result of all these flows is that lower unemployment in this recession has been driven by a combination of lower rates of job loss and slightly higher return rates to work than in past recessions.

Figure 10: Inflows and Outflow Rates Across Employment, Unemployment and Inactivity



Source: LFS. Note charts show annual transition rates between employment, (E), unemployment, (U) and inactivity (N), for population of working age excluding students.

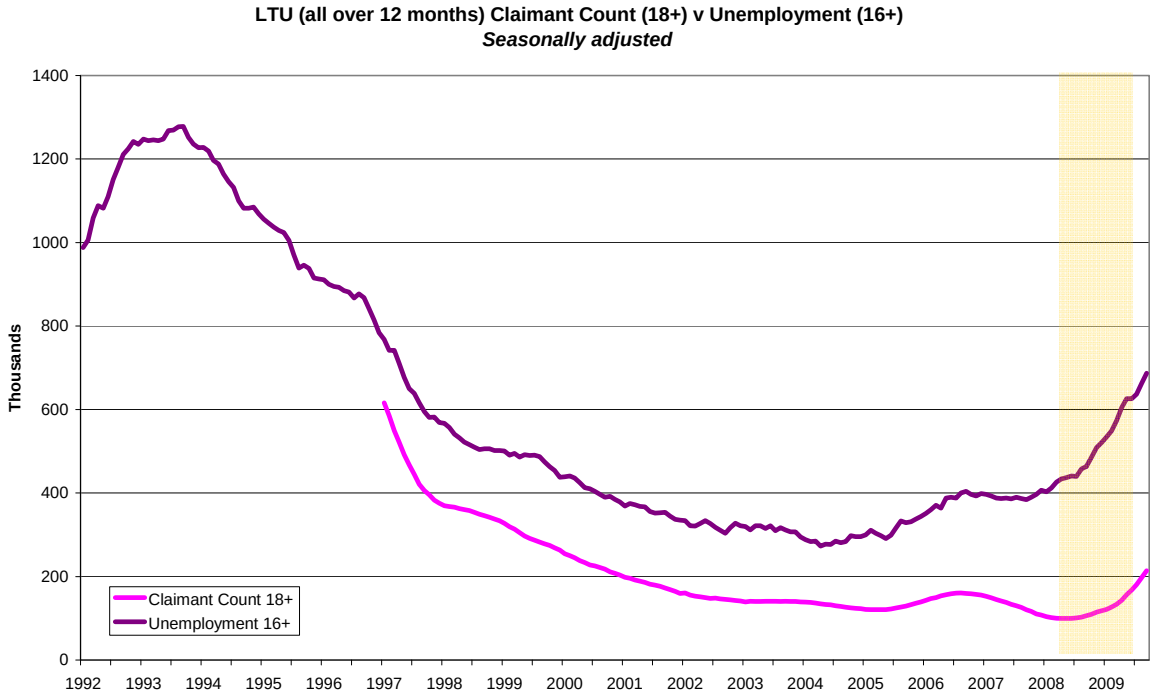
Long-term unemployment

In any 3 month window, some 1 million people move into work and 1 million stop working. In a recession there are small but important shifts in these patterns. An additional 100,000 individuals lose work each quarter and 50,000 fewer gain work, leading to unemployment rising by 50,000 a month or so. What shifts more markedly is that vacancies are filled much faster. Indeed the numbers of unfilled vacancies, registered at Job Centres, have fallen from around 700 to 430 thousand over the latest recession. More competition for fewer jobs means that it takes longer for any one person to get a job. Inflows into unemployment drive initial rises in unemployment, so that the stock is dominated by short-term unemployed. As the recession continues and job prospects and hiring stagnate, so long-term unemployment tends to rise.

Long-term unemployment typically begins to rise around one year after the initial rise in total unemployment and may often continue to rise even when the total unemployment first starts to fall again. In previous recessions, LFS-based long-term unemployment (12 months spell or longer), reached 1.2 million, some 40% of the unemployed. Long-term unemployment is starting to rise again this time and had reached 700,000 or 25% of the workforce by early 2010, still much lower than in the past. The numbers of long-term claimants for unemployment benefits (JSA) tends to be lower than the numbers saying they have not worked in the last year (LFS), (see Figure 11). Since the New Deal schemes were

introduced this gap has widened sharply. As a result, the numbers who have claimed JSA for over a year remains very low in this recession. With the government intervention programmes in place the latter should remain relatively low.

Figure 11: Long-Term Unemployment (ILO and Claimant Count)

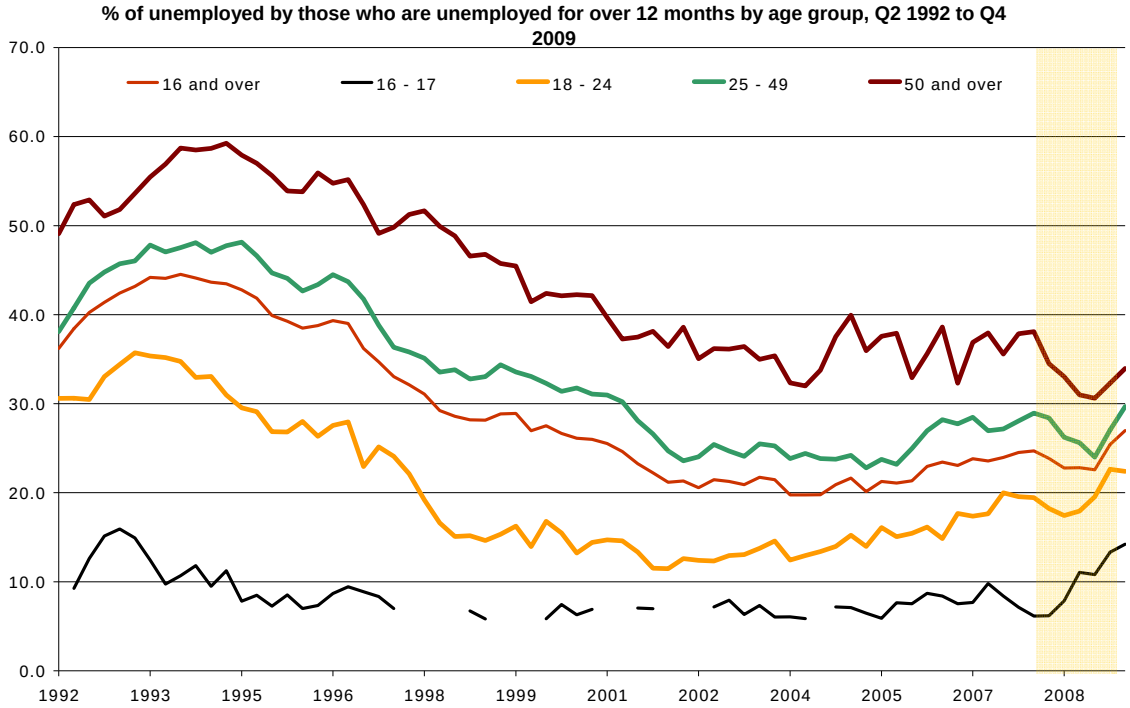


Source: ONS.

The experience of unemployment is also far from even in the population. Unemployment has always varied by factors like age, education, gender, ethnicity and region. Often the combination of these characteristics acts to make job prospects rather bleak for a significant minority. In good times, relative prospects tend to improve for these most disadvantaged groups. In bad times, relative prospects for the most disadvantaged worsen.

Disadvantage amongst the young has been a long standing feature of the labour market. As a general rule of thumb, the youth unemployment rate is always double the adult rate. However younger workers, as Figure 12 shows, typically have much shorter spells of unemployment than others. So while the risk of unemployment is higher among the young, so are the chances of escaping it. There are however recent concerns that, for some youths, the chances of escaping unemployment are not that high. Unemployment rates among less educated young people in the latest recession were well above those of previous recessions, whilst the situation for older workers is much better. In this recession, youth unemployment rates are nearer three times that of prime age adults, rather than double as in the past. The share of long-term unemployed among younger workers in 2009 was much closer to the share among older workers than in the past. This development looks set to be to be a cause for concern over the next few years.

Figure 12: Long-Term Unemployment by Age

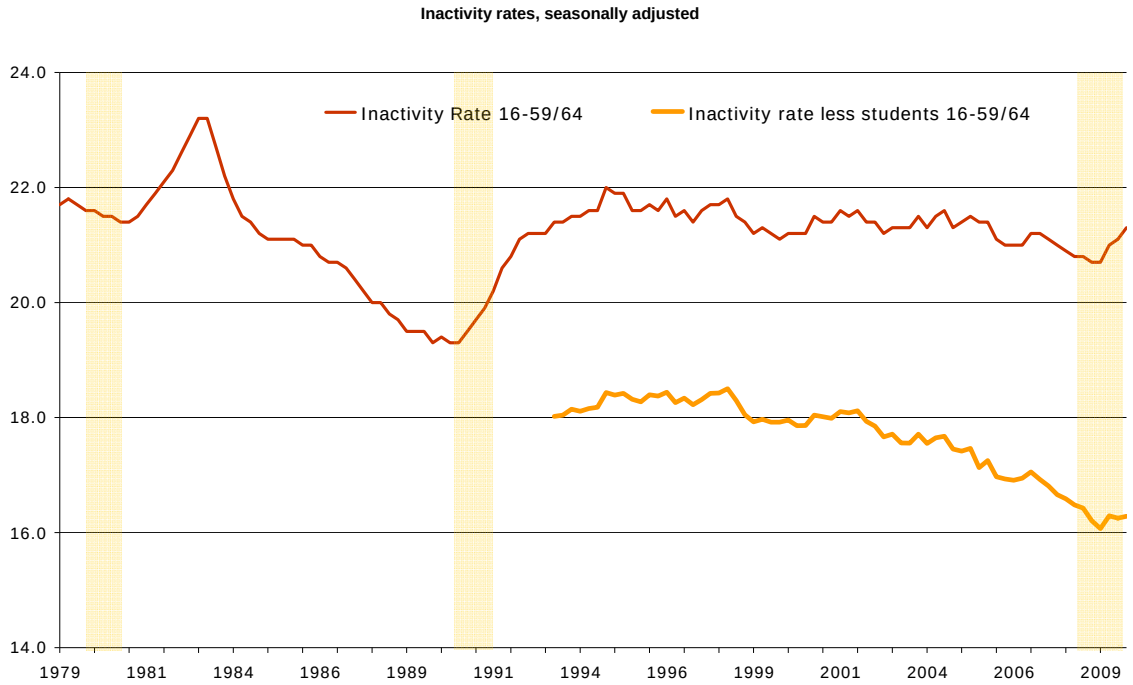


Source: LFS.

Inactivity

Only a minority of those not working at any point in time are unemployed. It is more common for people not working to be not actively seeking a job. It is also true that unemployment can fall both because individuals find work and because they become economically inactive. The main categories of inactivity are students, sickness, early retirement or looking after children. Inactivity normally rises in a recession, typically lagging behind movement in the unemployment rate by about a year. This can be viewed as a response to the recession, though the fact that, as Figure 13 shows, inactivity responds with a lag suggests that changes in the participation rate do not account for much of the fall in GDP. Some people losing work don't seek or are unable to find a fresh job. Others take early retirement because of this. For others there is a move from, often long-term, unemployment into sickness related inactivity. In some respects, for some, this latter movement has proved akin to an extended spell of what is effectively long-term unemployment. Figure 13 shows the proportion of the working age population who are economically inactive since 1979. The long-term average is for about 22% of the adult population to be neither working or actively looking for work. In each of the last two recessions the inactivity rate rose by around 2 percentage points. The rise in the latest recession has been more modest, but, on the basis of past experience, might be expected to increase later in the cycle.

Figure 13: Economic Inactivity 1975-2010 Including and Excluding Full-time Students

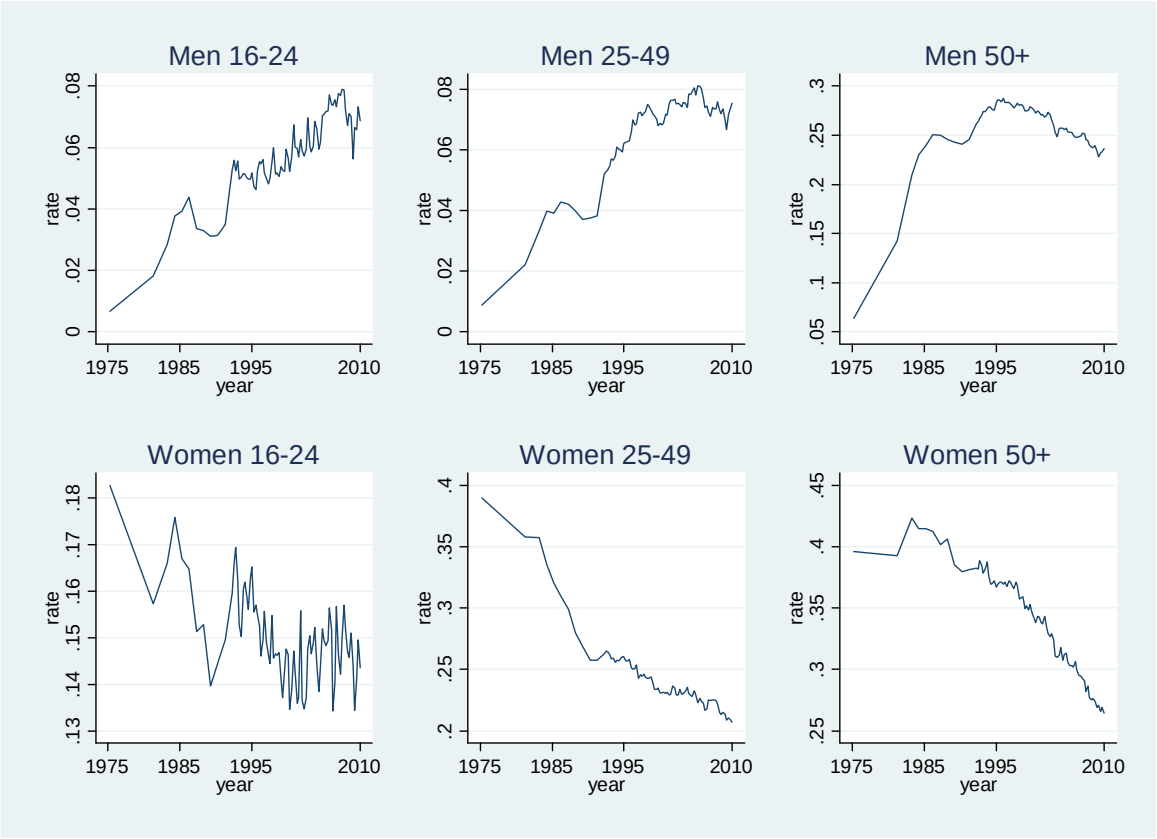


Source: LFS, ONS.

One major development worthy of note is the increase in numbers of young people staying on in both further and higher education. Staying on-rates have risen in past recessions and the latest downturn has also seen a substantial rise. The second line on Figure 13 tracks the inactivity rate excluding full-time students. On this basis, economic inactivity has falling steadily, by around 2 percentage points, since the aftermath of the 1990s recession. In 2009 there were just over 16% of the adult population neither economically active nor in full-time education, the lowest rate for over thirty years. The figure also makes clear that the small rise in inactivity observed in this recession has, so far, been mainly due to increased participation in education.

However the news is not all good. The composition of the (non-student) economically inactive has shifted markedly over time toward men. The gender ratio in favour of women has fallen from 87% in 1979 to 61% in late 2009. Back in 1979 around 40% of women aged 25+ were economically inactive compared to a rate of under 5% for men. Since then the number of women entering the labour force has grown rapidly and shows little sign of halting. Rising inactivity for reasons of ill health and disability is concentrated on men. At around 2.3 million, there were almost twice as many inactive men as there were unemployed men, (on the ILO/OECD definition), in the fourth quarter of 2009. Inactivity rates among men under the age of 50 did not fall significantly during the recovery, instead, as Figure 13 shows, ratcheting upward over time. Policy changes on pensions and incapacity benefits has arrested the inflow of sickness related inactivity recently, but the overall level of inactivity among men has been persistently high for twenty years. The net result is that inactivity among men is, at best, static and remains 3 times higher than the rates observed in the 1970s. Indeed more than half of the fall in the male unemployment rate from 1993 to 2008 can be accounted for by rising inactivity, though much of that rise in inactivity took place in the 1990s.

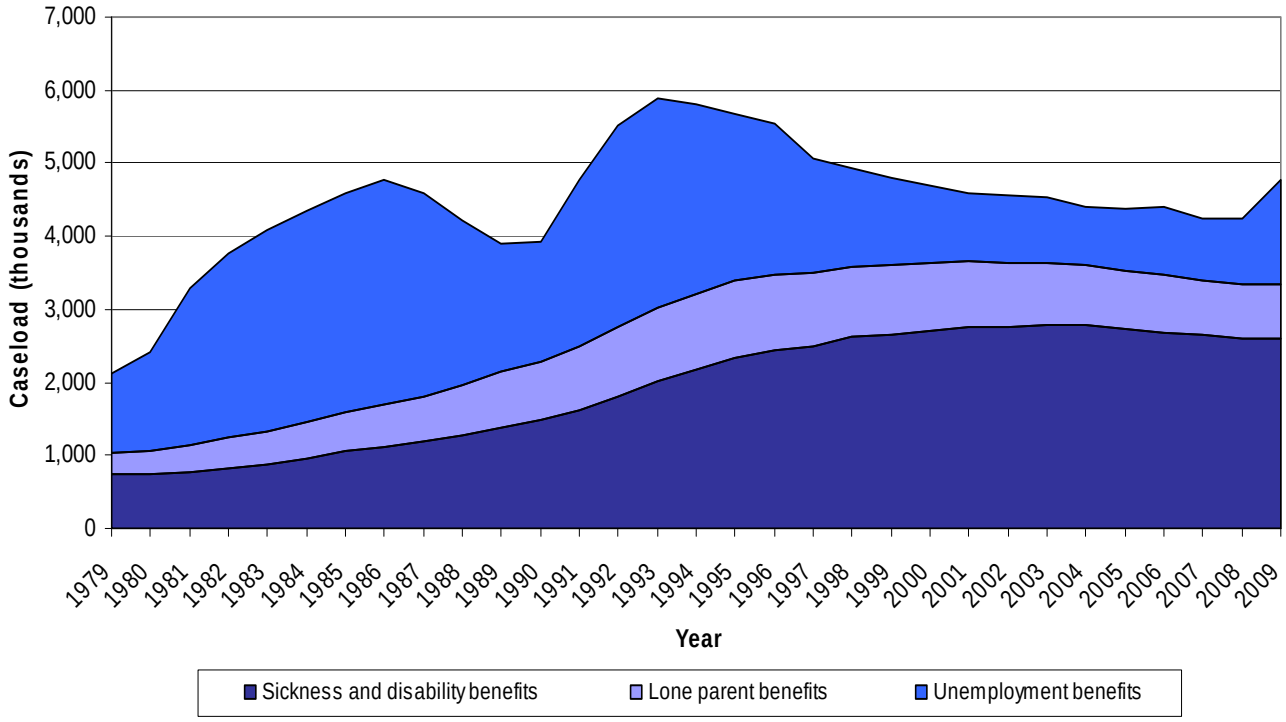
Figure 13: Inactivity Rates by Age and Gender



Source: LFS. Authors' calculations.

Figure 14 shows the numbers in receipt of the major welfare benefits available to those out of work. In addition to the large cyclical fluctuations in unemployment benefit receipt over time there have been marked increases in claims for Income Support (IS) for lone parents and in sickness-related benefits. This amounted to around ¾ million extra claims in the 1980s recession and 1 million extra claims in the 1990s recession. Unlike unemployment related benefit, claims for these other benefits did not fall back after the recessions ended. The claimant numbers for these inactivity benefits only started to fall around 2001 and then mainly for lone parents. Lone parents with children aged 7 and over are now being moved from IS to unemployment benefits (JSA) that require active job search and the new Work Capability Assessment tests are also making claiming disability benefits much harder. These changes are pushing up the number of claims for JSA during the recession making the small rise in JSA unemployment all the more remarkable. Yet claims for lone parent benefits did rise, once again during the latest recession. The uncertainty arises around how far, compared to previous recessions, they will rise this time. The expectation is that they will not because of the extra support ad job search schemes targeted at not just the unemployed but also the inactive.

Figure 14: Claims for Different Workless Benefits 1979 to 2008



Conclusions

This recession has been remarkable for the depth of the fall in GDP and the lengthy duration of falling output, but also for the relatively low loss of employment, at least so far. It seems that the explanation of how Britain got away with a smaller fall in employment in 2008-2009 consists of several elements. Policy makers did the right thing in saving the banks, cutting interest rates and inducing fiscal and monetary stimuli, that have all helped maintain demand and firm 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 in, wherever possible, 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. However, the recession means that firms have under-used labour at the moment and this will allow them to grow without then need for extra jobs in the short to medium term. However, if demand continues to be weak, then job shedding will 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, increased package 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 National Minimum Wage and Working Tax Credit should also help continue to make work pay through a downturn when job prospects may not be as good as in recovery.

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 on 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. As a result, for some groups, there has been a ratchet upward in joblessness from the 1980s onward and this will need to be addressed when the economy recovers. Yet, overall, it seem that the labour market has performed relatively better than expected. Whether this generally good news will be sustained when the focus shifts to cuts in public spending and employers begin to assess their longer-term employment needs is also less than clear. Employment took eight to nine years to get back to before-recession levels after the last two recessions. This time it might be less if a second wave of job shedding is avoided.

An extended version of this article appears in the opening chapters of 'The Labour Market in Winter 2010. The State of Working Britain', forthcoming Oxford University Press.

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