Addressing labour market scarring in a recession

Issues and options

For Te Pūtahitanga o Te Waipounamu

19 May 2021

SENSE PARTNERS

DATA LOGIC ACTION

Key points

Economic shocks scar labour market outcomes for affected groups for up to a decade. Active labour market policies need to be scaled up during and after recessions, with particular focus on disproportionately affected groups (Māori, Pasifika, youth and some older workers closer to retirement). The number of people on the Jobseeker Support increased by 65,000 in 2020.

Two groups are primarily affected.

First, those in transition (for instance, between education and work or returning from time away for family reasons, including maternity). This tends to affect Māori most intensely, followed by Pasifika and immigrant communities. Their populations are younger, and cohorts entering the workforce are larger.

Second, those who are unemployed – recent and already unemployed.[1] This affects Māori most, followed by Pasifika, as more of the population were already unemployed (on Jobseeker Support, for example) before the COVID-19 pandemic which rose more after the pandemic hit.

Our analysis shows that people from ethnic minorities, immigrants, young people and some older workers face the most significant shocks. Qualifications matter for employment outcomes. More-experienced and qualified workers accept lower-paid jobs, meaning less-qualified workers tend to face more time out of work. Wage losses for both groups can last for up to a decade.

Unemployment effects are intersectional, with higher and stickier rates of unemployment for ethnic groups. For example, young Māori and Pasifika have lower levels of qualifications than the population average (although this is improving over time), meaning Māori and Pasifika youth are more likely to be affected by unemployment than other youth, who are more likely to be affected by recessions than the population in general.

Recovery from wage scarring is non-linear, with consequences affecting age groups differently. Younger groups are most affected by reduced work experience and wage losses. Those in older groups, previously long-tenured positions or declining sectors are most likely to face difficulties in adjusting or not working. Those in older groups, previously long-tenured positions or declining sectors are most likely to face difficulties adjusting or not working again.

Active labour market policies are already used in New Zealand. Still, they need to be scaled up and prioritised for different cohorts. They need to be local and culturally specific. The current approach prioritises job search assistance, but the literature suggests that medium-term success requires increased investment in skills training and the transition of the unemployed into work.

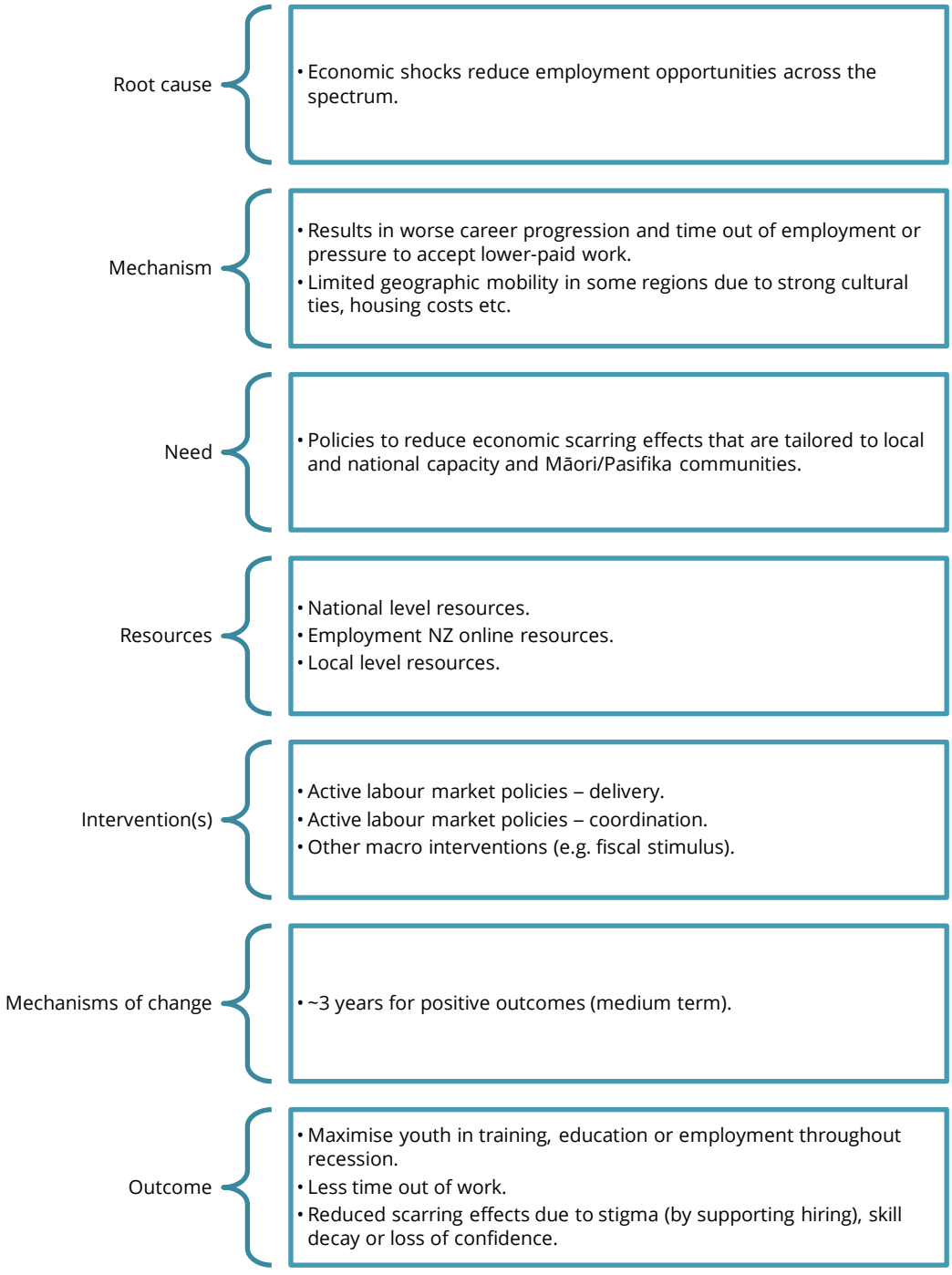
The scale of activity labour market policies is modest. It was last estimated at $307m in 2019. The lifetime cost of Jobseeker Support is around $140,000. The current investment in active

[1] What Works Centre for Local Economic Growth, 2020

labour market policies is equivalent to the lifetime cost of Jobseeker Support for just 2,200 people. There is the the risk of long-term unemployment and scarring for many 65,000 who lost their jobs in 2020. There is a , robustsolid case to look at the lifetime cost of Jobseeker Support and instead fund much greater investment to reduce the cost of unemployment.

Cultural barriers in accessing information and resources, as well as stigma, can reduce policy efficacy. These can be addressed by focused policy design to adequately address intersectional and magnified effects on ethnic groups. Whānau Ora – a social service delivery model for Māori – can be considered an approach to better serve underserved communities by labour market policies.

Anatomy of scarring and policy choices



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1.1. Unemployment has a lingering effect on future employment and income

Unemployment has a lingering effect on future employment and income prospects. There are several channels of wage scarring propagation.

Someone unemployed in the past is more likely to face unemployment in the future. Those previously unemployed are 5–8 times more likely to be unemployed in a recession. A UK study using panel data between 2009 and 2015 found unemployment rates of men varied sharply. The unemployment rate was 10% for those with no previous job loss compared to 50–80% for those with three or more previous unemployment spells.[2]

Those who face being long-term unemployed are less likely to find future employment. The longer a person is unemployed, the lower their chances of gaining employment. One study found that 2 years in, unemployment decreases the probability of becoming employed by 30%.[3]

Wage scar effects come from wages lost from either not being in work or from taking lower-paid jobs, which may be unmatched to their qualifications and experience, to get back into the workforce. This lengthens career progression. Unemployed people returning to work earn 10% less (or worse) upon re-entry.

Penalties vary between studies, regions and labour market structures. One study found unemployment penalty on subsequent earnings of around 14% for the first year, 12% for the second year and 11% for the third year.[4] Another study found 10%, 13% and 16% penalties for subsequent yearly earnings for one, two and three and more spells of prior unemployment. Other things being equal, the previous wave's unemployment carried a further wage penalty of about 4%.[5] In this case, scarring is cumulative.

Recovery from wage scarring can be uneven, and career quality can worsen. Wage scar effects are vital for formerly long-tenured workers, older workers who lost their jobs in declining sectors in the regional labour market, older workers who lost their jobs in declining sectors in the regional labour market, and workers who changed sectors.[6]

While the policy focus on the larger younger cohorts, older workers tend to face a stronger lingering impact on their incomes. They have less time to recover. One study of male unemployment found the least impacted are men experiencing unemployment when aged 25–34, while men aged 55–66 have rather stable though stronger penalties.[7]

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[2] Li & Heath, 2020
[3] Kalwij, 2004
[4] Gangl, 2006
[5] Li & Heath, 2020
[6] Deelen, de Graaf-Zijl & van den Berge, 2018
[7] Manzoni & Mooi-Reci, 2020

1.2. Wage scars vary between labour market structures

In a rigid labour market, the inability of wages to adjust to lower demand in a recession shield the internal labour market from competitive price pressure. This translates into employment losses and forgone job experience for groups in transition and those unemployed.

Flexible labour markets, such as in the US, which are likened to a spot market, have short and sharper wage penalties in a recession but less-persistent scarring effects because a greater proportion of people stay in work, albeit for a lower wage.[8]

Segmented labour markets experience bimodal effects of a recession in distinct primary and secondary job markets. Segmentation is more obvious in economic downturns, when firms have less incentive to invest in workers at the upper end of a secondary job market (defined as the market for lower-quality jobs and qualifications, usually with fewer job protections and higher job turnover).

As the usual upgrading links to the primary job market slow (the market for permanent contracts, usually with greater benefits and higher-quality jobs), a divergence between markets emerges. Workers in the secondary market get trapped in worse jobs than they otherwise would if firms invested in their skills, and as those in the primary market have strong incentives to stay in (relatively protected) jobs, high-educated groups in transition also get stuck in the secondary market on insecure contracts. Wage scarring occurs across all groups as less-educated transition groups are crowded out.

Labour market structure	**Flexible**	**Segmented**	**Rigid/protected**
Job market turnover	More dynamic ◄——————————————————► Less dynamic		
Scarring effects	• Mostly wage-based effects	• Unemployment losses for lower-educated groups • Higher-educated groups are forced onto lower-quality or temporary contracts, making education a double-edged sword and crowding out less-educated groups	• Protected wages but higher rates of unemployment • Division between lucky and unlucky cohorts as lucky cohorts are protected • High-educated youth bound to accept lower-quality jobs or reduced hours or face unemployment
Persistence and severity	• Shorter-lived wage scars but more severe	• Long-lived effects for higher-educated groups who churn on temporary contracts	• Evidence of greater persistence due to less work experience but less severe wage scarring

[8] Cockx, 2016

1.2.1. Labour market structure in New Zealand

New Zealand has been described as one of the most flexible labour markets in the OECD for ease of firing, but it has elements of a segmented market.[9]

While it is tricky to determine the extent of market segmentation in New Zealand, differences in job protections and the presence of an insecure workforce suggest some segmentation is likely. As there are no statutory requirements to provide redundancy upon dismissal, only about half of displaced workers receive redundancy pay. Lower-paid jobs are less protected, with voluntary redundancy, short notice periods and favourable legal structures keeping the cost of firing low, allowing for relatively easy adjustments for firms in a recession.

The downside of this approach is that the costs of economic restructuring largely fall on affected workers and their families. The New Zealand welfare system acts as a system of last resort, providing a flat-rate payment to those who have no income or partner to support them. Eligibility for support reduces drastically if a worker's spouse has full employment. This means only about a third of those who become unemployed go on to access a welfare benefit.[10] A subsequent risk is poor job matching: if workers are not supported in between work, they will rush to take jobs, even if they are not a good match for their skills.

1.3. Scarring is persistent

Many studies find convergence of wage scarring effects about a decade after a recession.[11] Exact findings vary by region and labour markets, but there is a broad consensus that there is a scarring effect that lasts for many years.

This is a selection of examples by country:

- Spain (segmented market) – studies find convergence of wages for all education groups after about 7 years.[12]
- Belgium (rigid market) – studies find negligible wage scarring because of strong wage floors but find the number of hours worked is reduced even 12 years later.
- Austria (moderate rigidity) – studies find a 1 percentage point increase in the unemployment rate at entry reduces the daily wage by 0.9%, which persists for at least 20 years.
- US (flexible market) – one US study finds that, for every percentage point increase in the national unemployment rate at graduation, university graduates incur wage penalties of 2% 1 year later. These persist for 8 years but are zero by year 10.[13]

[9] OECD, 2017
[10] OECD, 2017
[11] Cockx, 2016
[12] Fernández-Kranz & Rodríguez-Planas, 2015
[13] Regan, 2020

2. Who is at risk during a recession?

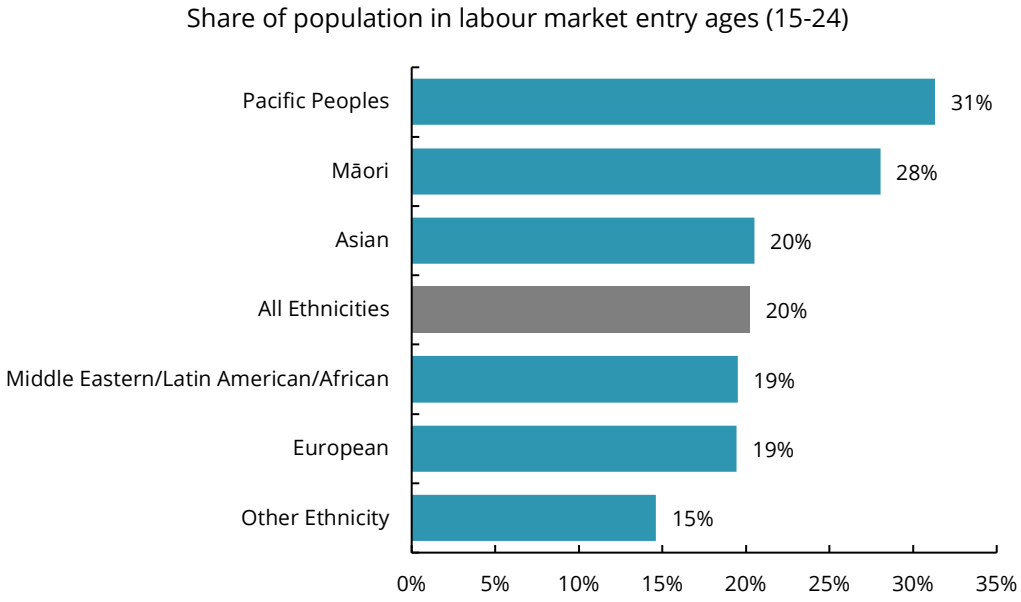
2.1. Who is affected by wage scars in a recession?

Two groups are primarily affected in a recession:

- Those in transition, for instance, between education and work. More Māori and Pasifika are in the peak labour market entry ages (31% and 28%) respectively than any other ethnicity (Figure 1). This means that a recession is likely to affect the job prospects of young Māori and Pasifika entering the labour market.
- Those who are unemployed – recent and already unemployed.[14] Figures 2–5 show that young people and particularly young Māori and Pasifika started with higher levels of unemployment in 2019 before the pandemic and experienced the largest increase in unemployment in 2020. Older Pasifika workers also experienced oversized job losses.

This means that Māori and Pasifika are most likely to be affected by the recession, not just in terms of immediate worsening in job opportunities but also long-term consequences through scarring.

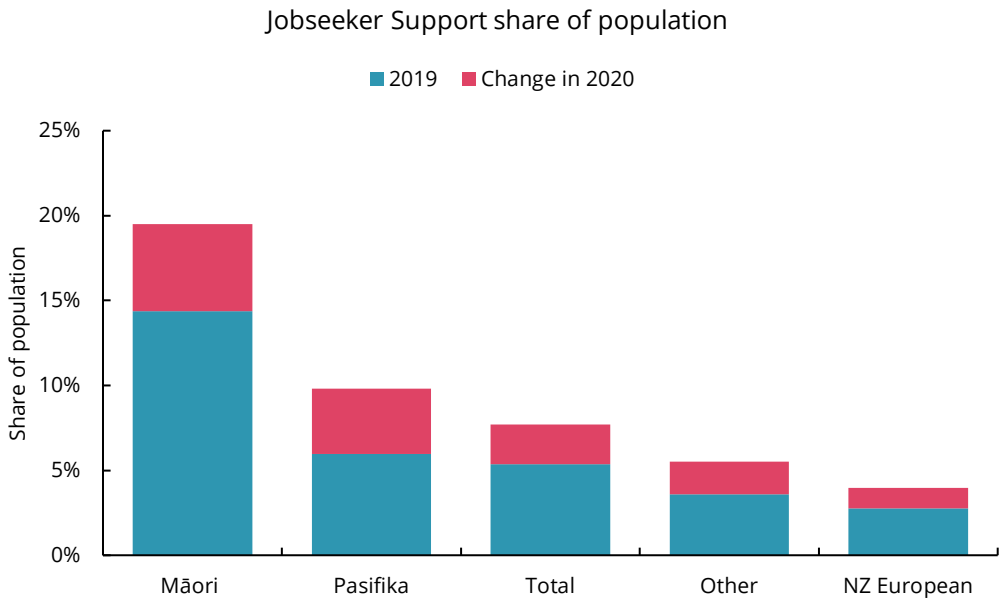
FIGURE 1: MĀORI AND PASIFIKA ARE MORE LIKELY TO BE IN YOUTH IN LABOUR MARKET ENTRY AGE



Source: Stats NZ, Sense Partners

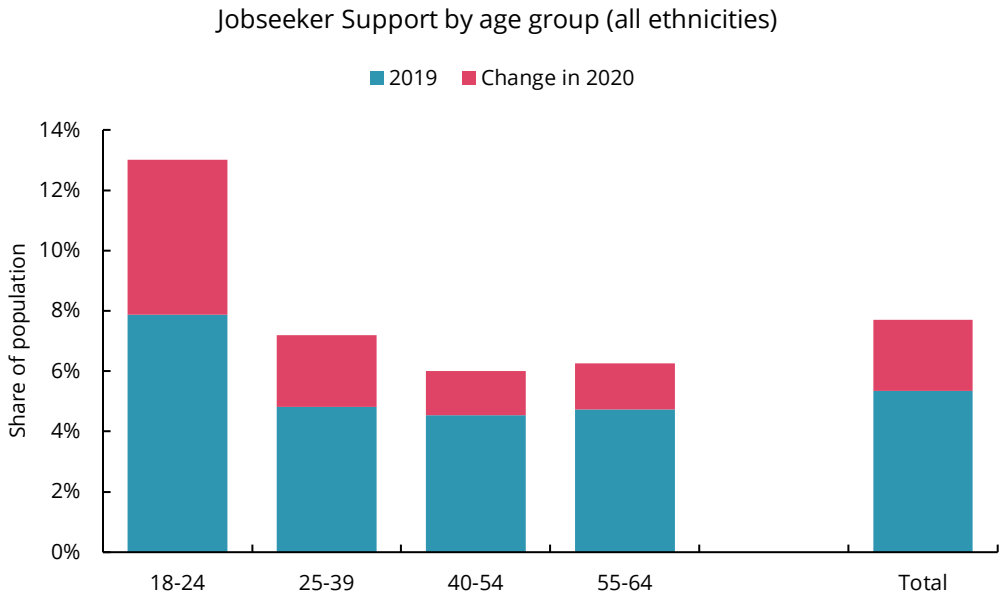
[14] What Works Centre for Local Economic Growth, 2020

FIGURE 2: MĀORI STARTED WITH HIGH LEVELS OF UNEMPLOYMENT, AND THE PANDEMIC HAS WORSENED THE PROBLEM



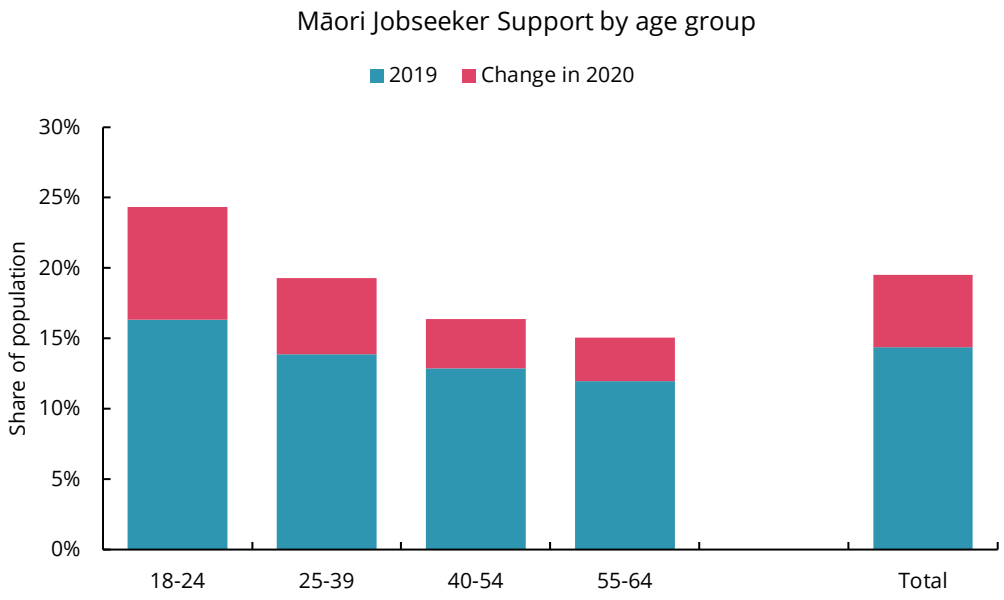
Source: MSD, Stats NZ, Sense Partners

FIGURE 3: YOUNG PEOPLE EXPERIENCE THE MOST HARDSHIP…



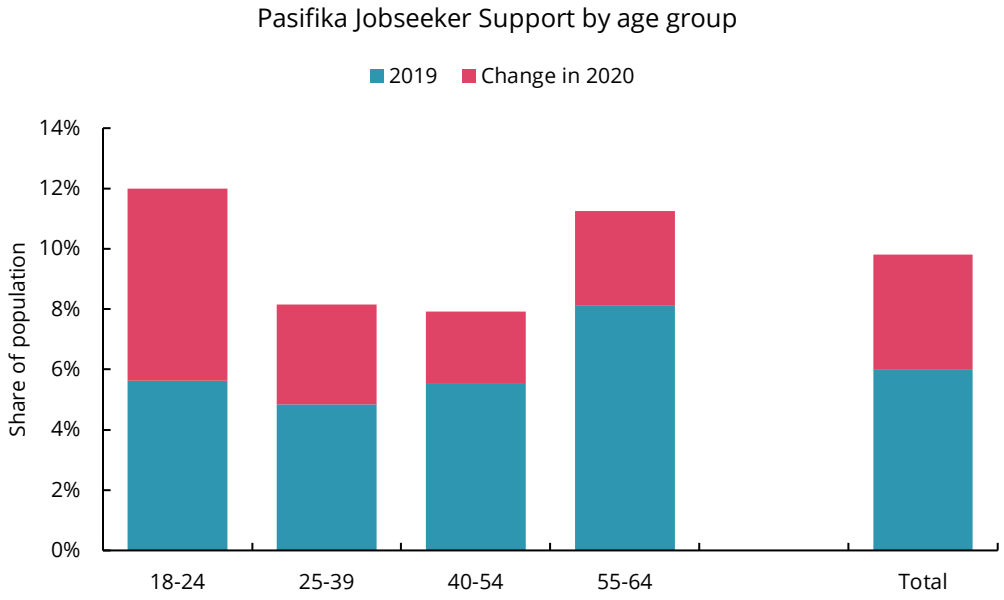
Source: MSD, Stats NZ, Sense Partners

FIGURE 4: YOUNGER MĀORI ARE WORST AFFECTED



Source: MSD, Stats NZ, Sense Partners

FIGURE 5: YOUNG AND OLDER PASIFIKA ARE MOST AFFECTED



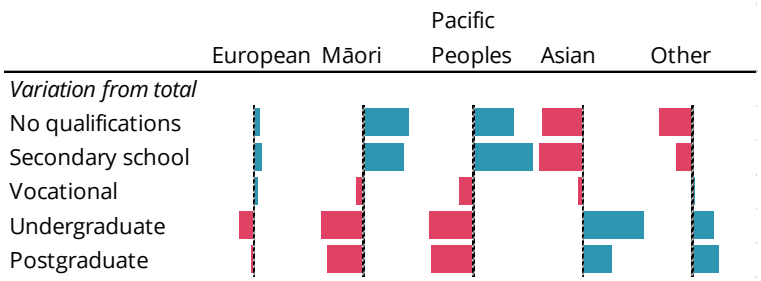
Source: MSD, Stats NZ, Sense Partners

2.2. Low qualified get crowded out

Recessions can affect anyone, but the impact is most pronounced for youth. Within youth, the impact is stratified by qualifications. Those with higher qualifications will trade down in a challenging labour market, choosing lower pay and unmatched jobs over unemployment. This crowds out less-qualified youth to unemployment. Māori and Pasifika are more affected by the qualification penalty as they are less likely to have higher qualifications.

FIGURE 6: QUALIFICATION OF THE POPULATION BY ETHNICITY

2018 Census, difference in qualification relative to total population (Blue means mores, red means less)



Source: Stats NZ, Sense Partners

Career progression is slower for those who enter the workforce during downturns, especially for educated groups who might otherwise have higher earning capacity in ordinary times. For those entering the workforce with high levels of qualifications, their income is not protected by a minimum wage. If labour market entry conditions are bad, this group must choose between taking low-quality jobs or unemployment.

As unemployment benefits are less generous for this group, higher-educated youth are more likely to take lower-quality jobs and lower wages.[15] This crowds out less-qualified workers, who are pushed into worse jobs in the secondary job market or spend longer unemployed.

Groups with less financial resilience and lower education are less equipped for transitions during recessions. Because they are more financially constrained, low-educated youth are less geographically mobile than higher-educated or older workers. This makes the short-term impact of a recession more severe for low-educated youth than for high-educated youth.

Young workers can respond to this by investing in their education and spending more time searching for higher-paying jobs, but this takes time and know-how, and so there is a persistence in the penalty incurred from a recession. A lag in career progression reinforces this persistence and slows the catch-up process.

[15] Cockx, 2016

2.2.1. Lessons from the GFC: long shadow

The Global Financial Crisis had particularly large, negative effects for university graduates.

One study in Europe found new university graduates in non-crisis countries experienced negative wage penalties for 10 years, close to 3% in each year,[16] but new university educated workers in crisis countries fared much worse. They incurred wage losses of over 20% 1 year after graduation. This decreased below 15% by year 6, but these losses were still around 20% 7–10 years after graduation.

Another study of Portugal, Italy, Ireland, Greece and Spain had similar findings. University graduates experienced wage losses of between 12% and 23% in each of the first 10 years of their career following the GFC.[17]

These 'unlucky' cohorts can lose 60% of a year of earnings over the course of a decade if starting their career in a typical US recession.

Effects are typically intersectional. Men and women experience similar losses, while non-whites and the least educated workers incur the largest losses.[18] Consistent with other studies, earning and wage losses tend to dissipate after a decade.[19]

2.2.2. Ethnic groups have higher and stickier unemployment rates

Unemployment scarring also amplifies disadvantage. This is particularly obvious in unemployment data. Overseas, unemployment rates were materially higher for ethnic groups in the UK between 2009 and 2015. In the US, there is persistent overrepresentation of black populations in unemployment data.

One UK study found Black Caribbean men were around 10 percentage points more likely to face unemployment than white British peers at each level of prior unemployment, as were black African women relative to white British women (by about 5 percentage points). Among those who reported no previous experience of unemployment, Pakistani, Bangladeshi, black African and Indian women earned around 15%, 11%, 9% and 8% less than white British women across one to three spells of unemployment. Bangladeshi, Pakistani, black African, Indian and black Caribbean men made 33%, 28%, 21%, 14% and 11% less than white British men after one spell of unemployment.[20]

Another Netherlands study also found individuals born outside of the Netherlands received lower re-employment income compared to Dutch counterparts with similar unemployment experiences.[21]

[16] Cockx, 2016
[17] Regan, 2020
[18] Schwandt & von Wachter, 2019
[19] Regan, 2020
[20] Li & Heath, 2020
[21] Mooi-Reci & Ganzeboom, 2015

As we showed earlier, similar patterns hold in New Zealand. For example, youth with fewer qualifications fare the worst, but the issues are magnified for Māori and Pasifika.

2.3. What drives ethnic employment gaps?

There are large ethnic differences in unemployment. Some of it can be explained by **underlying factors** like education, skills and work experience,[22] but that does not explain all the difference. There are also more fundamental causes like **discrimination** (racism) and social and spatial **dislocation**. Higher incarceration rates and child support burdens may increase the barriers to employment.

Ethnic disadvantage can cumulate across both hiring and firing decisions.[23] Evidence for discrimination is stronger in hiring than firing.[24]

For example, black Americans are not the first fired when the economy weakens but they are the last hired. Young women and men have lower probabilities of transitioning back into work as local unemployment rates grow, holding parental education constant.[25] When statistically controlling for education, test scores and work experience, observed earnings gaps between black and white workers largely (though not completely) disappear.[26]

A study of early career British graduates found that, although ethnic minority graduates are less likely to find a job in a recession, those who do have a job do not experience ethnic wage differentials.[27]

There is a smaller volume of evidence of discrimination in firing. However, a UK longitudinal survey found ethnic women were more likely to lose jobs than white peers.[28] Black Americans are more likely to enter and less likely to exit unemployment than whites, with disadvantages in both transitions amplified by economic downturns.[29]

A study of COVID-19 impacts in the UK finds intersectional disadvantages faced by Black, Asian and minority ethnic (BAME) groups, even when controlling for higher self-employment rates. BAME migrants were three times more likely to lose their jobs than UK-born white British, and UK-born white British were 1.7 times more likely to be furloughed than native BAME groups.[30]

Discrimination may not explain all ethnic differences in job losses during a recession. Rather, they may be more affected by fundamental factors like education, sector of work and so on, but discrimination and stigma may cause ethnic groups to spend longer in unemployment than their white counterparts. Queuing theory explains some of this phenomenon – if white

[22] Holzer, 2021
[23] Longhi, 2020
[24] Yu & Sun, 2019; Longhi, 2020; Reyneri & Fullin, 2011; Zwysen & Longhi, 2018
[25] Yu & Sun, 2019
[26] Holzer, 2021
[27] Zwysen & Longhi, 2018
[28] Longhi, 2020
[29] Couch, Fairlie & Xu, 2018
[30] Hu, 2020

applicants are preferred, non-white applicants are pushed back in the labour queue.[31] This creates more time out of work leading to scarring effects.

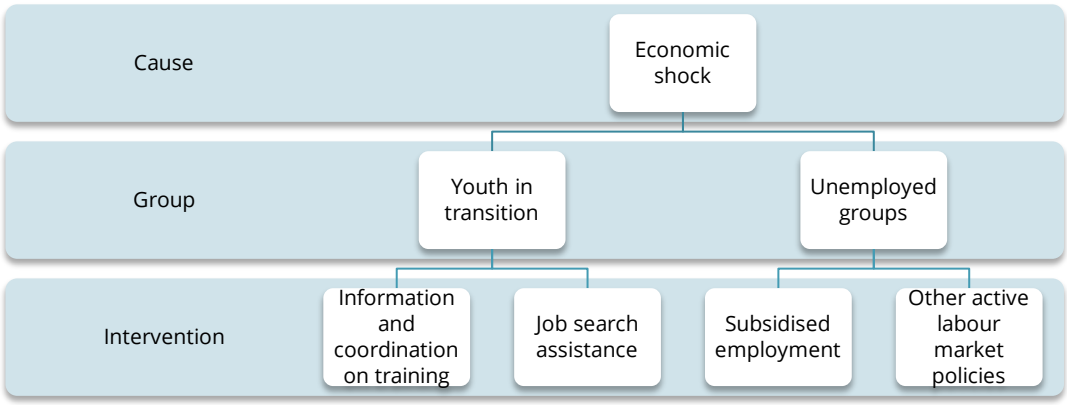
3. Policy choices

3.1. Interventions

Scarring is reduced by investments in education before, during and after unemployment. For groups in transition, facilitating the catch-up process and encouraging job upgrading are important.[32]

For groups out of work, preventing spill-over effects from unemployment (such as skill atrophy or reduced motivation) or overcoming stigma/discrimination in hiring can reduce the size of scarring effects.[33]

These interventions fall under the umbrella of active labour market policies. These are investments that help unemployed groups find work. These are the broad policy options:



3.2. Options for youth in transition

In the case of wage scarring for those in transition, policy makers must design policies that reflect the dampened career prospects faced by unlucky cohorts for up to a decade following a downturn.[34]

Policies that encourage ongoing job upgrading and human capital investments and do not tie workers to specific firms can shorten the catch-up convergence period.[35] Fostering geographic and job mobility are key measures. Facilitating job matching between youths and employers beyond graduation, even after finding the first job, may also be effective.[36]

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[31] Yu & Sun, 2019

[32] Groot, Schippers & Siegers,1990; Burgess, Propper, Rees & Shearer, 2003; Gregg & Tominey, 2005

[33] Borland, 2020

[34] Regan, 2020)

[35] Borland, 2020

[36] Cockx, 2016

Targeted policies must also ensure young people leaving secondary school enter university and other training programmes if not entering work. A study of 28 OECD countries found that, while tertiary education attendance among secondary school graduates increased during recessions, attendance increased less for young people whose parents had low qualification levels.

Support should be provided to these groups to encourage uptake of training and education. Information sharing plays an important role here. For example, a randomised control trial in the US found that individuals sent information about benefits and costs of post-secondary education were 40% more likely to enrol in post-secondary programmes.[37]

Design features for transition policies

There is a clear role for coordination and information sharing to ensure uptake of job matching/education programmes at a local level.[38] However, cultural barriers in accessing information and resources and stigma can worsen policy outcomes and limit uptake. Local and culturally suitable mechanisms are needed.

Whānau Ora is a local case study of overcoming cultural barriers, seeking to eliminate issues of uncoordinated delivery of social services using a whānau-centred framework. Policy lessons since have shown this approach is effective in enhancing wellbeing compared to conventional service delivery.[39]

The Taskforce for Whānau Ora notes it is critical that the cultural distinctiveness of whānau is recognised in the delivery of services. Services should be attuned to whānau cultural norms, whānau traditions and whānau heritage, while at the same time recognising the realities and opportunities in te ao Māori and in wider society.[40] Such lessons have potential to be highly applicable in the design and delivery of active labour market policies for New Zealand.

3.3. Policies for unemployment scarring

Active labour market policies also go beyond information sharing and coordination. They often include subsidised employment programmes, work readiness courses, flexible childcare assistance and integrated workplace skills training. These are more intensive policies, reflecting the greater needs of those in sustained unemployment.

A UK review of 1,000 active labour market policies for reducing youth scarring emphasised that they are an important tool in trying to reduce wage scarring due to long-term unemployment.[41]

[37] What Works Centre for Local Economic Growth, 2020
[38] What Works Centre for Local Economic Growth, 2020
[39] Te Puni Kōkiri, 2015
[40] Taskforce on Whānau-Centred Initiatives, 2010
[41] What Works Centre for Local Economic Growth, 2017

Some of the most successful subsidised employment schemes have included personalised support, training and job search activities such as those outlined above for groups in transition.

Design features for those in unemployment

Training has a positive impact on participants' employment or earnings in around half of the evaluations reviewed.[42] Shorter active labour market policy programmes (below 6 months and probably below 4 months) were more effective for less-formal training activity. Longer programmes generate employment gains when the content is skill intensive.[43]

Programme design plays a major role in effectiveness, more so than macroeconomic conditions. In-firm and on-the-job training tended to outperform classroom-based training programmes. Employer co-design and activities that closely mirror actual jobs emerged as key design elements.

As in the case of transition policies, culturally specific support (such as Whānau Ora or similar concepts) and policies that target stigma in hiring will be important in applying policies to the New Zealand context.

Card, Kluve and Weber (2018) undertook a meta-analysis of over 200 evaluations of active labour market policies including:

- subsidised private sector employment
- subsidised public sector employment
- classroom or on-the-job training
- job search assistance, monitoring or sanctions for failing to search
- programmes that combined two or more of the above.

They found the following:

- Effects are close to zero on average in the short run but become more positive 2–3 years after completion of the programme. That is, active labour market policies should be designed as a **medium-term intervention**, and policy makers should not anticipate immediate results.
- The time profile of effects varies by programme, with larger gains for programmes that **develop human capital**.
- Job search assistance programmes that prioritise taking up available employment opportunities over other outcomes tend to have similar effects in the short and long run, whereas **training and subsidised private sector employment** programmes

[42] What Works Centre for Local Economic Growth, 2020
[43] What Works Centre for Local Economic Growth, 2020

have larger average effects in the medium and longer runs. Public sector employment subsidies tend to have small or even negative average effects.

- There is variation in outcomes across participant groups, with larger effects for females and participants who enter from long-term unemployment. Effects were smaller for young people and older workers.
- Active labour market policies are more likely to show positive impacts in a recession.

3.4. What programmes do we already have in New Zealand?

New Zealand has below-average spending on active labour market policies compared to the OECD average.

However, the Productivity Commission notes that active labour market policy spending per unemployed person puts it closer to the OECD benchmark and that we do not include administrative costs in our estimates, which skews average spend.[44]

In New Zealand, the Ministry of Social Development is the primary agency for active labour market policy funding. Programmes are for people not in employment and on a benefit or for people who have recently left the benefit system, rather than those in low-skilled jobs at risk of unemployment.

Maddock (2019) estimates of spending on active labour market policies in New Zealand is shown in Figure 7. The total spend was $307m. The lifetime cost of a Jobseeker Support beneficiary is $140,000.[45] The current spending on active labour market policies is equivalent to the lifetime cost of Jobseeker for just 2,200 people, compared to 65,000 increase in Jobseeker Support in 2020.

FIGURE 7: NEW ZEALAND ACTIVE LABOUR MARKET POLICIES IN 2019

Active labour market policy	Cost of policy, $m
Job search assistance	84
Classroom-based courses for work readiness	78
Subsidised private sector employment and flexible childcare assistance	53
Other programmes	50
Skills training	42

Source: Maddock, 2019

For transitioning youth, classroom-based courses for work readiness, skills training and job search assistance are all good policies. For those who become long-term unemployed, there are no quick fixes, but medium-term solutions will require increased investment in skills training, subsidised private sector employment and flexible childcare assistance. The

[44] Maddock, 2019
[45] Taylor Fry, 2016. Updated to 2020 prices using the CPI.

programmes are already in place – they need to be recast to be made fit for purpose for the challenge at hand.

4. Conclusion

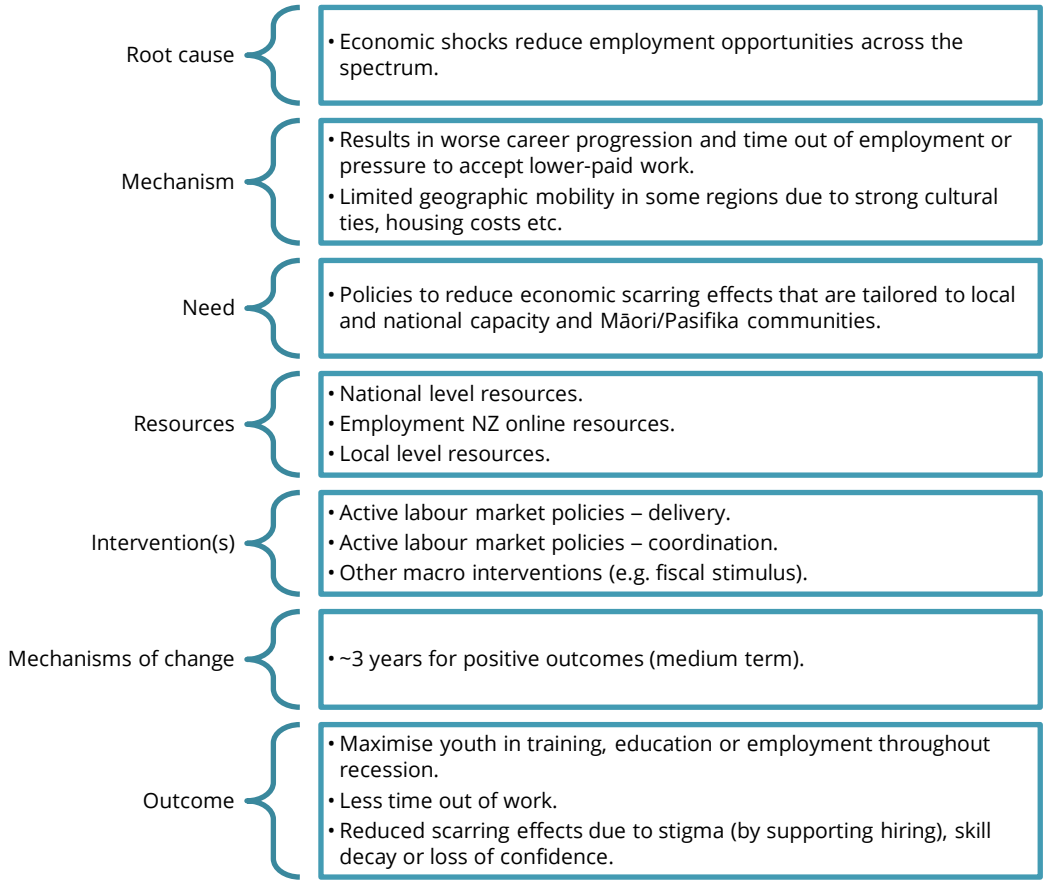
The COVID-19 pandemic has increased the number of people on the Jobseeker Support by 65,000 people over 2020. This is disproportionately affecting youth and those who are low skilled, particularly Māori and Pasifika.

The impact of job losses in a recession can last a decade through lower incomes, more time out of work and delayed career progression.

Recessions amplify pre-existing ethnic disadvantages, which cumulate.

Local and culturally specific policies that improve coordination of existing resources and assist youth into better-paid opportunities are required, as is subsidised training. Active labour market policies need to be more intensive for those who are long-term unemployed.

The policy and interventions are not new, but they need to be more effective. Current policy prioritises job search assistance, but the literature suggests medium-term success requires increased investment in skills training and transitioning unemployed into work.



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DATA LOGIC ACTION