THE JOBS CRISIS AND WHAT TO DO ABOUT IT

SUMMARY

This report uses data from two previous recessions and the latest Ernst & Young ITEM Club economic growth forecasts to estimate what might happen to claimant count unemployment and the number of long-term unemployed in particular. SMF analysis suggests that the claimant count will peak at over 2.7 million in 2011-12, while the number of long-term unemployed people (those without work for more than one year) will rise to a peak of around 1.1 million by 2012. While in recent years long-term unemployment has been a minor part of total unemployment, this is set to change radically with important implications for how policy should respond.

Evidence suggests that the costs associated with long-term unemployment, both human and economic, are substantial and long-lasting. While macroeconomic policy responses focus on regaining macroeconomic stability and minimising job loss across the economy, it is clear that a substantial microeconomic policy response is also necessary. It must aim to minimise the human and economic costs of long-term unemployment. To determine what the policy response should be, this report addresses three key questions:

- How does recession change the assumptions underlying welfare policy compared to normal economic conditions?
- What policy options are available to mitigate the impact of the recession on the long-term unemployed, and which of these is likely to be successful and cost effective in the long-run?
- What are the implications for the Government's existing welfare reform agenda?

In benign economic conditions, something approaching a consensus emerged about the role of welfare policy. Employment services were designed around a 'work first' approach on the understanding that their role is to reduce frictional unemployment by focusing efforts on matching jobseekers to available jobs. However, in conditions of rising levels of cyclical unemployment and rapidly falling vacancy levels, this strategy is less likely to be successful for the long-term unemployed over the next three years.

These observations have given rise to a range of suggestions about what the Government should do to mitigate the problems of long-term unemployment. Experience shows that some are highly expensive red herrings, while others have potential but depend for their success on careful design.

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- Mass **job creation** programmes are both highly expensive and may in fact be detrimental to people's employment chances in the long-run.
- Large-scale **employment subsidy** schemes are likely to be extremely expensive and a huge proportion will be deadweight cost rather than stimulating new jobs.
- **Hiring subsidies** are not a cost-effective way to create new employment, although they can be helpful in reducing social exclusion by making the long-term unemployed relatively more attractive to prospective employers than less disadvantaged workers.
- **'Intermediate Labour Markets'** – paid work in specially created temporary jobs, combined with personal support, training and job-search - may be effective in helping those furthest from the labour market who are unlikely to gain any opportunities for employment during a recession. Their success depends on effective design, which can be achieved if programmes are local, small-scale and dependent for funding on later job-placement success.
- **Work-focused training** can be more cost-effective in a recession, but its success depends on it being tailored to individual need and embedded within an outcome-based payment system to ensure that skills gained are relevant for local employers.

The deadweight costs associated with policies that try to keep people in employment are high. Meanwhile the risks of permanent social exclusion among the long-term unemployed are substantial. The evidence therefore suggests that using unemployment services to maintain and build skills to keep long-term unemployed people attached to the labour market should instead be the emphasis of policy.

Designing the 'right' programme in detail from Whitehall is doomed to failure. The key principles behind the right approach are that different kinds of interventions may be appropriate for different people, but those programmes must be: human capital building; job outcome-focused; tailored to individual needs; locally delivered.

Contrary to the views expressed by some - who see the direction of welfare reform as flawed in the current economic context - the Government now has the right vehicle in place to deliver the right policy combination in the 'payment by results' frameworks of the Flexible New Deal programmes. This flagship reform allows: devolution of programme design to the local level; a constant focus on achieving employment outcomes; profit motive for providers to drive innovation; and the necessary flexibility to tailor support to different people.

However, the current parameters of the Flexible New Deal programme, due to launch this October, do not reflect the rapidly changing macroeconomic context. As it stands, under-resourcing and perverse incentives in the

system are likely to be very harmful for the long-term unemployed. Significant changes must be made to allow the model to incentivise service providers to respond to the changing economic environment. These changes should include the following.

- Unemployment service providers' **engagement with jobseekers must be lengthened from one to three years**, to refocus their efforts on retaining employability and getting jobseekers back into work when the economy picks up.
- The level of resources available to providers of Flexible New Deal Phases 1 & 2 must be around **£1.4bn per year higher than planned in each of 2010, 2011 and 2012** just to maintain the level of spending per jobseeker that was planned when the scheme was designed, last summer.
- Extra resources, on top of those described above, must be provided to enable providers to make the kind of interventions required. As durations of unemployment increase and the necessary interventions become more costly, restoring resources per head to the *status quo ante* will be insufficient.
- **JSA rules** limiting the length of training that can be undertaken to 8 weeks should be changed to allow longer courses.
- Payments should remain **highly job outcome contingent** (80% on achieving an outcome) rather than moving back to process-based payments.
- Government should pay a greater proportion of **up-front funding** to ease providers' cash-flow problems and credit constraints, and recover funding where outcomes subsequently fall short.

INTRODUCTION

Since summer 2008 unemployment has begun to rise rapidly, with the claimant count in February 2009 up 75% or almost 600,000 on a year earlier, at 1.39 million. But focusing on the *level* of overall unemployment, rather than the underlying flows, can risk obscuring the real dangers. Strong polarisation is underway between the fast–moving majority of unemployed people, who spend just a few weeks without work even in recession, and a large and growing minority who were on the fringes of the labour market in the boom years. It is this latter group on whom the recession threatens to bite hardest and indelibly.

This report uses data from two previous recessions and the latest independent economic growth forecasts to estimate what might happen to claimant count unemployment and the number of long-term unemployed people in particular. It then goes on to address three key questions:

- How does recession change the assumptions underlying welfare policy compared to normal economic conditions?
- What policy options are available to mitigate the impact of the recession on the long-term unemployed, and which of these is likely to be successful and cost effective in the long-run?
- What are the implications for the Government's existing welfare reform agenda?

SECTION 1: UNEMPLOYMENT AND LONG-TERM UNEMPLOYMENT BY 2012

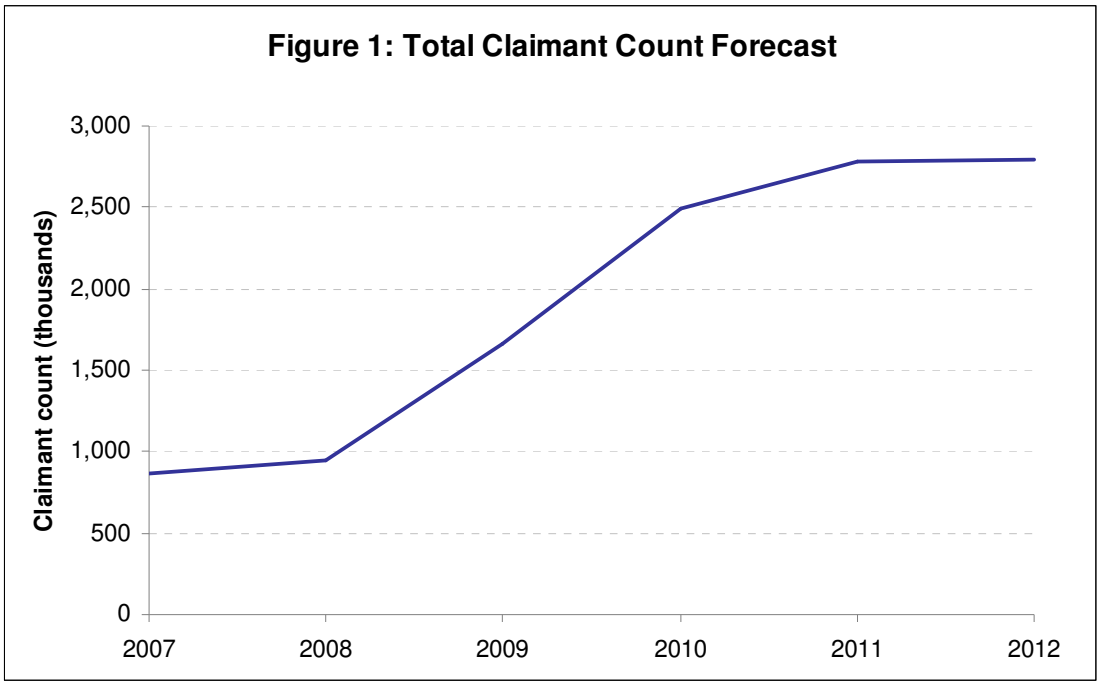
Our forecast of unemployment is based on analysing relationships in data from the past 30 thirty years and two recessions. Broadly, changes in short term unemployment resulting from slowing real GDP growth are estimated. After this, to forecast long-term unemployment, changes in the long-term unemployment rate as a result of changes in the short term unemployment rate are also estimated. These effects are combined with forecasts of future real GDP growth to calculate corresponding forecasts for changes in short term and long-term unemployment rates over the next four years.

Our forecast is based on claimant count unemployment, which covers all those claiming Jobseeker's Allowance (JSA). The internationally standardised ILO definition of unemployment has tended to be significantly higher in recent years. However, history suggests that in recession, the two measures track each other much more closely[1].

[1] Andrew Machin *Comparisons between unemployment and the claimant count* Labour Market Trends February 2004

Our estimates suggest that changes in GDP growth have both a current year effect on short term unemployment and a one-year lagged effect. A one percentage point fall in the real GDP growth rate this year alone increases the short term unemployment rate by 0.21 percentage points this year and a further 0.14 percentage points next year. It is also estimated that a one percentage point increase in the short term unemployment rate this year alone raises the long-term unemployment rate today by 0.42 percentage points and an additional 0.47 percentage points next year.

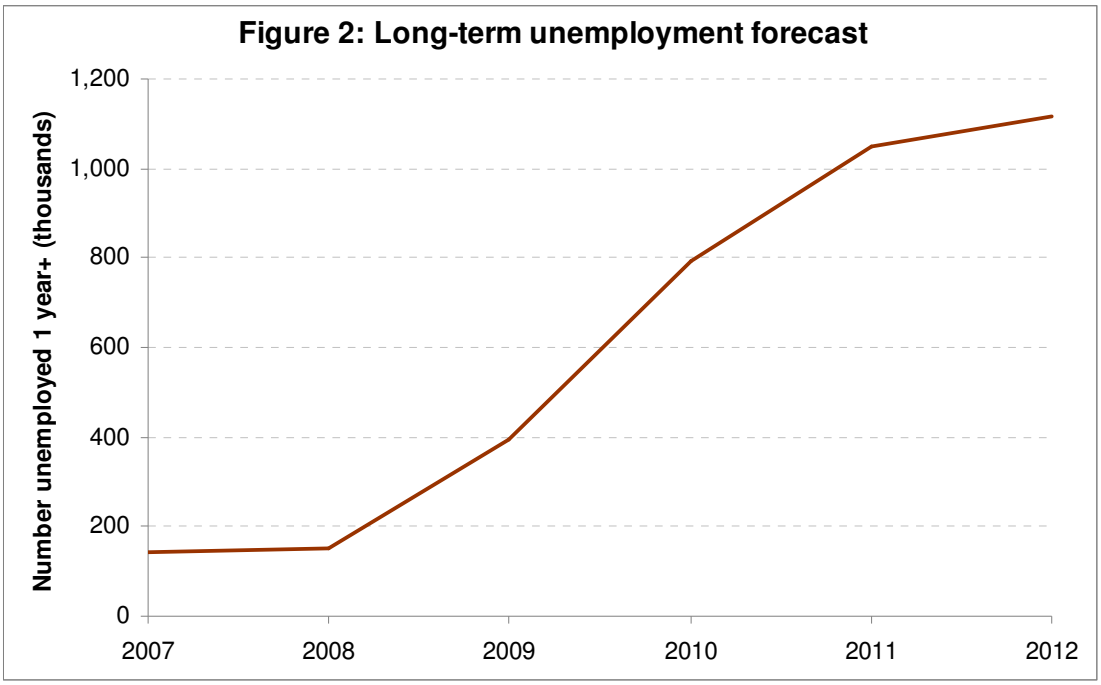
Applying the most recent ITEM Club economic forecast[2] to our analysis suggests that total claimant count unemployment number of long-term unemployed people (those without work for more than one year) will rise to over 2.7 million, peaking in 2011-12. Figure 1 shows the trajectory of claimant count unemployment to 2012 as forecast by our model. Applying the model to the previous two recessions shows that it may slightly under-estimate the total: unemployment could therefore rise even higher than these values.



Long-term unemployment is defined here as the stock of people claiming JSA for over 12 months. An important question is what happens to the level of long-term unemployment as overall unemployment rises. Does it rise disproportionately to the overall claimant count? Figure 2 shows that the stock of long-term unemployed claimants

[2] ITEM Club Spring 2009, 20 April 2009

is expected to increase by more than six times its 2007 level, peaking at around 1.1 million in 2012. This disproportionate rise in long-term unemployment reflects the polarisation that is occurring between JSA claimants of different durations. It indicates that the nature of the unemployment challenge changes radically in a recession - to a situation where long-term unemployment accounts for around 40% of the entire claimant count.



The anticipated huge rise in the long-term unemployed raises crucial policy questions about what should be done to mitigate the personal, social and financial impact of the recession among those most seriously affected. The next section explores the ways in which that policy approach should change in the current economic climate as well as the implications if it does not.

SECTION 2: THE ROLE OF EMPLOYMENT SERVICES IN RECESSION

In the benign economic conditions of recent years, something approaching a consensus emerged about the role of employment policy. Employment services were designed around a 'work first' approach on the understanding that their role should be to reduce frictional unemployment by focusing efforts on matching jobseekers to available jobs and easing the exchange of labour. The UK's employment services, in common with those of other developed countries in the recent years of macroeconomic stability, have tended to focused on a set of common interventions

known as active labour market policies (ALMPs) to encourage people to actively seek work. These interventions have been broadly effective and subject to continuous improvement[3].

However, in conditions of rising levels of cyclical unemployment and rapidly falling labour demand, this strategy is less likely to be successful for the long-term unemployed in the short run. Vacancies notified to Jobcentre Plus in the three months to February this year were 36% down on the same period a year earlier. And data on people moving into work suggests that the long-term unemployed have already been hit hardest as opportunities dry up. Off-flow rates from long-term JSA into employment in the three months to February this year fell to 5,400, less than half what they were in the same period a year earlier (4.8% versus 10.2% of long term unemployed stock).

Clearly, in the current environment, the ability of employment services to match growing numbers of jobseekers with vacancies is limited, no matter how good those services might be. As labour demand collapses, the timeframe in which a given jobseeker could expect to find employment lengthens considerably. So the challenge for both employment services and government is in establishing how best to deal with the increased cohort of long-term jobseekers.

During the recessions of the 1980s and early 1990s, millions of jobseekers were moved onto inactive benefits to reduce labour supply: between 1971 and 1995, the numbers claiming incapacity benefits increased from around 500,000 to over 2 million.[4] This has been widely regarded as a wrong-headed approach to the problem of mass unemployment. A commonly cited statistic is that an IB claimant of more than two years' duration is more likely to die or retire than to move off benefits into employment. Allowing people to become detached from the labour market in this way carried huge costs in human and economic terms many years after economic growth had resumed.

These costs are substantial and long-lasting. In economic terms alone, estimates of the impact of unemployment suggest that a six-month spell reduces future earnings by 5.1% compared to similar people who were not unemployed, while one year without work reduces future pay by some 11.1%. This reduced wage appears to be permanent, representing a significant loss of productivity for the economy[5].

[3] Mulheirn and Menne *Flexible New Deal: Making it work* SMF (2008)
[4] Michael Anyadike-Danes and Duncan McVicar *Has the boom in Incapacity Benefit claimant numbers passed its peak?* (London: Institute for Fiscal Studies, 2007), 19. See Figure 1.
[5] Wiji Arulampalam, Paul Gregg and Mary Gregory, "Unemployment Scarring" in *The Economic Journal*, 111:475 (2001).

Box 1: Estimating the productivity cost of long-term unemployment

Evidence on the impact of long-term unemployment on individuals makes a compelling case for the importance of doing something to mitigate its consequences. However, it is helpful to think about the aggregate financial cost of long-term unemployment given the huge numbers of people we expect to be involved.

Extrapolating the linear trend in earnings depreciation reported by Arulampalam et al implies that, if all of these people were to remain unemployed for a further 12 months, their wages on re-entering employment would fall by around a further 10%.

Since median full-time earnings in 2008 were £25,123 per year and, assuming that a reduction in wages reflects a loss of human capital and therefore productivity, the cost of an extra year's unemployment may be around £2,500 per person on average. Analysis suggests that this wage reduction is permanent, reducing annual pay by the same amount each year.

In its letter to Flexible New Deal bidders in January 2009, DWP warned prospective providers that they should be prepared for the number of people starting on FND – i.e. the number of people passing 1 year's unemployment – to be up to 3 times higher than the estimates set out in the Invitation to Tender. This implies that DWP anticipates the number of people passing the 1 year unemployment point to rise to 1.1 million per year[a].

If all of these people were to spend a further year unemployed, the productivity loss to the economy might therefore be in the order of £2.8bn per year every year into the future. If high levels of long-term unemployment were to persist for two years, the aggregate productivity loss could be over £5bn per year.

This represents a worst case scenario, with upper-bound costs giving a sense of the magnitude of the problem. Clearly some people will continue to move off long-term unemployment into work, even in the depths of recession. For these people the additional wage loss will therefore be less than the 10% associated with a full extra year of unemployment. How the off-flow rates for long-term unemployed people change over the cycle is complicated. But current rates of only around 20% of the stock per year suggest that the above figures may not be a wild overestimate of the likely ultimate cost of long-term unemployment.

a. FND Phase 1 onflows April 2010 to March 2012 were projected to average 150,000 per year in the ITT. A 300% increase implies an expected onflow of 600,000 per year. Phase 1 areas cover 53% of the UK long-term unemployed implying a total FND onflow of 1.13m per year. Note that this figure differs qualitatively from the stock figure estimated in Section 1.

Macroeconomic policy rightly aims to minimise the impact of recession and therefore the number of job losses across the economy. But to avoid the kinds of costs associated with long-term unemployment, the microeconomic policy focus must be to prevent jobseekers who are struggling to find employment in the short-term from becoming detached from the labour market in the long-term. In doing so, policy must prepare them to take advantage of the economic upswing when it comes. As Meager and Evans put it, the key question for microeconomic policy "is not which policies are most effective in stopping people becoming unemployed, but rather which are most effective in maintaining the 'employability' of the unemployed so that they are less likely to flow into long-term unemployment."[6] In pursuing this goal, strategies to maintain human capital is paramount. An individual's human capital consists of their skills – both job-specific and more general 'employability' skills – which quickly deteriorate during extended periods out of employment.

But recession also presents an opportunity to do things that are not cost-effective in more benign economic conditions. The acquisition of new skills takes time and investment, can keep people away from the labour market, and may only pay a return on the investment over a long period of time. As such, when employment is growing, skills-focused interventions can appear costly relative to the alternative work first approach. But in a recession the comparison changes: since the alternative to training is, for many people, no longer finding a job, its cost-effectiveness increases[7]. In short, a recession reduces the opportunity cost of skills maintenance and acquisition and therefore arguably changes the balance of the 'skills or work' focus of policy towards the former.

There exists a variety of means through which maintaining and building the skills of the unemployed workforce can be achieved, most of which have been trialled on some scale during previous periods of high unemployment. The next section discusses the viability of many of these suggestions and what lessons can be drawn for the right policy approach today.

SECTION 3: MITIGATING THE IMPACT OF LONG-TERM UNEMPLOYMENT

The above observations have, in recent months, motivated a range of suggestions from various organisations about what Government should now do to mitigate the growing problem of long-term unemployment. These have included:

- Work creation schemes;

[6] Ceri Evans and Nigel Meager, *The Evaluation of Active Labour Market Measures for the Long-Term Unemployed* (Geneva: International Labour Office, 1997), 7.
[7] See David Willetts, "Press Release: Raising Skills in the Recession".

- Subsidies to employers to retain staff;
- Hiring subsidies for employers taking long-term unemployed;
- Intermediate labour market programmes; and
- Training courses.

Here we take each option in turn, drawing on existing evidence about the effectiveness of these approaches.

Job Creation programmes

Recent weeks have seen numerous proposals for a revamped version of the mass public job creation programmes employed during earlier recessions. The Trades Union Congress (TUC), the Association of Learning Providers and commentators such as Lord Richard Layard, Polly Toynbee and Will Hutton have called for the government to act as an 'employer of last resort', providing temporary jobs for the long-term unemployed in a scheme akin to the Community Programme of the 1980s.[8]

Public works programmes involve a centrally engineered creation of jobs, usually ones with a social purpose. As recession mitigation policies, such schemes aim at least to maintain the work habits of participants, and where possible, to maintain and build skills that may be of use in future employment opportunities.

The last time a large-scale public works programme was implemented in the UK was through the Community Programme (CP). Introduced during the recession of the early 1980s, by 1986 the CP was providing placements for 230,000 of the long-term unemployed at a cost of over £1 billion. According to the Department of Employment, its two key advantages were that "existing jobs are not replaced and that the local community derives benefit from a particular project".[9] Qualitative surveys found participants to be positive about the programme's effects, particularly on their personal development.[10]

The actual effectiveness of the CP is more questionable, however. Providing sufficient funding for such schemes is a major challenge, and restrictions on rates of pay offered to CP participants meant that, effectively, participation was

[8] See Polly Toynbee "As the job market plunges, the fantasy politics prevail" in *The Guardian,* 21st March 2009; Nicholas Timmins and Alex Barker "Call to bring back 1980s welfare-to-work plan" in *The Financial Times,* 14th March 2009 and Brian Groom "A Fragile Flexibility" in *The Financial Times,* 13th April 2009.
[9] Department of Employment (1982) cited in David Dolowitz, "British Employment Policy in the 1980s: Learning from the American Experience", in *Governance*, 10:1 (1997), 34.
[10] Leslie Rosenthal, "Employment Effects of Community Programme Participation: Evidence From Matched Samples," *The Manchester School,* LXIV: 1 (1996), 54.

only worthwhile for those aged under 25: 62% of participants were aged between 18 and 24.[11] Haskel and Jackman found a slight increase in outflow rates amongst younger participants, which they point out may have been due to a degree of self-selection of participants. In other words, many of the positive post-programme job outcomes may have occurred anyway, since CP was voluntary and participants were on average better qualified and perhaps more highly motivated than non-participants.[12]

Indeed, most studies are highly sceptical about the effectiveness of any public job creation programmes, suggesting that they may in fact be not only expensive but harmful to participants' post-programme employment chances. In his extensive review of the quantitative effects of active labour market policies in the EU, Kluve found that public sector job creation programmes "are rarely effective and frequently detrimental regarding participants' employment prospects."[13] Similarly, in a study of ALMPs in Switzerland, Gerfin and Lechner attributed the poor performance of public employment programmes to the fact that "the resulting reduction of received job offers due to being in these comparatively long programmes by far outweighs the gains in terms of additional work experience provided by these programmes."[14] Meadows concludes that this option generally represents "exceptionally poor value for money."[15]

Therefore, while there have been numerous calls to revert to job creation strategies, the evidence suggests that such programmes are both highly expensive and may in fact be detrimental to people's employment chances in the long-run.

Subsidised employment programmes

A variation on a mass public job creation scheme would be a centrally-funded employment subsidy for firms to make up the wages of employees who agree to a reduction in working hours. This has recently been proposed by a coalition of organisations including the TUC, the British Chambers of Commerce and the Federation of Small Businesses. They argue that this kind of scheme would allow organisations to retain skilled workers and prevent the

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[11] Jonathan Haskel and Richard Jackman, "Long-Term Unemployment in Britian and the Effects of the Community Programme," *Oxford Bulletin of Economics and Statistics,* 50: 4 (1988), 392.
[12] Haskel and Jackman, "Long-Term Unemployment in Britian and the Effects of the Community Programme", 394.
[13] Jochen Kluve, "The Effectiveness of European Active Labour Market Policy," (Paper presented at the *COST Network Conference* conference, May, 2006), 27.
[14] Michael Gerfin and Michael Lechner, "A Microeconometric Evaluation of Active Labour Market Policy in Switzerland," *Economic Journal,* 112 (2002), 35.
[15] London Development Agency, *What Works With Tackling Worklessness?*, by Pamela Meadows (London: London Development Agency, 2006), 6.

collapse of many viable businesses.[16] The attraction of such a scheme is that it could prevent the significant penalties paid by employees who lose their jobs, as well as preventing their ever suffering the degradation of firm- and industry-specific skills associated with long-term unemployment.

However, such schemes run huge risks of deadweight costs associated with subsidising jobs that would not have been lost in the absence of the policy. In addition, the experience of this kind of scheme in the 1980s suggests that many of the jobs that might be saved by this temporary programme were ultimately lost anyway.[17]

All in all, large-scale employment subsidy schemes are likely to be extremely expensive and a huge proportion will be deadweight cost.

Hiring subsidies

A variation on subsidy schemes for existing employees, described above, is wage subsidies for employers who take on long-term jobseekers. Such 'golden hellos' have already featured in the Government's proposals to combat unemployment of over six months. In January 2009, the Department for Work and Pensions announced they were earmarking £400m to provide subsidies of up to £2,500 for employers hiring a jobseeker who has been unemployed for more than six months. The aim of such policies is to stimulate demand for labour and increase off-flow rates from long-term unemployment.

Government subsidies to allow employers to continue creating jobs during a recession have been widely used in the past. However, evidence suggests that they are seldom cost-effective in terms of increasing the aggregate level of labour demand in the economy. For example, Martin and Grubb found both deadweight and substitution costs of around 90% in their analysis of private sector subsidy schemes in Australia, Belgium, Ireland and the Netherlands. This implies that, for every 100 jobs subsidised, only ten were net gains in employment.[18] Further, the need to prevent gaming of the system (firing existing employees to hire subsidised ones) leads governments to restrict the offer to firms who have not laid people off, making schemes complex to administer. Hence cash-strapped governments might be wary of investing in this policy.

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[16] See Trades Union Congress et al., "Letter to Rt Hon Alistair Darling MP on Short-Time Working", http://www.tuc.org.uk/extras/shorttimeletter.pdf.
[17] Jean Eaglesham, "Darling likely to reject plea for job subsidy" in *The Financial Times*, 16th April 2009
[18] IFAU - Office of Labour Market Policy Evaluation, *What Works and for Whom: a Review of OECD Countries' Experiences With Active Labour Market Policies*, by David Grubb and John P Martin (Paris, 2001), 21.

This is not to say that subsidies are wholly ineffective, however. Meadows points to evidence from Sweden and the evaluation of the New Deal for Young People in the UK, which suggests that, while the net job creation impact of subsidies may be dubious, they do offer benefits to the individuals involved. As the SMF has argued before, where employers hire new staff from the long-term unemployed rather than the short-term group as a result of the subsidy, that may serve to spread the pain of recession more evenly and reduce the chances of long-term detachment from the labour market for all.[19] As a measure to minimise social exclusion, therefore hiring subsidies can have an important role.

Evidence suggests that hiring subsidies are not a cost-effective way to create new employment. However, they may have other benefits in minimising the chances of exclusion by making the long-term unemployed relatively more attractive to prospective employers.

Intermediate Labour Markets

Intermediate Labour Markets (ILMs) provide sheltered, transitional employment opportunities combined with intensive personal support, training and job search, which allow disadvantaged groups or the long-term unemployed people to gain job-specific or general employability skills before moving into the mainstream labour market. They are small in scale and can either form an arm of a larger business, or consist of a firm run by a third sector provider. Two examples of such schemes currently operating in the UK are: The Wise Group's local regeneration social enterprise based in Glasgow, and Marks and Spencer's 'Marks and Start' programme.

The potential of ILMs for combating social exclusion in deprived areas has increasingly been realised: many Employment Zones incorporated 'Neighbourhood Match' schemes, in which ILMs were established to reflect the needs of local people.[20] The TUC is now calling for £2 billion intermediate labour market programme to be introduced in the Budget, targeted to the most disadvantaged areas and people.[21]

Evaluation evidence also suggests that ILMs can be relatively effective. Meager and Evans cite conclusions from Phase 1 of the EU's ERGO study, which found that ILMs "can provide a better solution, more cheaply, and frequently with less deadweight than the general application of wage subsidy schemes or than 'work of public utility'

[19] See Ian Mulheirn "Two Kinds of Unemployment" in *Social Market Foundation Newsletter,* January/February 2009.
[20] Select Committee on Education and Employment, "Government Reply: Second Special Report, Session 1997-1998 (HC 496)".
[21] Trades Union Congress, *Budget Submission 2009: A Budget for Jobs and Green Growth* (London: Trades Union Congress, 2009), 5.

programmes."[22] There is, however, a general consensus that ILMs are best suited to small-scale projects focused on the most disadvantaged individuals. As Marshall and Macfarlane concluded, "ILMs offer added value when working with the longer-term unemployed or people who are otherwise 'excluded', and are best used as part of a range of measures. It is not recommended that they are elevated to large-scale or national programmes."[23] This may also be an opportune moment to seek innovative solutions in the ILM vein, such as investing in social firms.

ILMs have the potential to be effective in helping those furthest from the labour market who are unlikely to gain any opportunities for employment during a recession. But their success depends on effective design. Programmes should be locally administered, small-scale and dependent for funding on later job-placement success (see Section 4).

Work-focused training

The UK is ranked 18th out of 30 OECD countries in terms of the proportion of its working age population with low skills. The 2006 Leitch Review of skills suggested this would prove a major barrier to future economic growth. But training need not be focused solely on basic skill, and low levels of labour demand in recession offer the possibility of up-skilling the unemployed workforce in a more cost-effective manner than in more normal times.

Training has to some extent fallen out of favour in recent years. First, the up-front costs are high and the pay-offs, relative to work first approaches, are longer-term. Second, it is often claimed that training courses bear little resemblance to the skills needs of local employers, hence they can be an expensive distraction with no benefit for jobseekers.

While the latter objection relates to system design (see section 4, below), the former is something that changes according to macroeconomic conditions. With unemployment rising both in aggregate and in average duration, the alternative to training for a given jobseeker is less likely to be secure employment. Hence, time-consuming investment in human capital, or skills, becomes more cost-effective (for either government or the individual) than in benign economic conditions, as the opportunity cost of training falls. Indeed, the effect of this dynamic among school leavers is already being seen.[24] Equipping jobseekers with a relevant set of skills and qualifications in the

[22] Commission of the European Communities (1992) cited in Evans and Meager, *The Evaluation of Active Labour Market Measures for the Long-Term Unemployed*, 63.
[23] *The Intermediate Labour Market: A Tool for Tackling Long-Term Unemployment*, by Bob Marshall and Richard Macfarlane (York: Joseph Rowntree Foundation, 2000), 52.
[24] Nicola Woolcock, "University applications rise by 8% as recession bites" in *The Times,* 16th February 2009.

short-term should then put them in a better position to capitalise on a future economic upswing. There have been numerous recent calls – among them the Chief Executive of the UK Commission for Employment and Skills – for the Government to increase training budgets in light of this.[25]

However, assessing the impact of training programmes has proved a controversial area and, as Meager and Evans put it, the general consensus is that these programmes "have not lived up to expectations."[26] Leitch identified the frequent disjoint between skills provision and employment services (for example, there were no effective links between New Deal programmes and Train to Gain) and the need to ensure that incentives were aligned. [27] The Government has sought to tackle this through the introduction of a more joined up 'Adult Advancement and Careers Service' (due to be rolled out nationally in 2010). However, some employment advisers continue to believe jobseekers may be offered 'training for training's sake', with little emphasis on securing relevant qualifications that actually boost employability. If jobseekers encouraged to take up training during the recession are not to be sidelined during the upswing, they believe that the quality and accessibility of training on offer must be improved.

A more flexible training agenda would also allow for more innovation amongst training providers and better tailoring of training to individual jobseekers. There is now a wide consensus that the most effective programmes are targeted on the requirements of the local labour market, with a work-based component and good links to local employers.[28] The challenge is to ensure that training is highly job outcome-focused. How this can be achieved is explored further in Section 4.

More broadly, the consensus on the relative ineffectiveness of training that has dominated policy in recent years is also beginning to be questioned. Meadows cites evidence from a number of sources suggesting that many of the studies on the effectiveness of training have not included appropriate timeframes. Recent research suggests that training does keep jobseekers away from the labour market in the short-term, but that if it is appropriately work-focused returns to the investment may in fact be high in the long-run.[29]

The weakness of training has traditionally been that its opportunity cost is high and its relevance to employment often low, hence it yields poor returns. Recession changes the first of these. A flexible and outcome-based system is required to change the second (see Section 4).

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[25] Lindsay Clark, "Skills chief urges employers to see recession as opportunity to upskill staff" in *Personnel Today,* 24th October 2008.
[26] Evans and Meager, *The Evaluation of Active Labour Market Measures for the Long-Term Unemployed*, 65.
[27] Leitch Report: Review of Skills, 'Prosperity for all in the Global Economy – World Class Skills, Final Report', (HMOS: London, 2006), 13.
[28] IFAU - Office of Labour Market Policy Evaluation, *What Works and for Whom: a Review of OECD Countries' Experiences With Active Labour Market P olicies*, 16.
[29] See London Development Agency, *What Works With Tackling Worklessness?*, 35.

SECTION 4: A SYSTEM THAT WORKS IN RECESSION - IMPLICATIONS FOR WELFARE REFORM

This paper has briefly reviewed evidence on five key policy approaches for preventing skills atrophy and labour market disengagement during a recession. This final section draws out the lessons from past experience and what they mean for the government's welfare reform agenda. The clear messages from this work are as follows:

- Job creation schemes are wasteful of public money and can in fact reduce later employment chances for jobseekers.
- Large scale job subsidy programmes for existing employees will be very costly and ineffective.
- The deadweight costs associated with trying to keep people in employment are high. Using unemployment services to maintain and build skills to keep long-term unemployed people attached to the labour market should instead be the emphasis of policy.
- Hiring subsidies can share the pain of unemployment, preventing permanent disengagement, but will not greatly improve the aggregate situation.
- Appropriate human capital-focused interventions can come in many forms but must be highly work-focussed if they are to offer value for money.
- Interventions such as training courses, on-the-job training and ILMs can be effective but must be: small in scale; designed with the needs of the local labour market in mind; flexible to accommodate the needs and past experience of individuals; and heavily job outcome-focussed.

The challenge for the Government is therefore to deliver interventions quickly and in a way that meets these criteria. But designing the 'right' programme from Whitehall is doomed to failure. In fact, the Government has the right infrastructure to achieve these aims through the Flexible New Deal programme. Under this new scheme, due to begin in October 2009, private providers have the flexibility to design specific and small scale programmes to find the best way to help specific individuals. They are paid for each person they get into employment, however achieved. While some have suggested that this model is now unworkable, it in fact offers the best opportunity for the kind of solutions that are now required.

However, the current parameters of FND do not reflect the rapidly changing macroeconomic context. As they stand, incentives in the system are likely to be very harmful for the long-term unemployed. Significant changes

must be made to allow the model to prompt service providers to respond to the changing economic environment. These changes should include the following.

- Private providers are currently paid for job starts they can achieve within one year of a jobseeker coming to them. In current conditions they are unlikely to get much more than 20% of jobseekers into work within that one year; meanwhile a one-year horizon actively discourages interventions to build and sustain human capital for the majority. Unemployment service providers' **engagement with jobseekers must therefore be lengthened from one to three years**, to refocus their efforts on retaining employability and getting jobseekers back into work when the economy picks up.
- Three times more long-term unemployed jobseekers per year (a total of around 1.1 million per year) are now expected to move onto the (specialist provision part of the) Flexible New Deal once it starts, in late 2009 and early 2010. This means that the level of resources available to private providers must be **around £1.4bn per year higher than planned in each of 2010, 2011 and 2012** just to maintain the level of spending per jobseeker that was planned when the scheme was designed.
- Extra resources, in addition to those described above, must be provided to enable providers to make the kind of human capital-focused interventions required. As durations of unemployment increase and the necessary interventions become more costly, restoring resources per head to the *status quo ante* will be insufficient. Post-employment skills funding, such as Train to Gain money should therefore be deployed within the pre-employment welfare-to-work system for the duration of the recession.
- **JSA rules** limiting the length of training that can be undertaken to 8 weeks should be changed to allow longer courses. The efficacy of such courses would be monitored by providers being paid by results.
- Payments to employment service providers should remain **highly job outcome contingent** (80% on achieving an outcome) rather than moving back to process-based payments.
- Government should pay a greater proportion of **up-front funding** to ease providers' cash-flow problems and credit constraints, and recover funding where outcomes subsequently fall short.

With these changes in place FND will provide strong incentives for employment service providers to make the right choices now to prevent long-term unemployed people becoming permanently disengaged from the labour market. Without these changes, under-resources providers will target short-term job outcomes for a small minority of the most 'job ready.' The consequences of that for the majority would be dire.