

What should be done about rising unemployment in the OECD?

28th September 2009

ORGANISATION
FOR ECONOMIC
CO-OPERATION
AND DEVELOPMENT



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Summary

- The costs of unemployment will vary across countries and between groups within populations. The young will be hit hard.
- I examine the world economic outlook, arguing that it is much more fragile than many commentators believe and that return to previous levels of unemployment is not guaranteed.
- I analyze increases in unemployment that have already taken place at a country level, looking at how they relate to other economic indicators of the recession.
- Then I will consider the human and social costs of increased unemployment, especially among the young. I conclude with some policy issues and conclusions.

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The crisis was predictable

- Asset markets looked like bubbles (UK house price/earnings ratios)
- The oil price rise looks like it was driven by speculation above \$70
- Patterns in consumer and business surveys in the EU were similar to those in the UK and the US. These surveys fell sharply in the US from July 2007 well before the falls in the quantitative data (GDP, retail sales, employment etc)
- The financial crisis represents a major failing of economics in general and macroeconomics in particular

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1995 Nobel Laureate Robert Lucas

2003 Presidential address to the American Economic Association

"Macroeconomics was born as a distinct field in the 1940's, as a part of the intellectual response to the Great Depression. The term then referred to the body of knowledge and expertise that we hoped would prevent the recurrence of that economic disaster.

My thesis in this lecture is macroeconomics in this original sense has succeeded: its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades".

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Financial crisis represents a failure of modern macro

- *“New classical and new Keynesian research has had little impact on practical macroeconomists who are charged with the messy task of conducting actual monetary and fiscal policy”*

(Gregg Mankiw, (2006), ‘The macroeconomist as scientist and engineer’, Journal of Economic Perspectives, 20(4), Winter, pp. 29-46).

- *“The state of macro is good”*

(IMF Chief economist Olivier Blanchard, ‘The state of macro’, NBER WP14259, August 2008)

- *“Over the last three decades, macroeconomic theory and the practice of macroeconomics by economists have changed — for the better. Macroeconomics is now firmly grounded in the principles of economic theory”*

(V. V. Chari and P. Kehoe (2006), ‘Modern macroeconomics in practice: how theory is shaping policy’, Journal of Economic Perspectives, Fall, pp. 3–28)

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Nobel Laureate Robert Solow (2008)

“The other possible defence of modern macro is that, however special it may seem, it is justified empirically. This too strikes me as a delusion. In fact ‘modern macro’ has been notable for paying very little rigorous attention to data.

...I am left with the feeling that there is nothing in the empirical performance of these models that could come close to overcoming a modest scepticism. And more certainly, there is nothing to justify reliance on them for serious policy analysis”

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Robert Solow (2008), Journal of Economic Perspectives, 22(1), Winter, pp. 243-249.

Outlook for the World Economy – it is unlikely to be over!

Reinhardt and Rogoff show that financial crises have “deep and lasting effects on asset prices and employment”

First, asset market collapses are deep and prolonged. Real housing price declines average 35 percent stretched out over six years, while equity price collapses average 55 percent over a downturn of about three and a half years.

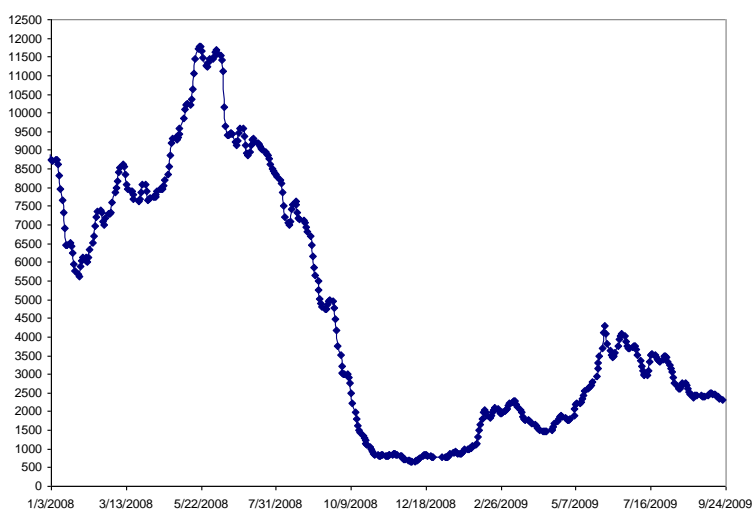
Second, the aftermath of banking crises is associated with large declines in output and employment. The unemployment rate increases, an average of 7 percentage points over the down phase of the cycle, which lasts, on average over four years. Output falls (from peak to trough) an average of over 9 percent, although the duration of the downturn, averaging roughly two years, is considerably shorter than for unemployment.

Third, the real value of government debt tends to explode, rising an average of 86 percent in the major post–World War II episodes. The government budget constraint implies that any short-run fiscal expansions must be compensated by future reductions in demand and consequent weakened growth.

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C.M. Reinhart and K.S. Rogoff (2009), 'The aftermath of financial crises', NBER Working Paper #14656.

Figure 1. The Baltic Dry is down 46% since June 6th 2009



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Table 1. Decline in output since peak

| | | | |
|-----------|--------|-----------------|--------|
| Australia | -0.3% | Netherlands | -4.9% |
| Austria | -3.5% | New Zealand | -3.8% |
| Belgium | -4.4% | Norway | -0.5% |
| Canada | -2.7% | Poland | 0% |
| Denmark | -5.3% | Portugal | -4.2% |
| Finland | -7.6% | Slovak Republic | -19.1% |
| France | -3.7% | South Korea | -3.9% |
| Germany | -7.7% | Spain | -4.1% |
| Iceland | -8.0% | Sweden | -7.8% |
| Ireland | -14.0% | Turkey | -20.2% |
| Italy | -6.5% | United Kingdom | -6.6% |
| Japan | -9.5% | United States | -4.7% |
| Mexico | -10.7% | OECD | -5.6% |

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Table 3. Decrease in employment since the peak

| | | | |
|-----------|-------|-----------------|-------|
| Australia | -0.2% | Netherlands | 0% |
| Austria | -1.0% | Norway | -0.7% |
| Belgium | -1.1% | Poland | -0.3% |
| Canada | -1.8% | Portugal | -1.7% |
| Denmark | -1.4% | Slovak Republic | -2.4% |
| France | -0.4% | South Korea | -0.7% |
| Germany | -0.8% | Spain | -6.4% |
| Greece | -1.1% | Sweden | -2.7% |
| Ireland | -8.6% | Turkey | -1.7% |
| Italy | -1.2% | United Kingdom | -1.1% |
| Japan | -2.4% | United States | -3.9% |

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Table 4. Increases in unemployment rate since peak (percent pts)

| | | | |
|-----------|-------|-----------------|--------|
| Australia | +1.9% | Netherlands | +0.6% |
| Austria | +3.6% | Norway | +0.8% |
| Belgium | +1.5% | OECD Europe | +2.1% |
| Canada | +2.8% | Poland | +1.4% |
| Denmark | +3.1% | Portugal | +2.4% |
| Finland | +2.3% | Slovak Republic | +2.7% |
| France | +1.8% | South Korea | +1.0% |
| Germany | +0.6% | Spain | +10.2% |
| Greece | +1.2% | Sweden | +3.4% |
| Ireland | +8.0% | Turkey | +4.4% |
| Italy | +1.5% | United Kingdom | +2.9% |
| Japan | +1.8% | United States | +5.0% |
| Mexico | +2.4% | OECD | +2.7% |

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Keynes in 1931

"The duration of the slump may be much more prolonged than most people are expecting and ... much will be changed both in our ideas and in our methods before we emerge. Not, of course the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least sub-normal prosperity, which may be expected to succeed the acute phase."

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J.M.Keynes (1931). 'An economic analysis of unemployment' in 'Unemployment as a world-problem' edited by Wright, Keynes, Pfiibram, & Phelan.

Dominique Strauss-Kahn, MD of the IMF in 2009

"I expect this recovery to be relatively sluggish. In the advanced economies, it is still largely driven by policy stimulus and restocking, with underlying private demand remaining weak. The outlook for the emerging economies is considerably better, though the pace of recovery in advanced trading partners remains a risk.

Given the fragility of the recovery, there are risks that it could stall — though thankfully these risks appear to be receding. Premature exit from accommodative monetary and fiscal policies is a principal concern. In addition, problems in the financial sector could persist or even intensify further, particularly if efforts to restore banks to health are not completed."

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Symptoms of Recession

Output Turning Points (Table 2)

- It is apparent that the fall in world trade has been more rapid than that of world output. Hence Germany and Japan where trade is important have experienced rapid declines in output (-7.7% and -9.5% respectively)
- Output peaked in the OECD in 2008Q1 and the EU27 and the Euro Area
- Output peaked in the USA and the UK in 2008Q2
- Output peaked in 2007 in Ireland, Iceland, Luxembourg, Denmark, New Zealand and Canada

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Symptoms of Recession

Employment Turning Points (Table 3)

- In this recession the labour market has been a lead indicator in some countries and contemporaneous with output in most others.
- The NBER dated the US recession as starting in 2007Q4 based on the decline in non-farm payrolls
- Employment peaked in 2007 in Japan and Hungary
- In all other countries employment peaked in 2008
- Employment peaked in 2009 in Australia and the Netherlands

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Symptoms of Recession

Unemployment Turning Points (Table 4)

- Unemployment hit its low point in 2007 in the OECD, the USA, Spain, Ireland, Japan, Italy and Luxembourg and 2006 in Turkey.
- Unemployment has increased by *more* than employment has *fallen* in several countries, e.g. UK, USA and Sweden. In these countries youth unemployment has risen a lot
- Unemployment had turned upwards by June 2008 in Australia, Austria, Belgium, Canada, Denmark, Finland, France, Greece, Hungary, Ireland, Italy, Mexico, Norway, Portugal, Spain, Sweden, Turkey, the UK and the USA.
- The labour market may not lag on the upside

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Latest OECD Unemployment Rates July 2009 (%)

| | | | |
|----------------|------|-----------------|------|
| Australia | 5.8 | Mexico | 5.7 |
| Austria | 4.4 | Netherlands | 3.4 |
| Belgium | 8.0 | Poland | 8.2 |
| Canada | 8.6 | Portugal | 9.2 |
| Czech Republic | 6.4 | Slovak Republic | 12.0 |
| Denmark | 5.9 | Spain | 18.5 |
| Finland | 8.7 | Sweden | 9.2 |
| France | 9.8 | United Kingdom | 7.8 |
| Germany | 7.7 | United States | 9.7 |
| Hungary | 10.3 | European Union | 9.0 |
| Ireland | 12.5 | Euro area | 9.5 |
| Japan | 5.7 | G7 | 8.2 |
| Korea | 3.8 | OECD - Europe | 9.3 |
| Luxembourg | 6.4 | OECD - Total | 8.5 |

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Source: OECD Harmonised Unemployment Rates, News Release, OECD Paris, 14 September 2009

Symptoms of Recession – House Price Declines (Table 5)

- In a number of countries the fall in the price of housing has been dramatic. Home owners in the UK and USA have been among the hardest hit by the fall in value of what is likely to be their largest single asset.
- The Baltic Republics, with the exception of Lithuania, Poland, along with Ireland and Denmark have also experienced significant drops in value.
- House price declines have been modest in Germany, Finland, Italy and Sweden
- Countries with big house price declines have also seen big increases in unemployment e.g. UK, USA, Ireland, Spain, Denmark.

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Table 5. House price inflation year on year Q12009

| | | | |
|----------------|-------|-------------|--------|
| Israel | 10.9% | Canada | -2.4% |
| Czech Republic | 9.9% | Luxembourg | -2.4% |
| Switzerland | 5.6% | Slovenia | -3.1% |
| India | 5.1% | China | -3.9% |
| Indonesia | 4.6% | New Zealand | -4.0% |
| Austria | 4.1% | Croatia | -4.5% |
| Russia | 3.6% | Malta | -5.6% |
| Bulgaria | 3.3% | France | -5.7% |
| Belgium | 2.7% | Portugal | -5.9% |
| Hungary | 2.5% | Australia | -6.7% |
| Netherlands | 1.0% | Spain | -6.8% |
| Lithuania | 0.8% | Norway | -9.4% |
| Slovakia | 0.3% | Ireland | -10.0% |
| Italy | 0.1% | Denmark | -11.6% |
| South Africa | -0.3% | Poland | -13.0% |
| Sweden | -0.6% | Hong Kong | -15.7% |
| Finland | -0.7% | Estonia | -16.2% |
| Germany | -1.5% | UK | -16.5% |
| Greece | -1.5% | USA | -16.9% |
| Ukraine | -2.3% | Latvia | -36.0% |

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Symptoms of Recession – Youth Unemployment

- Youth unemployment is especially high
- There is a very large cohort in many countries. The size of the cohort declines rapidly in the former Soviet Bloc countries.
- Young unemployed people commit crime.
- Unemployment is especially high across the OECD among youngsters that are the least skilled, least educated and among minorities and foreigners. But many are college graduates.
- Applications to college are up in many countries.
- Minimum wages have not had large employment impacts on the young but likely that this will change when few jobs are available.

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Youth Unemployment Rates

| | July 2008 | July 2009 | Ratio youth/all |
|-------------|-----------|-----------|-----------------|
| EA16 | 15.4 | 19.7 | 2.1 |
| EU27 | 15.4 | 19.8 | 2.2 |
| Belgium | 19.9 | 21.6 | 2.7 |
| Denmark | 7.9 | 11.2 | 1.9 |
| Finland | 16.5 | 22.6 | 2.6 |
| France | 19.3 | 24.2 | 2.5 |
| Germany | 9.6 | 11.2 | 1.5 |
| Ireland | 12.4 | 25.5 | 2.0 |
| Netherlands | 5.3 | 6.6 | 1.9 |
| Poland | 16.6 | 19.8 | 2.4 |
| Portugal | 16.7 | 18.9 | 2.1 |
| Spain | 25.0 | 38.4 | 2.1 |
| Sweden | 17.7 | 27.3 | 3.0 |
| UK | 15.0 | 19.8 | 2.5 |
| USA | 13.5 | 17.8 | 1.9 |

Source: Euro area unemployment up to 9.5%, Eurostat 1st September 2009.

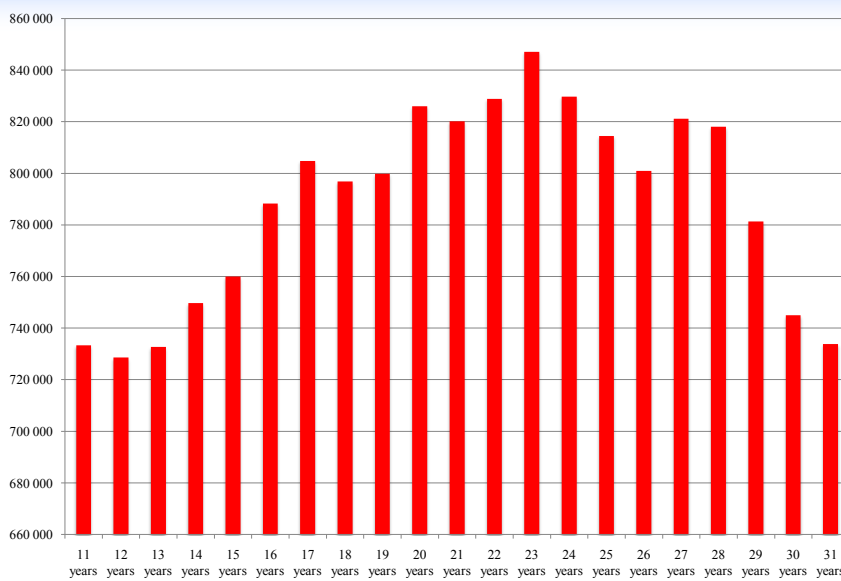
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Youth cohort size # 10 year olds where # 20 year olds=100 (Table 8)

| | | | |
|----------------|-------|--------------------|-------|
| Euro area | 88.3 | Latvia | 48.6 |
| Armenia | 70.2 | Lithuania | 65.6 |
| Australia | 92.1 | Luxembourg | 109.7 |
| Austria | 88.2 | Macedonia | 77.7 |
| Belgium | 95.0 | Montenegro | 82.1 |
| Bulgaria | 57.4 | Netherlands | 97.9 |
| Cyprus | 81.8 | Poland | 70.2 |
| Czech Republic | 67.3 | Portugal | 88.4 |
| Denmark | 111.6 | Romania | 62.2 |
| Estonia | 55.2 | Russian Federation | 49.9 |
| Finland | 96.8 | Serbia | 78.0 |
| France | 93.0 | Slovakia | 70.1 |
| Georgia | 73.6 | Slovenia | 70.1 |
| Germany | 83.1 | Spain | 81.6 |
| Greece | 88.0 | Sweden | 82.4 |
| Hungary | 78.5 | Switzerland | 92.3 |
| Iceland | 98.2 | Ukraine | 57.4 |
| Ireland | 98.2 | United Kingdom | 89.4 |
| Italy | 93.0 | USA | 94.2 |

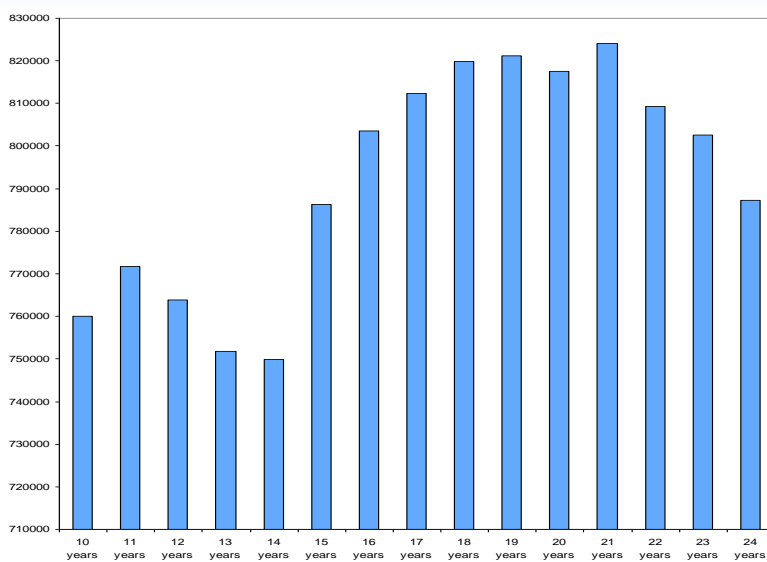
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The size of the youth cohort, UK, 2008



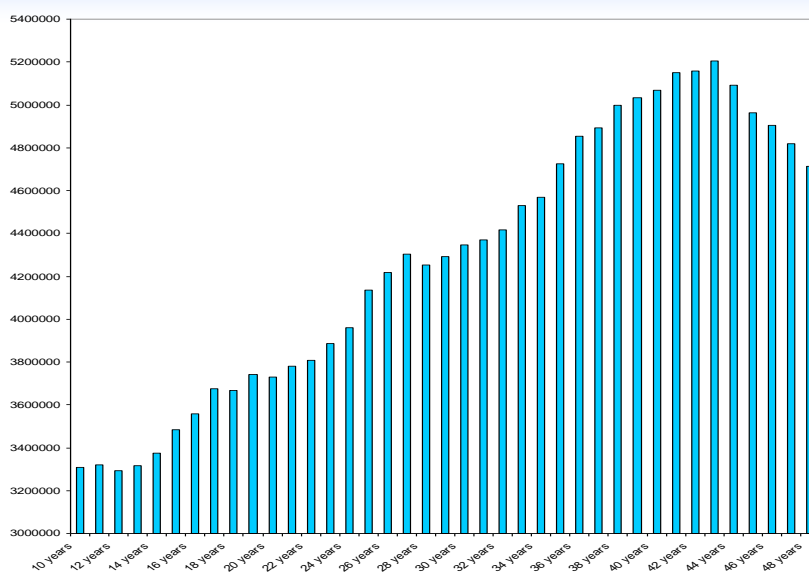
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The size of the youth cohort, France, 2008



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The size of the youth cohort, Euro Area, 2008
(BE, DE, IE, GR, ES, FR, IT, CY, LU, MT, NL, AT, PT, SI, FI)



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Explanations for the Growth in Unemployment

- Countries that have had big increases in unemployment have the following characteristics
- Exposed to world trade (Germany, Japan and Sweden)
- Had large increases in house prices (Spain, Ireland and the UK)
- Had large financial sectors (UK and the USA).
- Countries with low unionization rates such as the United States and Korea as well as ones with high rates such as Denmark and Sweden have also done badly

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Consumer Confidence and Attitudes to Unemployment

- Consumer confidence fell early in many countries
- In the USA and most EU countries individuals expected increases in unemployment early in the recession
- US individuals and firms in 2009 believe unemployment is going to remain high
- In the EU surveys the *fear of unemployment* rose from early in 2007 but has fallen in most countries since the beginning of 2009
- In the EU firms are much more pessimistic about job prospects
- Consumers in Europe appear to be unrealistic about the seriousness of the unemployment problem.

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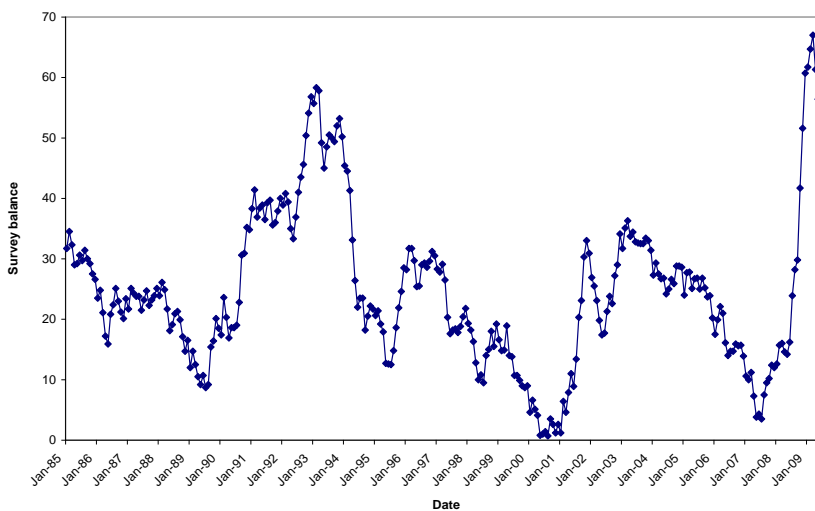
OECD 2009 Economic Outlook forecast for unemployment rates (%)

| | 2010 | 2009 | | 2010 | 2009 |
|----------------|------|------|-----------------|------|------|
| Australia | 7.7 | 5.8 | Luxembourg | 7.2 | 6.4 |
| Austria | 7.9 | 4.4 | Mexico | 6.9 | 5.7 |
| Belgium | 10.6 | 8.0 | Netherlands | 7.0 | 3.4 |
| Canada | 9.8 | 8.6 | New Zealand | 7.9 | 6.0 |
| Czech Republic | 9.2 | 6.4 | Norway | 4.3 | 3.1 |
| Denmark | 7.9 | 5.9 | Poland | 11.6 | 8.2 |
| Finland | 10.8 | 8.7 | Portugal | 11.2 | 9.2 |
| France | 11.2 | 9.8 | Slovak Republic | 13.6 | 12.0 |
| Germany | 11.6 | 7.7 | Spain | 19.6 | 18.5 |
| Greece | 10.3 | 8.7 | Sweden | 11.4 | 9.2 |
| Hungary | 11.7 | 10.3 | Switzerland | 5.1 | 4.1 |
| Iceland | 9.9 | 7.0 | United Kingdom | 9.7 | 7.7 |
| Ireland | 14.8 | 12.5 | United States | 10.1 | 9.7 |
| Italy | 10.2 | 7.4 | Euro area | 12.0 | 9.5 |
| Japan | 5.7 | 5.7 | Total OECD | 9.8 | 8.5 |
| Korea | 3.9 | 3.8 | | | |

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The fear of unemployment

Figure 7. How do you expect unemployment to increase over the next 12 months? - EU



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EU Business owners views on how employment will change

| | Building | Industry | Retail | Services |
|--------|----------|----------|--------|----------|
| Jan-08 | 4 | -2 | 5 | 10 |
| Apr-08 | -4 | -4 | 3 | 6 |
| May-08 | -4 | -6 | 1 | 8 |
| Jul-08 | -9 | -11 | -3 | 4 |
| Aug-08 | -10 | -11 | -3 | 5 |
| Sep-08 | -13 | -13 | -4 | 3 |
| Oct-08 | -18 | -19 | -3 | -1 |
| Nov-08 | -20 | -24 | -5 | -5 |
| Dec-08 | -24 | -31 | -14 | -9 |
| Jan-09 | -31 | -34 | -18 | -16 |
| Feb-09 | -32 | -37 | -16 | -18 |
| Mar-09 | -31 | -41 | -16 | -21 |
| Apr-09 | -30 | -39 | -16 | -22 |
| May-09 | -28 | -38 | -13 | -22 |
| Jun-09 | -27 | -36 | -15 | -22 |
| Jul-09 | -27 | -33 | -13 | -23 |
| Aug-09 | -25 | -31 | -13 | -17 |

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The Consequences of Unemployment (1)

- Because of the lost output involved. During a long period of unemployment, workers can lose their skills, causing lost human capital.
- Unemployment is a stressful life event that makes people unhappy
- Unemployment increases susceptibility to malnutrition, illness, mental stress, and loss of self-esteem, leading to depression.
- Increases in the unemployment rate tend to be associated with increases in the suicide rate. The unemployed appear to have a higher propensity to commit suicide.
- Being unemployed can also reduce the life expectancy of workers.

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The Consequences of Unemployment (2)

- Unemployment increases the probability of poor physical health outcomes such as heart attacks in later life.
- The long-term unemployed are at a particular disadvantage trying to find work. People's morale sinks as duration rises.
- As unemployment rates increase, crime rates tend to rise, especially property crime.
- Increases in the unemployment rate, lowers the happiness of everyone, not just the unemployed. The fear of becoming unemployed in the future lowers a person's subjective wellbeing
- Unemployment while young, especially of long duration, causes permanent scars rather than temporary blemishes.

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The Consequences of Youth Unemployment

- In a recent paper, David Bell of the University of Stirling and I, found that youth unemployment is especially harmful and creates scars
 - We used data from the UK 1958 (3rd -9th March) birth cohort the National Child Development Study (NCDS).
- I
- Youth unemployment while young (\leq age 23) raises unemployment, lowers wages, worsens health and lowers job satisfaction
 - No such effects could be found for spells of unemployment when the respondents were in their thirties
 - The effects continued into middle age when the respondents were in their late forties.

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D.N.F. Bell and D.G. Blanchflower (2009), "What to do about rising unemployment in the UK?", IZA DP #4040

Policy Solutions (1)

- 1) *Maintain or even increase aggregate demand*
 - i) stimulative fiscal policy
 - ii) low interest rates and quantitative easing. Keep going....!
- Little evidence from around the world that banks are lending. Foreign banks have left.
- Bank's balance sheets have not been fixed.
- Most demand growth is due to public not private stimulus
- It remains unclear where the new jobs will come from in the decade ahead. Not in financial services, construction, public sector so where?

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Policy Measures (2)

2) *Target assistance on the young*

- a) Active labour market programs
- b) Expand education
- c) Wage and employment subsidies for the young
- d) Incentives for hiring the young in public sector organisations such as in education and health
- e) Lowering the minimum wage for the young.

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Policy Measures (3)

3) *Other Measures have included the following**.

- i) Training and non-dismissal requirements
- ii) Use of short-time work or temporary layoff
- iii) Reductions in social security contributions
- iv) Tax exemptions or deferrals for enterprises
- v) Income tax cuts
- vi) VAT tax cuts
- vii) Direct and indirect enterprise support
- viii) Job matching, counseling and career guidance
- ix) Incentives for companies to employ additional workers especially from vulnerable groups
- x) Retraining of unemployed people
- xi) Mobility grants
- xii) Supporting self-employment including funding for start-ups
- xiii) Extension of the duration of unemployment benefits

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*Tackling the recession: Employment related public initiatives in the EU Member States and Norway, European Foundation for the Improvement of Living and Working Conditions, 2009.

Policy Measures (4)

- The difficulty is that there are simply **insufficient jobs** available. This means that measures such as retraining, mobility grants and counseling are unlikely to be successful on their own.
- At the very least these measures will not be as successful as they were when unemployment was low.
- Expansion of self-employment may well get unemployment down but doesn't deal with the problem that there is little work out there so earnings may well be very low. Architects aren't finding much work currently.
- Directly stimulative measures are likely to be most successful including use of short-time work subsidies, tax exemptions, tax cuts and incentives to employ additional workers.

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Keynes' Biographer Lord Robert Skidelsky

“Keynes’s big idea was to use macroeconomic policy to maintain full employment. His specific suggestion was to use monetary policy to secure a permanently low interest rate and fiscal policy to achieve a continuously high level of public or semi-public investment.”

Over time, as the returns on further additions to capital fell, the high-investment policy should yield to the encouragement of consumption through redistributing income from the higher to the lower-saving section of the population. This should be coupled with a reduction in the hours of work. In short, the object of macro-policy should be to keep the economy in ‘quasi-boom’ till the economic problem was solved and people could live ‘wisely, and agreeably, and well’.

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Conclusions (2)

- We are not yet in 'quasi-boom. We are still experiencing the dragging conditions of semi-slump.
- Recovery may not be V-shaped but W-shaped
- Moves to cut public expenditure or public sector wages or employment deep in a recession are a mistake and may turn a recession into depression
- Solving youth unemployment is the most pressing problem governments are facing today. Not dealing with the problem of high, and rising levels of youth unemployment hurts the youngsters themselves and has potentially severe consequences for us all for many years to come.
- **The time to act is now. The young must be the priority.**

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End



Thank you

Professor David Blanchflower
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