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**LONG-TERM UNEMPLOYMENT, THE INVENTION OF 'HYSTERESIS'
AND THE MISDIAGNOSIS OF THE UK'S PROBLEM
OF STRUCTURAL UNEMPLOYMENT**

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Long-Term Unemployment, the Invention of ‘Hysteresis’ and the Misdiagnosis of the UK’s Problem of Structural Unemployment

Over the last twenty years, a huge academic literature and a raft of policies have grown up on the basis of the idea that an increase in unemployment produces an increase in long term unemployment which is not simply reversible by an increase in demand for labour. This is assumed to be because being unemployed makes people less “employable”, so that the existence of a pool of long-term unemployed people in itself becomes a barrier to full employment. It is argued that there is “hysteresis”, in other words the behaviour of the labour market is determined not by the current state of economic variables, but by what has happened before. Special policies are alleged to be required to “reconnect” the long-term unemployed with the labour market.

This paper will show that there never has been any problem of irreversibility in long-term unemployment and that the policies supposedly required to deal with it are largely a waste of time and money. A rise in unemployment duration is a natural and unavoidable consequence of a rise in unemployment level. It reverses itself with falling total unemployment in the same way that it rises. The belief that it has some special significance is the result of analytical mistakes including jumping to conclusions on the basis of very short runs of data, failure to examine the relevant lag structures, and failure to consider the geography of unemployment and its connection with employment change. There is a straightforward explanation for the persistency of high unemployment in Britain, indicated by much previous experience in the interwar period and before. Because it arose mainly from loss of employment in manufacturing and mining, which was concentrated in particular places, it is structural. Adjustment both sectoral and geographical has been required, and this takes time. Furthermore, the employment losses were not merely a once-for-all “shock”, but a continuing trend. Jobs have gone on being lost from the same industries in the same places, so that adjustment processes could not catch up.

The failure of analysis of long-term unemployment has had consequences going far beyond the pages of the economic journals. In response to it, official policy has not only de-emphasised the demand-side urban and regional policies which would have addressed the real problem. It has also directed large resources to “active labour market policies” aimed at shortening unemployment durations and addressing “employability”. The efficacy of these programmes is at best doubtful. Most seriously, the state of being unemployed has been made so unattractive, by reducing benefits, shortening their duration, and imposing increasingly stringent conditions on their receipt, that large numbers of people have been driven into the status of long-term sickness, where they have even less chance of getting a job. Thus economists and policy makers have created a problem of the very kind they

thought they were addressing. The whole story graphically illustrates the principal weaknesses of modern academic economics.

The paper is laid out as follows. The first section sets out what has actually happened to unemployment and unemployment duration in Great Britain from the 1940s to the present day, drawing data from the claimant count, Labour Force Survey and Census. The second section outlines the theories around unemployment duration which grew from the mid-1980s onwards. The third section outlines the policies which were based upon them and shows how these policies have led to a real problem of “hysteresis”, of an unforeseen kind. The brief final section draws out some lessons.

This paper uses the now standard definition of “long-term” as over a year.

1. UNEMPLOYMENT AND UNEMPLOYMENT DURATION SINCE THE WAR

FIGURE 1 shows the course of total and long-term claimant unemployment in Great Britain since 1948, as percentages of the labour force (the “economically active”). The huge scale of the surge in unemployment in the early 1980s is apparent. The peak of the early 1990s was lower, but also very high. Total and short-term unemployment show marked seasonality, whereas by definition long-term unemployment cannot do so. Otherwise, short- and long-term unemployment have moved very closely together, when allowance is made for the time lags. Short-term unemployment leads total unemployment (“U”) by about one quarter. Long-term unemployment, measured as a percentage of the labour force (“L”), lags total unemployment by 3 quarters, and lags short-term unemployment by one year. Long-term unemployment measured as a percentage of total unemployment (“LAPU”) lags total unemployment by 6 quarters.

In measuring long-term unemployment, economists have usually focused on LAPU rather than on L. This has proved unfortunate, in that LAPU behaves oddly, as shown in FIGURE 1. Its lag behind total unemployment is double that for L. Unlike L, LAPU is affected by seasonality in U, which is its denominator. In addition, while L tracks U smoothly, LAPU moves in the opposite direction at turning points. This is because a turning point has an immediate effect on short-term unemployment, which makes LAPU rise or fall, even if the actual level of long-term unemployment remains unchanged. Finally, LAPU is not of intrinsic interest since in relation both to policy and to hysteresis-type theories, the issue is the actual amount of long-term unemployment, which is only consistently shown by L. However, L does have one disadvantage, in that the variability of the relationship between long-term unemployment and total unemployment is constrained by the fact that long-term is included within total unemployment. In examining this relationship it is therefore worth looking at all the different measures.

Allowing for the appropriate lags, FIGURES 2, 3 and 4 show the relationships between the different measures of unemployment in 1948-2003 more directly. Throughout the half century and more since the 1940s, these relationships have remained effectively the same.

Although long-term unemployment did indeed rise hugely after 1979 and 1990, it has tracked down in relation to short-term and to total unemployment in almost exactly the same way that it has tracked up. In spite of changes in policy, there has been no significant change in the relationship at any time, however it is measured. There is no sign that the pool of supposedly less employable long-term unemployed people, which has so preoccupied economists and governments, ever existed. Even the New Deals, introduced since April 1998 and aimed particularly at addressing long-term unemployment, have had no visible effect at this level.

The relationship between L and U (FIGURE 2) is the most important, because L measures the stock of long-term unemployed people, while U is a good measure of the overall balance of supply and demand for labour. The L-U curve is asymptotic to the U-axis, with a pronounced curvature when U is below about 7 per cent, but almost linear above this. This form has an obvious explanation. First, it must be the case that if unemployment is higher, average duration of unemployment will be higher, since more people will be competing for each job vacancy and therefore the probability of re-employment in any given time period must be lower. This process was analysed for the USA by Sider (1985), who showed that there is a simple linear relationship between unemployment rate and unemployment duration. He estimated that 84 per cent of the impact of a change in unemployment rate resulted in altered durations, and only 16 per cent in altered incidence of unemployment. Machin & Manning's finding (1998) that the rise in long-term unemployment since the 1960s is due to a collapse in outflow rates from unemployment at all durations points the same way. This explains the monotonic form of the relationship over its whole length, and its almost linear character at higher levels of unemployment. Second, there are people in the labour force who really are less easily employable, as the result of various genuine handicaps, such as disabilities, illiteracy, criminal record etc. These people are more likely to be long-term unemployed. At high levels of unemployment they are a small proportion of the total of long-term unemployed people, and scarcely affect the almost linear form of the curve at these levels. But as unemployment falls this less employable group forms an increasing proportion of the total, and becomes significant. Hence the curvature, and the approach to the horizontal, at lower levels of unemployment. This process comes particularly clearly out of the wartime evidence where the number of people "classified as unsuitable for ordinary industrial employment" was 16.1% of the unemployed total when it was 217,546 in February 1941, but 29.2% in November 1941 when unemployment had fallen to 95,335 (ILO 1942). Similarly, the registered disabled were only 12.2% of the male unemployed in 1971, when total unemployment was close to 3%, but 25.9% in 1953, when it fell below 2% (Baxter 1972, p.337).

There is some scatter of observations about the L-U curve. In part, this is due to fluctuations in U, arising from seasonality, changes in trend, or extraneous shocks. For, although L is independent of short-term unemployment, the L-U relationship itself is obviously not. An example of the effect of a shock is October 1963, which is a conspicuous outlier below the curve. This is because unemployment in January 1963, 3 quarters earlier, was boosted by short-term unemployment caused by a severe winter.

There was similar turbulence around the turning point of July 1990 to July 1991.

FIGURE 3 demonstrates that the form of the L-U curve is not merely an artefact of the chosen measure. It shows the relationship between long-term and short-term unemployment over the same period 1948-2003, using the 1-year lag which is appropriate in this case. This relationship is indeed somewhat less close than in the L-U curve, but it has essentially the same form. Here it could be argued that there is some evidence of “stickiness” in the return after the 1984 peak, though not after 1993. However, any such effect has been small and temporary, and is of course relative to short-term unemployment. It does not indicate significant “stickiness” in the absolute level of long-term unemployment.

FIGURE 4 shows the relationship in 1948-2003 of LAPU with total unemployment, with its 6-quarter time lag. The form of the curve in this case is the mirror image of the L-U curve, with the slope falling as U rises. This reflects the fact that, as seen in FIGURE 2, L rises relative to U while U is low, but then develops an approximately linear relationship. The LAPU-U relationship is somewhat less close again, but the chart shows that LAPU also has tracked total unemployment fairly smoothly, both up and down. If hysteresis really existed, higher and higher percentage values of LAPU would be seen in the downswing, as short-term unemployment fell while long-term unemployment remained elevated.

If, as has commonly occurred (e.g. OECD 1987, Machin & Manning 1998), the LAPU-U relationship is charted without a lag, the effect is to produce the characteristic “loops” shown in FIGURE 5. There has been considerable discussion of these “loops”. Looking at a short time series, the OECD drew from them the unwarranted inference that there was a “ratchet effect” or “long-term unemployment trap”. Machin & Manning (1998) criticised the OECD, pointing out that the loops are only a cyclical effect. But even they did not identify that there is an omitted 6-quarter lag. The “loops” are in fact the same pattern as that of the “cobweb” cycle familiar from studies of the delayed adjustment of agricultural supply to demand, and have the same cause.

The UK quarterly series for the ILO measure of unemployment derived from the Labour Force Survey has been available only since 1992, and therefore is of little use in the present study. However, FIGURE 6 uses a reasonable substitute, namely the annual series for 1979-2001 printed in the OECD’s *Employment Outlook*. A 1-year lag is used as the best approximation to the correct 3-quarter lag. On the basis of this series also, UK long-term unemployment has tracked down in approximately the same way that it tracked up.

Geographical cross-section analyses

Defenders of hysteresis theories might try to argue that the L-U curve would have shown downward stickiness but for the fact that they persuaded the British government to adopt policies which successfully headed it off. This would leave their position based on a hypothetical alternative state. Moreover, British policy towards the unemployed has

varied substantially over the period since the 1983 unemployment peak, so that it is unlikely that policy change could explain a consistent absence of downward stickiness. However, what finally disposes of “hysteresis” is that the cross-section data tell the same story as the time series.

FIGURE 7 shows the relationship between claimant L and U for British regions for the five years 1977, 1982, 1990, 1995 and 2001, in the official series. It is clear that all regions have tracked up and down the same curve over this 24 year period, even though some, such as the North, have consistently had higher L and U than others. There is no sign that any region has had consistently elevated long-term unemployment. Anyone wishing to argue that the North East of Britain has an “employability” problem because of its still relatively high long-term unemployment would have to reckon with the fact that the stock of long-term unemployed there, as a proportion of the labour force, is already much lower than it was in East Anglia in 1995.

The British “regions” are not much use in analysing labour markets, which for the kind of people who experience unemployment are much more local. The local labour market level is best captured by local authority boundaries, rather than the official Travel-to-Work Areas, which conceal the high concentrations of unemployment in the cities within large areas covering their white collar commuting hinterland (Webster & Turok 1997).

FIGURE 8 shows the relationship between L and U for all British local authorities when L was at its peak in the mid-1980s. L for July 1984 is plotted against U for October 1983, 3 quarters earlier. The denominator is the count of economically active working age people in the Census of April 1981.

Remarkably, this shows the same curve as seen in the time series data for Great Britain. This is confirmed by adding the data points for the Great Britain national relationship for 1948 to 2003 already shown in FIGURE 2 to the chart in FIGURE 8, as open circles. They are almost entirely hidden, because the two curves are effectively identical. The main difference between the two data sets is that for individual local authorities at the unemployment peak, unemployment and long-term unemployment ranged up to over double the national average. The local authority data set also has more scatter about the curve. The main reason is the existence of high seasonal unemployment in some localities. This boosts the unemployment total with people who by definition cannot be long-term unemployed. Confirming this, the outliers, almost all below the curve, are mainly seaside places. Unfortunately no official seasonal adjustments are available at local authority level, and they could not be produced for this paper within the resources available. However, an exercise was undertaken earlier to make a seasonal adjustment of data for the 60 Scottish Travel-to-Work Areas at October 1995 (Webster 1997). This confirmed the nature of the seasonal effect and produced a large reduction in scatter about the L-U curve.

FIGURE 9 shows that the L-U curve across British local authorities was the same in July 1996 as in July 1984.¹ Although the level of unemployment had fallen greatly in most areas, long-term unemployment had everywhere tracked back down in a uniform way.

FIGURE 10, by contrast, shows that by July 2001 some change had occurred in the L-U relationship across local authorities. The curve had shifted downwards, so that areas with higher levels of unemployment had a systematically lower level of long-term unemployment than they would have had on the basis of the relationship applying in 1984 and 1996. This is very likely to be the result of the New Deals. These will initially have had little effect, because they were largely confined to people aged under 25, who are not often long-term unemployed. But they have gradually affected the prime 25-49 age group. Since April 2001 it has been effectively impossible for anyone of this age to be claimant unemployed for longer than about 22 months. However, this does not necessarily mean that these people have moved into work, either permanently or even temporarily. This issue will be taken up again in section 3.

2. THEORIES OF UNEMPLOYMENT DURATION: THE BIRTH OF “HYSTERESIS”

It is clear from the data that long-term unemployment has had an almost completely unvarying, simple relationship with total unemployment throughout the post-war period. At no time or place has there ever been significantly more or less long-term unemployment than would be predicted from this simple relationship, other than as a result of incidental factors such as localised seasonal unemployment or, since 1998, the New Deals which are specifically designed to prevent people from being long-term claimant unemployed. How then did the idea take root that there have been pools of long-term unemployment exceptional enough to wield significant influence on the labour market in their own right?

The most basic reason seems to have been simply that there was a pre-existing belief that this would be the case. The idea occurs in the Minority Report of the Poor Law Commission in 1909: “The effect of Unemployment upon the individual workman is to make him in course of time Unemployable” (S. & B. Webb, 1909). Pigou (1933, p.16) asserted: “If a man is subjected to unemployment for a long period of time, injurious reactions on his industrial and human quality are almost certain to result....when opportunity comes again, the man, once merely unemployed, is found to have become unemployable”. Beveridge (1937) also drew the conclusion from the inter-war data that long-term unemployment remained on a new higher level after the Depression, even though his own data showed a simple relationship between unemployment level and duration (Webster 1996). He commented about the long-term unemployed: “Nor is it possible for most of them to escape physical and psychological deterioration through long idleness”. The wartime analyses by the ILO (1942) and Reubens (1945), which contradicted this view by showing that long-term unemployment in Britain fell away almost completely when the war started, seems to have been ignored. In line with the analysis in the present paper, Reubens noted about data for 1940 that “When the depressed areas were ranked for percentage unemployed and for percentage of unemployed out of work for a year or more, the correlation was perfect”.

From the later 1950s, unemployment began to rise slowly again, and long-term unemployment with it. At low levels of unemployment there is a pronounced upward curvature in the L-U relationship. This was observed by Simler (1964), who showed that the long-term to total unemployment ratio for the USA in 1958-63 was underpredicted by the data for 1947-57, and assumed that the relationship was worsening. Baxter (1972) drew similar conclusions from the British data.

Thus when commentators came to look at the huge upsurge in long-term unemployment after 1979, especially if they were writing on the basis of evidence before the downswing began after 1986, they were primed to see it as indicating the existence of a specific problem of unemployment duration distinct from that of unemployment level. A consensus to this effect rapidly emerged. Budd et al. (1988), in the last of a series of papers, wrote: "The ratio of long-term unemployment is higher than one would expect for a given level of unemployment". Layard & Nickell (1987, pp.148-9) referred to "the pile-up of long-term unemployment" and asserted that "If there were now a major economic recovery....it is most unlikely that long-term unemployment would fall at all rapidly, unless specific measures were taken to encourage employers to hire the long-term unemployed". The OECD (1988, p.28) argued: "Long-term unemployment is now more serious than it was in the pre-recessionary 1979 period and is most unlikely to revert to the levels which prevailed at that time. This suggests that what we are observing is a ratchet -type effect".

A number of other factors contributed to the misinterpretation.

Neglect of the time-lags Bean (1994), writing on European unemployment, commented: "Most of the empirical literature is characterised by a distinctly cavalier attitude to lag structures". Nowhere has this been more true than in the analysis of long-term unemployment. In time series analyses, it has led commentators to assume that long-term unemployment was proving downwardly sticky, when in fact it was simply conforming to the normal relationship. In cross-section analyses, especially between countries, neglect of the time lags has led to a spurious appearance of variability which was simply due to different places being at different points in the cycle. The OECD alone has provided numerous examples (e.g. OECD 1994, p.12 and 2002). The frequency of both types of mistake has been increased by the common use of LAPU, with its much longer time lag. A particular problem is that it is impossible to obtain even a reasonable approximation to the correct one-and-a-half-year time lag for LAPU from annual data which are often all that are available on an international basis.

Seasonal unemployment In geographical cross-sectional analyses seasonality can also lead to a spurious appearance of variation, since some areas have far more seasonal unemployment, which by definition cannot be long-term and therefore increases the denominator but not the numerator of LAPU. Examples are Green (1985) and Rigg & Robertson (1996).

Institutional differences There is clear evidence that the long-term to total relationship in the inter-war period in the UK was different from that since 1948 and that

this was probably due to the administrative treatment of unemployment spells (Webster 1996). It is therefore almost inevitable that such differences should exist between countries. The OECD (2002) lists some of the differences in the operational definitions of long-term unemployment between countries. Machin & Manning (1998) point out that these differences probably also affect the ILO unemployment measures, even though they are intended to be comparable.

Omission of scatter diagrams Presumably because they had been primed to think that variations in long-term unemployment were complex and interesting, investigators have often asserted or implied that their data showed a loose relationship between long-term and total unemployment when a simple scatter diagram would have shown them that it was close. Examples are Beveridge (1937), Oliver & Webb (1982) and Green & Owen (1990). Oliver & Webb commented that “Broadly speaking, those regions with the highest overall unemployment rates also have the highest....rates of long-term unemployment” when their data actually showed correlations of 0.98 and 0.99. It needs to be remembered that up to around 20 years ago, scatter diagrams had to be drawn by hand, and this was undoubtedly a constraint on the thoroughness with which researchers did their work.

Theories

This analysis has shown that there is nothing for hysteresis-type theories to explain. The persistence of unemployment and of long-term unemployment have the same simple explanation, indicated by FIGURES 8, 9 and 10. The distribution of unemployment between different local labour markets is very uneven. Only if unemployment in the worst areas was much closer to the national average could this average itself be substantially lower; and persistent long-term unemployment is an inevitable accompaniment of the high levels of unemployment in the worst areas. These areas are mainly those which have been most affected by deindustrialisation, losing large numbers of manufacturing and mining jobs since the 1970s and in the main not yet having acquired an alternative economic base. The spatial connection between job loss and unemployment has been spelled out for cities by Turok (1999), for the coalfields by Beatty et al. (1997) and at regional level by Rowthorn (2000), although it has been much confused by misleading official statistics which are only now being rectified (Webster 2002).

The appropriate diagnosis is therefore one of spatially concentrated structural unemployment, with a *spatial mismatch* between the unemployed and job opportunities. However the belief that there was “hysteresis” has led to a variety of other theories. It is important to look at these for two reasons. First, the evidence which has been put forward to corroborate these theories can be shown to be equally compatible with the view that the problem is geographically concentrated structural unemployment. Second, it is striking how these theories have been clung to in spite of much evidence that contradicted them. Third, some of the theories have led to policy changes which have had important consequences in the real world.

From a policy viewpoint, the key theories relate to alleged “state dependence” and to the role of out-of-work welfare benefits. Less important are “insider-outsider” and “characteristics” theories.

State Dependence

The most straightforward theory was that the pools of unemployable long-term unemployed which were believed to exist had built up because the exposure of large numbers of people to the experience of unemployment as a result of “shocks” to the economy had made them less employable. (The “shocks” were particularly the oil price hike of 1973 and the Thatcher-Howe recession of 1979-83.) The probability of exit from unemployment was thought to be *dependent* upon the length of time for which a person had been in the *state* of being unemployed - hence the rather confusing phrase “state dependence”, which has nothing to do either with the State or with dependence on welfare benefits. This idea was advocated in particular by Budd (e.g. 1998), Layard et al. (e.g. 1991) and the OECD (e.g. 1983, 1988). It has a very obvious policy implication, namely that it is overwhelmingly important to catch people early in each unemployment spell and give them work or training to prevent the loss of employability. This has underlain the development of the New Deals, and of “active labour market policy” in general.

The main evidence adduced for this type of theory has been the secular rise in LAPU. However, three other main arguments have also been put forward.

*** The declining probability of re-employment with increasing unemployment duration** This is a well established empirical phenomenon. It is universally accepted that at least a large part of the decline is due to “heterogeneity”, i.e. *ex ante* differences among the unemployed in their personal probability of exit at each duration. As those with the best chance of exit leave the pool of unemployed, the probability of exit for those remaining must fall. Even advocates of “state dependence” therefore accept that it is very difficult to show that there is any “state dependence” over and above the “heterogeneity” effect. In spite of the large literature devoted to this topic, it is probably generally accepted that no one has yet succeeded.

Advocates of “state dependence” have cited employer discrimination, atrophy of skills, and declining job search intensities as explanations of the declining probability of re-employment. But Layard et al. (1991, p.237) and Robinson (1991, pp.11-12) note that employer discrimination is stronger in areas with tight labour markets and weaker in slack ones. To explain the declining probability, it would have to be the other way about. Bean (1994, p.608) finds a lack of convincing evidence for skills atrophy. And Layard et. al (1991, p.237) and Robinson (1991, p.14) find that search intensity does not in fact decline with unemployment duration.

By contrast, spatial mismatch can clearly in principle account for that part of the

declining probability of exit from unemployment which is not due to personal heterogeneity. It takes longer to get a job in Glasgow's Parkhead than in, say, Ripon, because jobs are scarcer. The unemployed of Parkhead must therefore steadily come to account for an increasing share of the UK total at each successively longer duration, irrespective of their personal characteristics.

*** Changing exit probabilities over time** Budd et al. (1988) attached great importance to the fact that the exit probability for the 2+ quarters unemployed fell proportionately more than that for the newly unemployed over the period 1979-87. They argued that this *proved* that there is state-dependence. But:

- The newly unemployed contain more of the seasonally and temporarily unemployed than do the 2+ quarter unemployed; their exit probabilities are relatively invariant to the level of unemployment and this must reduce the degree of fluctuation in their exit probabilities.

- A worsening degree of spatial mismatch would produce differential effects on exit probabilities of the type observed. Spatial mismatch did increase sharply in 1979-84, which was the period of most rapid manufacturing employment loss. Therefore Budd et al. were wrong to state (*ibid.*, p.1088) that "the observed pattern of exit probabilities from unemployment *can only* be explained by the existence of state-dependence" (emphasis added). Similar objections apply to the parallel argument of Jackman & Layard (1991), based on changes in exit probabilities 1969-85. Machin & Manning (1998) also note that this latter argument was dependent on an unreasonable assumption.

*** The outwardly shifting U-V ("Beveridge") curve** There is nowadays more unemployment at any given level of job vacancies than there used to be (Jones & Manning 1990, p.327-9). Budd et al. (1988) presented econometric evidence of a strong association between long-term unemployment and the outward U-V shift and concluded that this was due to state dependence rendering the long-term unemployed less capable of taking up the vacancies. Layard et al. shared this view (1991, p.268), although more "by a process of elimination" of other explanations than because the direct evidence was particularly convincing (Jackman et al. 1989, p.393). However, there is now good evidence that the increase in vacancies is largely due to the expansion of sectors which have high labour turnover and therefore high vacancy rates, and therefore indicates nothing about labour demand (Webster 2000). In addition, the association noted by Budd et al. can be readily explained by spatial mismatch. The long-term unemployed are disproportionately concentrated in areas where there are few vacancies, and are prevented by travel costs and difficulties from taking up jobs in other areas. Indeed, Layard et al. (1991, pp.248-9) cited evidence of this type themselves, without however allowing it to influence their analysis.

*** Non-contribution of the long-term unemployed to wage adjustment**

There have been recurrent findings from econometric studies that higher long-term unemployment is associated with higher rates of wage inflation. Budd et al.

(1988), the OECD (1987, p.178), and Layard et al. (1991, p.39) all argued that (in the latter's phrase) the long-term unemployed are not "good inflation-fighters". They attributed it to the loss of employability of the long-term unemployed. But it can equally well be explained by spatial mismatch. As shown in FIGURES 8, 9 and 10, the long-term unemployed are disproportionately concentrated in areas which already have a labour surplus. Naturally therefore they are not going to be much use in relieving labour supply bottlenecks in areas of low unemployment.

Layard et al. (1991) looked directly at the question of spatial mismatch as an explanation of unemployment persistence. However, the lowest spatial level which they considered was the official TTWAs, which as noted earlier wash out the most important spatial variations in unemployment. This renders invalid their conclusion that mismatch of all types (occupational etc as well as spatial) could account for at most some two-fifths of total unemployment.

Nickell (1997) argued directly that "active labour market policies" (ALMP) have cut long-term unemployment, on the basis of cross-national regressions using averages of OECD "standardised" ILO unemployment for 1983-88 and 1989-94. However replication of these regressions shows that the positive effect of ALMP depended entirely on two observations for Sweden. With a longer run of data now available it is clear that the apparent effect of ALMP simply reflected the fact that Sweden had low unemployment. Up to 1992 Swedish "standardised" ILO unemployment had never risen above 4%. Since then however there has been a rapid escalation, to 9.9% in 1997, falling back only to 5.9% in 2001. It can be seen from FIGURE 6 that once Sweden's unemployment had risen to UK levels, its long-term unemployment rose in the same way.

Benefit Dependence Theories

Benefit dependence theories are based on the idea that unemployment durations are higher when the ratio of benefits received by people out of work to net wages obtainable in work (the "replacement ratio") is higher, and/or the duration of benefits is longer. Their strongest advocates have been Layard and the OECD.

There is a fundamental implausibility about this idea in relation to the UK. To explain the huge variations in long-term unemployment since the 1970s there would have had to be huge variations in replacement ratios and/or benefit durations. Up to the mid-1980s, these had not occurred, and the significant changes since then have been in the wrong direction to account for rising long-term unemployment. Layard et al. (1991, p.258) themselves conceded that "In Britain neither the replacement ratio nor the duration of benefits has altered much since the mid-1960s". There is, moreover, a good deal of direct British evidence against the theory (Bean 1994). Budd (1988), while appearing to give some credence to it, noted that his own empirical evidence contradicted it.

Nevertheless this type of theory appears to have had major effects on British policy.

Starting in the early 1980s there have been successive reductions in unemployment benefit levels and duration. In part this has probably simply reflected the fact that it is an apparently easy way to save money, and an intuitive feeling that even if there is no evidence that attractive benefits might lead people to stay unemployed, there is a possibility that they might. However, it has also reflected a widespread belief that less generous benefit regimes have given a handful of countries lower ratios of long-term to total unemployment. These countries were the USA and Canada, and to a lesser extent Australia and New Zealand. Otherwise, there is a remarkable similarity and constancy in the long-term to total unemployment relationship across countries (Webster 1996, 1997). It is beyond the scope of this paper to investigate the reasons for these international differences. They could at least partly be due to differences in the administrative treatment of unemployment duration; none of those advocating a benefit dependency explanation for long-term unemployment has actually examined this possibility systematically. However, in the context of the present paper, what matters most is that there is now clear evidence that the differences are likely to be at least partly due to the effect of the benefit system on whether unemployment is classified as such, rather than to its effect on true labour market status. This has now become a major issue in the UK and is discussed further below.

“Characteristics” Theories

These theories are based on the observation that long-term unemployment is concentrated among people with particular characteristics. In particular, older workers consistently have the highest propensity to be long-term unemployed and young workers the least; and the long-term unemployed tend to be less well qualified educationally and to have higher rates of various types of disability. It is reasoned that if the labour force were to come to contain higher proportions of these types of people, then this in itself could explain increases in long-term unemployment. This was Simler’s “structural hypothesis”. There is detailed analysis of this and other similar studies in Webster (1996). This type of theory has not featured much in recent debates since to explain changes in long-term unemployment on the scale seen since the 1970s, the changes in the character of the labour force would have had to be implausibly large.

Insider-Outsider Theories

These theories, associated for instance with Blanchard & Summers and Snower, are based on the idea that re-entry to jobs of the long-term unemployed is inhibited by restrictive behaviour by those already in employment. This is often attributed to trade unionism. These theories have not had particularly obvious effects on policy, other than to contribute to a general belief in the virtues of “flexible” labour markets.

The evidence put forward for “insider-outsider” theories is often the same as for “state dependence”, in particular the lesser effectiveness of the long-term unemployed in relation to wage inflation. As noted, spatial mismatch can also explain this effect.

3. EMPLOYMENT AND WORKLESSNESS SINCE THE MID-1980s: THE IMPACT OF POLICY

It would be difficult to overstate the impact of the misdiagnosis of long-term unemployment on UK economic policy, and also on the subsequent development of the unemployment problem itself. Budd, Layard et al. and the OECD all drew from their analysis the corollary that the UK had a high “natural rate of unemployment” or NAIRU as a result of its high level of long-term unemployment. The OECD (1995, p.16) argued “long-term unemployment places a high floor on the ‘natural rate’ (of unemployment), which will only be effectively addressed by raising the labour market skills of the long-term unemployed and/or by increasing their attachment to the labour force”. Budd went on to be the UK government’s Chief Economic Adviser, while Layard was largely responsible for designing the employment policies of the present Labour government.

The evidence of FIGURES 8, 9 and 10 also indicates that the UK has an unnecessarily high NAIRU. But the issue is not detachment of the long-term unemployed from the labour force due to the experience of unemployment, but the distance of a large number of the unemployed of all durations from relevant job vacancies as a result of spatial mismatch. The way to address this problem would have been through spatially targeted urban and regional programmes. But the misinterpretation of long-term unemployment has led to these types of policy being sidelined, while the main policy thrust has been on a “supply-side” package comprising “active labour market policy” and reductions in unemployment benefit levels and duration. This in turn has had adverse consequences going beyond the mere diversion of effort and resources.

The policy package has been put into place in the UK in three main stages. In the first stage, in 1986, the level of unemployment benefits was reduced relative to sickness benefits, and the Restart programme was introduced which in effect made unemployment benefit conditional on the claimant “actively seeking work”. In the second stage, in 1996, unemployment benefits were replaced by the Job Seekers Allowance, which lasts only 6 months and is more strongly dependent on active job seeking. The third stage was the present government’s New Deal, for which the rationale was put together by Layard (1997). The principle is to compel all claimants at a given unemployment duration to take up a preparatory “Gateway” followed by a subsidised or unsubsidised job placement of varying quality, or training. This again has been introduced in stages, with the first stage applying mainly to young people aged 18-25. The bulk of prime working age people were brought in only in April 2001 and those aged 50+ are as yet involved only on a voluntary basis. There is a geographical component to the policy in the form of Employment Zones, which have been designated in areas of high unemployment. These however do not recognise any labour demand deficiency in these areas; they purely comprise additional supply-side measures.

There have been other changes along the way, which have together produced a steady worsening of the position of the unemployed and increased pressure on them to find a job.

To take only three examples: earnings-related unemployment benefits were abolished in the early 1980s; the number of unemployed people having their benefit cut for not meeting jobseeking conditions increased from about 100,000 in 1993/94 to over 300,000 in 1995/96 (Murray 1996); and in the Budget of April 2003 the maximum length of journey to work the unemployed are expected to undertake was doubled from half an hour to an hour.

FIGURE 10 clearly indicates that the New Deals are now reducing long-term unemployment relative to short-term unemployment, in terms of the claimant count. However there are three main problems.

New Deal outcomes No evaluation is yet available of the full extension of the New Deal to prime age workers. But the results for the 18-25s suggest only modest and mixed results. Estimates indicate an increase in youth employment of only 8,000 to 20,000 (House of Commons 2002). Not surprisingly, results have been systematically and seriously worse in areas of high unemployment than in other areas (Sunley et al. 2001). Finally, there is growing evidence that a substantial proportion of participants are simply going through a cycle of short-term unemployment in entry-level jobs, registered unemployment and participation in the New Deal. By 2002, only 36 per cent of participants were obtaining sustained jobs (*Financial Times* 20/3/2001, 3/4/2003).

Spatial unemployment disparities The New Deal has been ineffective in reducing unemployment disparities. This is evident from FIGURE 10. Even on the increasingly narrow claimant basis, unemployment at April 2003 ranged up to 10 per cent in individual local authority areas (using Census 2001 economically active as denominator). Many of the high unemployment areas are very large population centres, representing a correspondingly large problem. These include Liverpool (8.9%), Manchester (8.9%), Middlesbrough (8.6%), Hull (8.1%), Birmingham (7.9%), Leicester (7.7%), Glasgow (7.4%), Dundee (7.2%) and Nottingham (6.8%).

Movement into other statuses The most serious problem however is the enormous growth of economic inactivity, especially in the form of sickness, among men. FIGURE 11 shows the course of male and female employment rates since 1959 (Bell 2000). The recession of 1979-83 cut the male rate by 9 per cent in only 4 years, and it has recovered by only 2 percentage points. Some of the loss represents an increase in the number of students, but this is a lesser factor than it might be because many of the additional students are economically active, and participation in higher education is biased towards low unemployment areas. Most of the fall in employment is due to an increase in sickness. The European Labour Force Survey results for 2000 show the UK with the highest working age sickness in the European Union, at 6.8 per cent.

The growth of sickness claims lasting over 6 months from under 400,000 in 1963 to over 2 million in 2002 is shown in FIGURE 12. Most of the increase took place in the decade following the 1986 package of unemployment benefit changes, and it has been concentrated in areas of high unemployment. FIGURES 13 and 14 show the distribution

of claimant long-term unemployment, sickness or disability, and total inactivity for men and women across British local authorities at April 2001. Long-term claimant unemployment is clearly a small part of the picture, even for men, for whom it reaches a maximum of 3.1% of the working age population, in Liverpool. Sickness is a far bigger element, ranging up to 20% for men (13.4% in Liverpool). It is clearly strongly correlated with unemployment. It needs to be borne in mind that in 1981, almost no area had more than 5.0 per cent of its working age population long term sick, and no city area more than 4.2 per cent.

Nickell & Quintini (2002), while acknowledging the scale of the increase in working age sickness, characterise it as an incidental “imbalance” which does not undermine what they present as a highly successful UK labour market performance, with ILO unemployment which is relatively low by both national and international standards. However, they do not consider the geographical distribution of sickness or any other evidence on its direct relationship with unemployment. Evidence has steadily accumulated that at least a large part of the growth of working age sickness is a direct result of the relative worsening of unemployment as a status brought about by the hysteresis-inspired policy changes since 1986. This comprises evidence on the large numbers of people in all labour market statuses who have a potential sickness claim, on the timing and geographical distribution of the changes in status, and on direct tracing of the effect of benefit differentials (Autor & Duggan 2003, Boeri & Edwards 1998, Beatty et al. 2000, Webster 2002). Schmitt & Wadsworth (2002) estimate that all of the 1.6 percentage point decline in the UK unemployment rate in 1990-2000 was due to workers leaving the labour market rather than entering jobs. The conclusion that a large part of sickness is really disguised unemployment has recently been accepted by the House of Commons Work and Pensions Committee (2003). Like the behaviour of long-term unemployment itself, this is a phenomenon which it should not have been difficult for economists to notice and to understand. All that these people are doing is to respond to the incentives with which the system now presents them. In areas where it is difficult to get work, why should someone with a viable sickness claim stay unemployed, when sickness is both more attractive financially, and far more liveable in terms of freedom from pressure by the authorities?

Unfortunately, it is clear that movement into jobs is far less frequent from sickness than from unemployment. For instance, in Glasgow the proportion of the working age population claiming sickness benefits has not fallen at all since 1995, in spite of several years of economic upturn which have seen a halving of claimant unemployment.

4. CONCLUSION

This story exemplifies many of the weaknesses of contemporary academic economics: almost complete lack of interest in geography or any kind of spatial analysis; pursuit of model-building for its own sake; inability to carry out basic analysis of economic statistics, in spite of great proficiency in more complex techniques; uncritical adoption of analysis at a “macroeconomic” level without any attempt to establish the validity of the aggregates involved; ignorance of the real situations which ordinary economic actors face; and a bias against considering the role of demand in labour markets which appears to reflect an ideological stance harking back to polemics of the 1930s. Most fundamentally, there is a lack of commitment to, and probably also understanding of, the basics of scientific method. In particular, there is a constant search for corroboration of the same narrow range of established hypotheses, rather than pursuit of the Popperian principle of falsification.

The practical consequences of the misinterpretation of Britain’s long-term unemployment have been of the utmost seriousness. Not only have effort and resources been directed away from the kind of spatially differentiated labour demand policies which would have addressed the real problem of structural unemployment; but the policies actually adopted have led to the creation of what appears to be a real problem of the very type that the advocates of hysteresis theories thought they were addressing. There now really is a large pool of people who are going to be particularly difficult to get into employment. The problem is rendered all the more intractable by the fact that the official statistics no longer disclose it as such, with the consequence that the very high concentrations of what is really unemployment in areas hit by deindustrialisation are largely invisible to policy makers - albeit large sections of the public are well aware of them. Cutting unemployment benefits has been largely if not wholly a false economy. The UK would have been better off following the example of the supposedly less efficient economies of France and Germany, whose better unemployment benefits have resulted in similar levels of unemployment but much lower sickness.

Peter Mathias (1983) pointed out how the Benthamite Poor Law reform of 1834 sprang from a fundamental misdiagnosis, in which widespread poverty was thought to be due to workshy attitudes among the poor rather than to the disruption resulting from drastic economic change. It is sobering to think that a century and a half later, in spite of great technical development, economists should have made essentially the same mistake.

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FIGURE 1 GREAT BRITAIN: TOTAL AND LONG-TERM CLAIMANT UNEMPLOYMENT 1948-2003
(quarterly data, not seasonally adjusted)

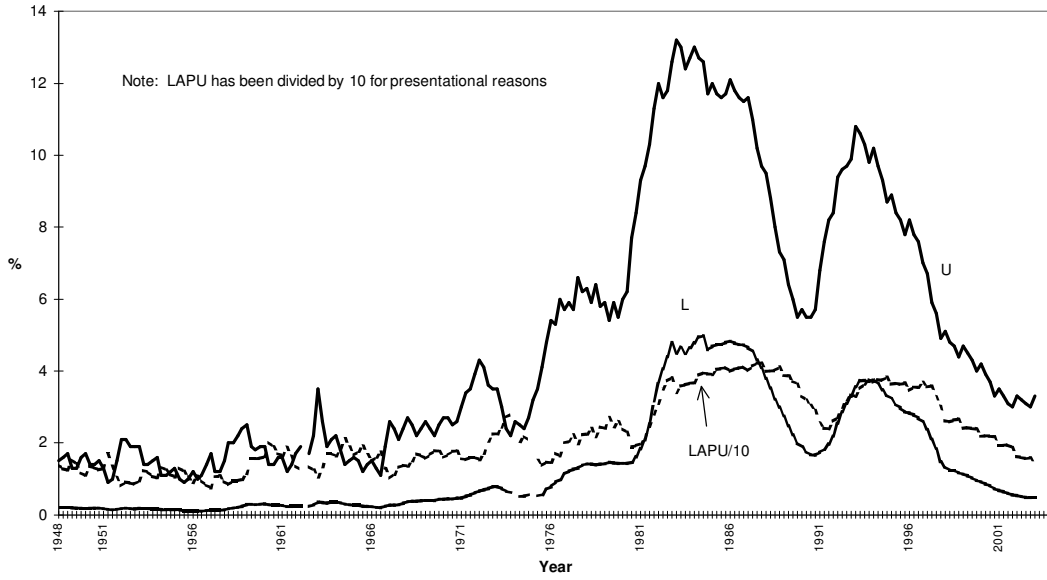


FIGURE 2 GREAT BRITAIN 1948 - 2003:
LONG-TERM BY TOTAL UNEMPLOYMENT 3 QUARTERS EARLIER
(quarterly claimant data, not seasonally adjusted)

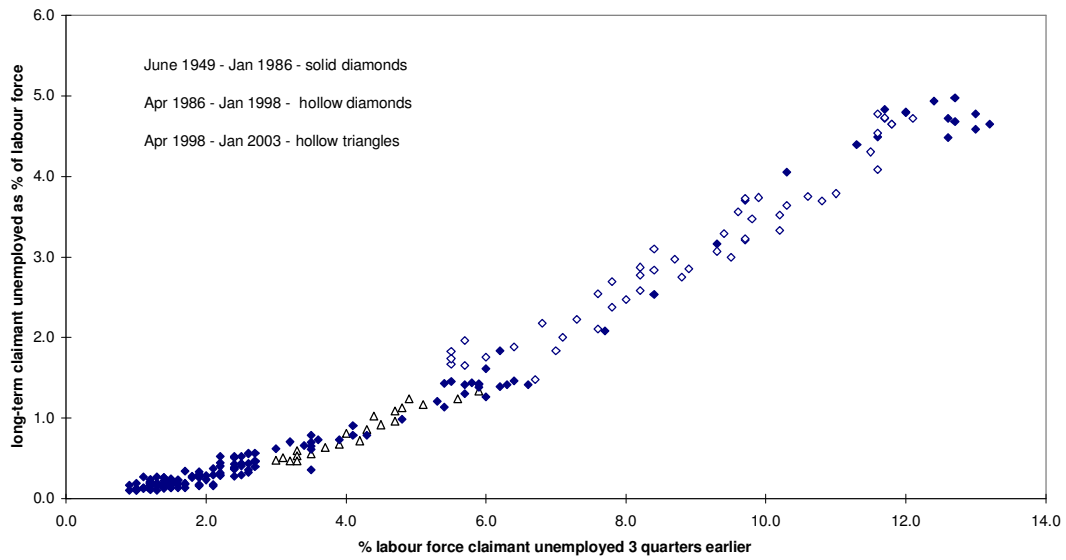


FIGURE 3 GREAT BRITAIN 1948-2003: LONG-TERM UNEMPLOYMENT BY SHORT-TERM UNEMPLOYMENT ONE YEAR EARLIER (quarterly claimant data, not seasonally adjusted)

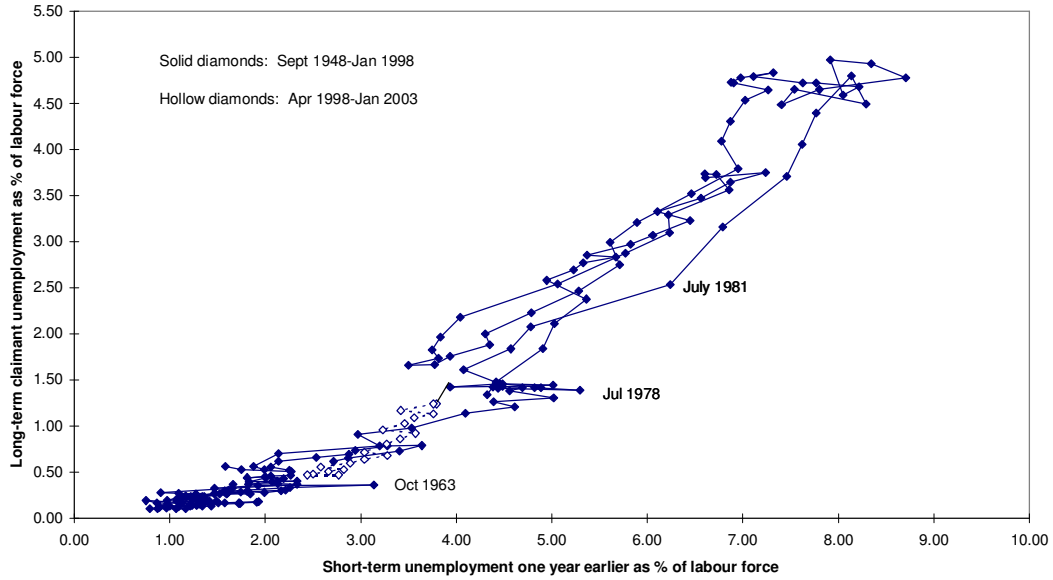


FIGURE 4 GREAT BRITAIN 1948 - 2003: LAPU BY U 6 QUARTERS EARLIER (quarterly claimant data, not seasonally adjusted)

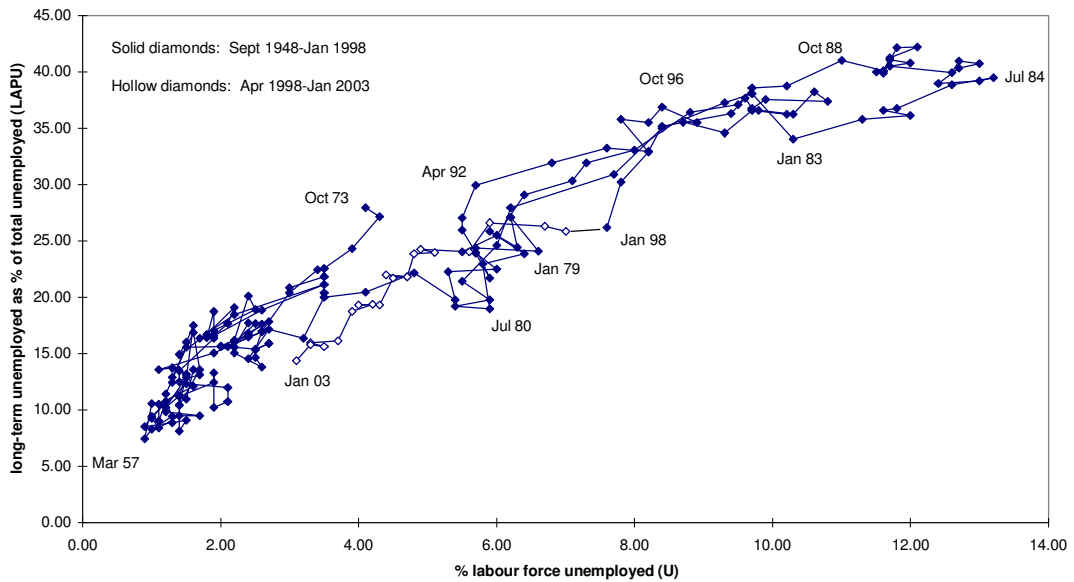


FIGURE 5 GREAT BRITAIN 1948 - 2003: LAPU BY U (unlagged)

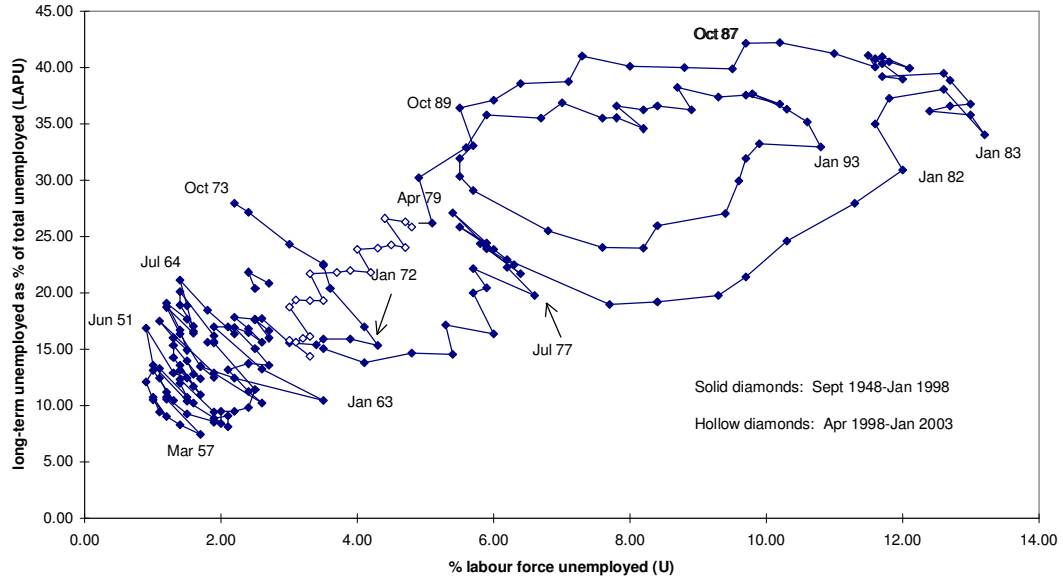


FIGURE 6 LONG-TERM UNEMPLOYMENT BY TOTAL UNEMPLOYMENT ONE YEAR EARLIER UK AND SWEDEN 1980-2001 according to OECD

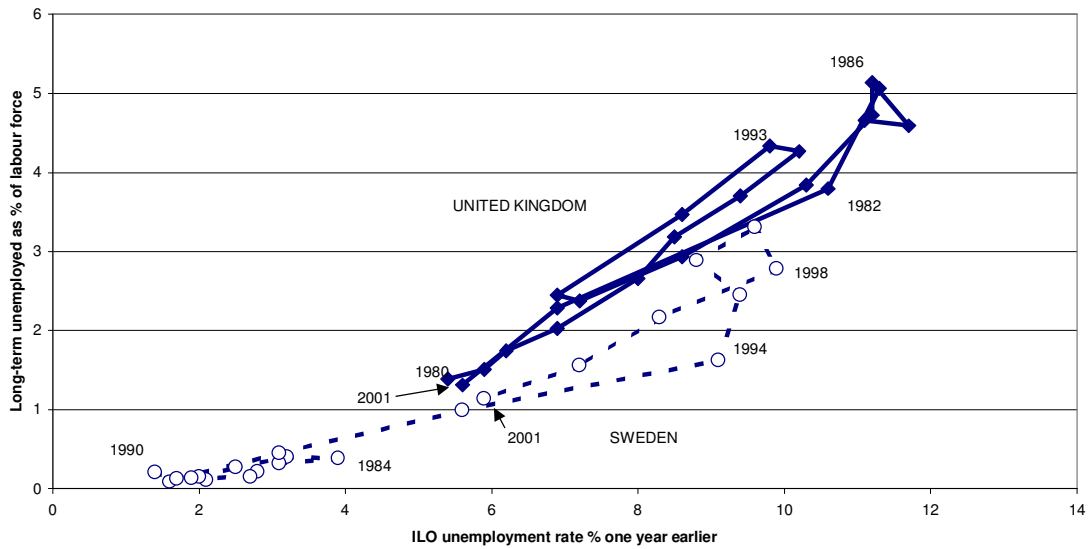


FIGURE 7 GB REGIONS: LONG-TERM UNEMPLOYMENT BY TOTAL UNEMPLOYMENT 3 QUARTERS EARLIER

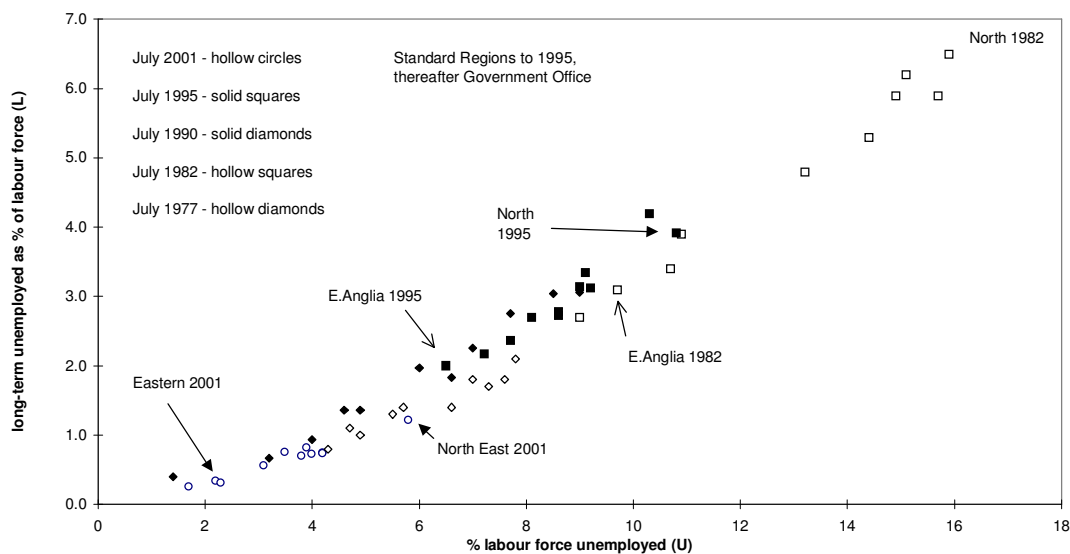


FIGURE 8 GB LOCAL AUTHORITIES: LONG-TERM UNEMPLOYMENT Jul 1984 by TOTAL UNEMPLOYMENT Oct 1983 (Census 1981 working age economically active denominator) with GB time series 1948-2003 (as FIGURE 2) for comparison

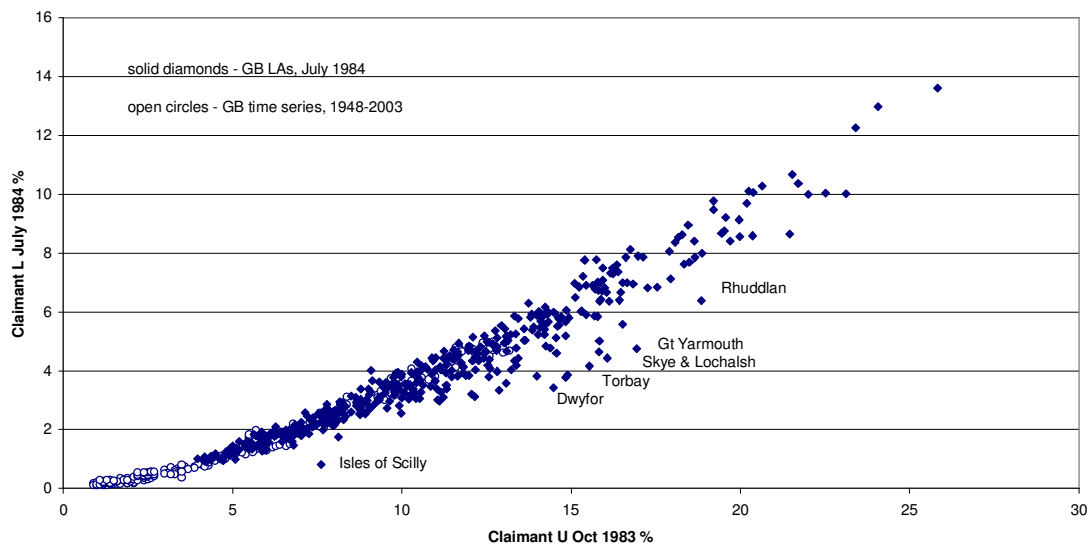


FIGURE 9 GB LOCAL AUTHORITIES: LONG-TERM UNEMPLOYMENT Jul 1996 by TOTAL UNEMPLOYMENT Oct 1995 (Census 1991/2001 mean working age economically active denominator) with GB LAs Jul 84/Oct 83 (as FIGURE 8) for comparison

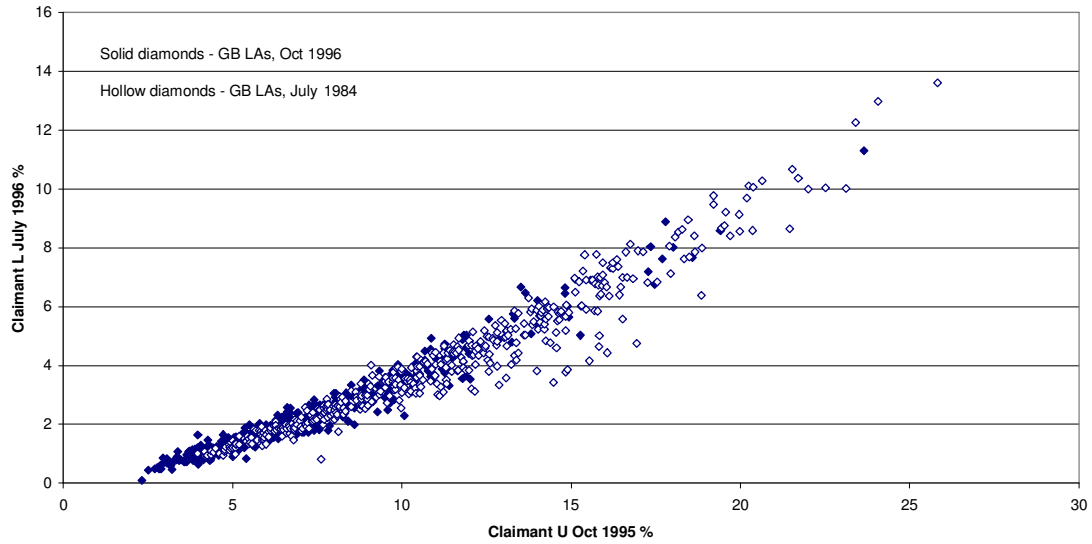


FIGURE 10 GB LOCAL AUTHORITIES: LONG-TERM UNEMPLOYMENT Jul 2001 BY TOTAL UNEMPLOYMENT Oct 2000 (Census 2001 working age economically active denominator) with GB LAs July 1984 (as FIGURE 8) for comparison

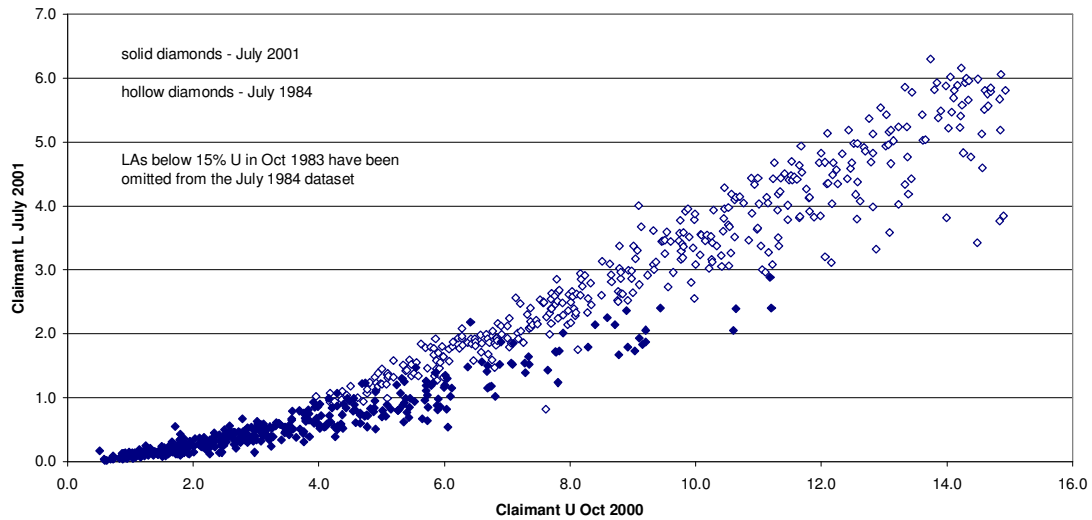


FIGURE 11 WORKING AGE EMPLOYMENT RATES UK 1959-2002

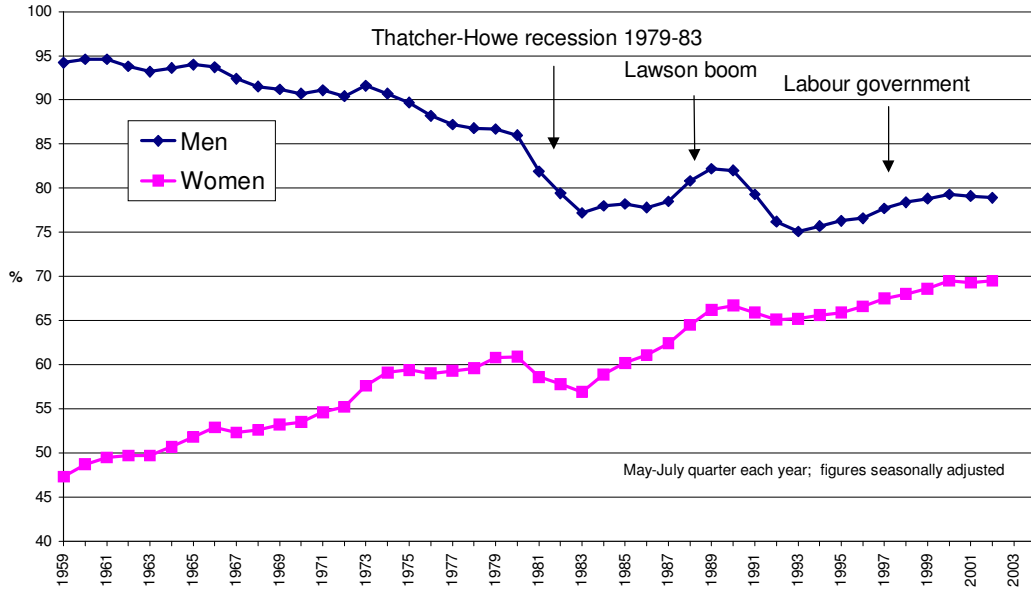


FIGURE 12 WORKING AGE CLAIMANTS OF SICKNESS, INVALIDITY AND INCAPACITY BENEFITS LONG TERM (over 6 months)

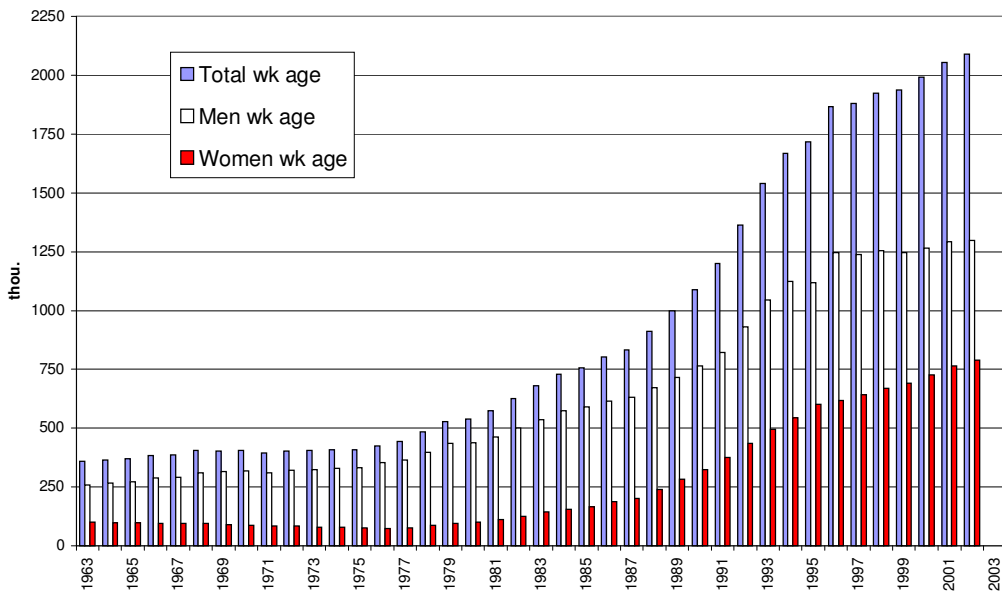


FIGURE 13 GB LOCAL AUTHORITIES, April 2001: LONG-TERM CLAIMANT UNEMPLOYMENT, SICK/DISABLED AND TOTAL ECONOMICALLY INACTIVE AS % OF WORKING AGE POPULATION, BY CENSUS UNEMPLOYMENT RATE: MALES

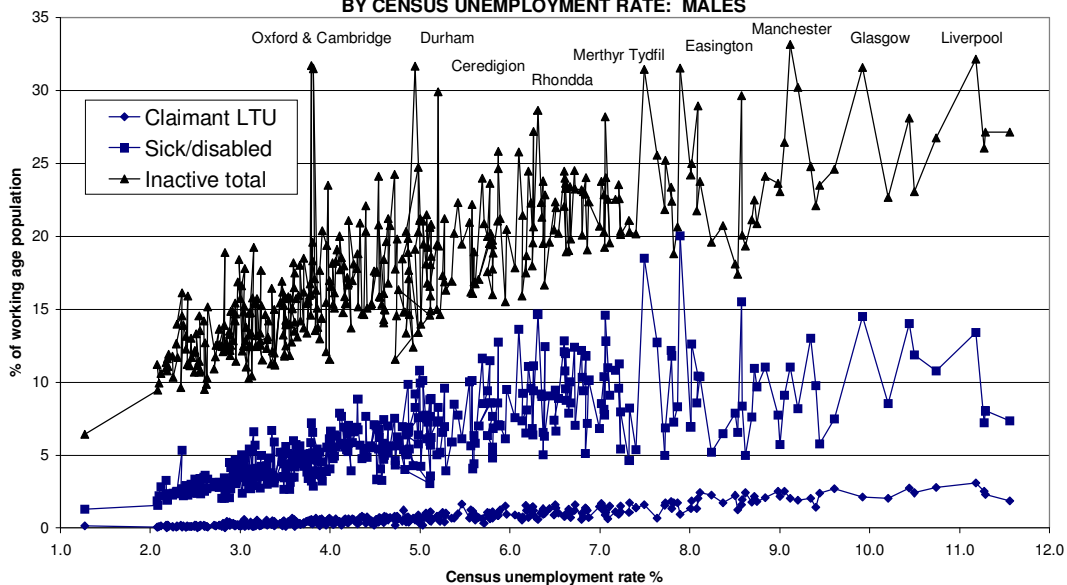


FIGURE 14 GB LOCAL AUTHORITIES, April 2001: LONG-TERM CLAIMANT UNEMPLOYMENT, SICK/DISABLED AND TOTAL ECONOMICALLY INACTIVE AS % OF WORKING AGE POPULATION, BY CENSUS UNEMPLOYMENT RATE: FEMALES

