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# Inactivity and Unemployment in Wales: A Contribution to the Policy Debate

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## Introduction

Over the post-war period Wales has gradually moved away from traditional 'smoke stack' industries such as coal and steel, towards lighter manufacturing and service-sector based employment. Helped by successes in attracting high levels of investment, much of it foreign, the manufacturing sector has declined less slowly in Wales compared with other parts of Great Britain, and achieved productivity and profitability gains. However, these characteristics are not shared by other sectors of the Welsh economy, and Wales remains at the bottom of many league tables measuring economic welfare. For example, relative earnings in Wales have fallen over the period of restructuring, and at the turn of the century average male employee earnings in Wales were among the lowest in Britain (New Earnings Survey, 2000), a position accounted for by low earnings in service industries and an unfavourable occupational structure. Whilst in the 1990s the (claimant count) unemployment rate was converging with the national average, inactivity rates remained relatively high (suggesting that observed reductions in unemployment were more equivocal than real) and hence Gross Domestic Product (GDP) in Wales relative to Britain has not improved. The North-East of England is the only region in Britain with an inactivity rate higher than in Wales. Increases in the economic activity rate would therefore provide an important source of labour supply and a potential means of increasing the output growth in Wales.

Within Wales, economic inequalities have increased as some areas have managed industrial and structural change better than others. An east-west divide is apparent, with proximity of major communication routes (the M4 in the South and the A55 in the North) to neighbouring English centres of population allowing greater success in responding to the decline of heavy industries in Wales. Large scale losses of well-paid (mainly male) jobs have proved difficult to replace, particularly in the Valleys, where male inactivity rates have increased. Instead, employment growth has been achieved by females, many working part-time.

There is a substantial gap between the levels of prosperity experienced by areas in Wales and the rest of the UK (www.betterwales.com, National Economic Development Strategy). Relatively low GDP per head in Wales, and in particular within the Objective 1 area, can be traced to two linked factors; low economic activity rates and low wages. Wales has only 4.3 per cent of the UK workforce but 5 per cent of the population, demonstrating proportionately fewer people at work, generating less output by value. Activity rates in Wales, which are lower than the UK are evident for both men and women and particularly for older age groups. Understanding the determinants of economic activity is therefore of particular interest to policy makers in attempting to increase GDP in Wales relative to other parts of the UK.

Research has shown that inactivity and unemployment rates in Wales are closely associated with a number of supply-side labour market characteristics such as gender, marital status, age, education and type of housing tenure (O'Leary et al, 2003). In addition to these supply-side characteristics, unemployment and inactivity vary across areas and are related to the business cycle, revealing the importance of demand-side factors. There are more vacancies per employee in Wales than in any other region, suggesting that the labour market in Wales is not functioning as effectively as in other regions of the UK. Such a finding would be consistent with (a) skills mis-matches, (b) reservation wages which are relatively high when compared to wage levels found in local labour markets, and (c) social security payments which encourage those without work to register as inactive.

## Supply-Side Factors

An analysis of the factors that influence the probability of an individual being inactive highlights the importance of supply-side factors. Moreover, much of the variation in inactivity levels between Wales and other regions can be explained by differences in observable characteristics. In terms of Welsh policy-making, it would be logical to target these adverse characteristics as a first step towards tackling the problem.

## III Health and Social Security Reform

Reported health problems have been found to have a dramatic two-fold effect upon economic inactivity in Wales. First, the higher incidence of health problems in Wales increases inactivity rates. Second, a reported health problem increases the likelihood of inactivity more in Wales than in other regions. Beatty *et al* (2000) suggest that the large increase in the recorded sickness level since 1981 (rising from 0.6 million in 1981 to 1.9 million in 1998) is not easy to explain given that general standards of health have been increasing and therefore may represent hidden unemployment. They note that at the end of the 1990s the number of sickness benefit claimants was more than double the claimant unemployed. Part of the explanation they attribute to sickness-related benefits being more generous than unemployment benefit. In addition, unemployment benefits are means-tested over time whilst sickness benefits are not. Nickell and Quintini (2002) also claim that the administration of the benefits system has played an important role in increasing inactivity rates. The Employment Service, during the 1980s downturn, advised many individuals who would have been difficult to place into jobs to claim inactivity benefit, so decreasing measured unemployment rates and job search (for evidence see National Audit Office, 1989). This resulted in activity rates, especially for men, being much higher in areas of high unemployment than in low unemployment areas.

Reform of the social security system is, therefore, essential for the whole of Great Britain and particularly for Wales. The practical need for reform is emphasised by Schmitt and Wadsworth (1994). They stress that a direct consequence of transferring those 'able to work' unemployed from claimant unemployed to long-term sickness is to lower the search activity of the unemployed who are excluded from the system. Once outside the claimant system, those hidden unemployed are no longer eligible for the Government support schemes, including the Job Clubs and Restart courses. Reversing this failure within the system is paramount since overwhelming

evidence confirms that Job Centres provide an efficient search network by which the low-skilled unemployed are assisted into work (Schmitt and Wadsworth, 1994; Forsythe, 1995; Gregg and Wadsworth, 1996; Robinson, 2000).

Beatty and Fothergill (1996), when analysing the dramatic loss of coalmining jobs between 1981-1991, found that the claimant count unemployment rate did not rise in mining areas. Rather, labour market adjustment took the form of increased male economic inactivity rates, with the largest component being increases in recorded sickness. Part of the increases in recorded sickness they suggest were benefit driven, but part of the response to job loss *'is that sickness which was previously hidden becomes visible'*.

Industrial decline and closure of large plants often go hand-in-hand with increases in social deprivation and social exclusion, and this is certainly the case in Wales (see Mapping Social Exclusion in Wales, 1999). General levels of health have been found to be worse in Wales than in England, and considerably worse in many of the Valleys areas, where average life expectancy is five years lower than for prosperous parts of Wales.

Unemployment arising from structural change in combination with social factors may precipitate a cycle of decline, following the initial increase in unemployment. Redundancy leads not only to the loss of jobs and income, but also to the breakdown of social relationships, which can increase stress, anxiety and ill health. Gordon (2000) outlined the causal links in the reproduction of unemployment arising from concentration of unemployment, which includes poorer local job information networks, attitudes to work, shorter employment spells (especially for the young), health deterioration, family fragmentation and lower educational outcomes. These links, he states, *'provide a very powerful set of, largely social, forces tending to reproduce concentrations of unemployment within areas where they may originally have emerged for quite other reasons - presenting more complex challenges for policies to reverse the process'*.

### **Education and Training**

Since the late 1970s labour market conditions have turned against low-skilled or less-educated workers. The demand for unskilled workers has fallen faster than the supply. This has resulted in an increase in the pool of low-skilled, particularly male, workers especially in areas where the demand for labour has

been relatively low. The importance of qualifications as a factor in explaining unemployment and inactivity is well documented and increasing over time (Dickens, Gregg and Wadsworth, 2001; Arulampalam and Stewart, 1995). Hence, a long-term emphasis has to be placed upon raising the general levels of skills of the population throughout Wales in order to bring the stock of human capital in line with the rest of Great Britain. The National Assembly's *The Learning Country* is attempting to address this issue by setting out a basic skills strategy for adults, children and young people.

The New Deal offers subsidies to those employers who offer training to the young unemployed. Early indications show that this has been helpful in tackling youth unemployment (Dickens *et al*, 2000). It would also appear appropriate that training and education policies should be directed towards the young economically inactive population.

In his review of active labour market policies, Martin (2000) suggests that target returns to policies directed at disadvantaged youths come from *'early and sustained interventions... These interventions include efforts to boost performance in primary and secondary schooling'*. He noted *'it is also important to target support not only at the youngsters themselves but also at their families and local communities. It cannot be over-emphasised that if young people leave the schooling system without qualifications and a good grounding in the 3Rs, it is well nigh impossible for labour market programmes to overcome these handicaps later on'*. Heckman (2000), in reviewing the literature on human capital, finds that adult skill remediation programmes are much less effective in comparison to early intervention programmes in schools.

The explanation of early school leaving can be classified into three broad categories, namely the children, the family and the school. Independent from innate ability, children who lack concentration and have a poor disciplinary record (such as delinquency and truancy) are more likely to leave school early. Introverted children and those who have difficulty in forming relationships with other children are also more likely to leave school early, as are children with a poor health record, (characterised by prolonged absences from school).

Schools themselves influence the success of pupils. In the past the proportion of grammar school places was one index of school quality. More recently, school league tables have

become important sources of information. Schools characterised by depressing physical surroundings, large class sizes and poor teachers, all tend to have a poor record of retaining pupils beyond the compulsory school-leaving age.

However, the family and its circumstances are thought to have the most important influence on school leaving. Parents who take an active interest in their children's education are aware of the importance of the choice of school and are prepared to make sacrifices to ensure that their children are placed in what they consider to be 'good' schools. A 'virtuous spiral' ensues, with good schools remaining so, while poor schools are ensnared by a 'vicious circle'.

### **Age**

Age also appears to influence the likelihood of an individual experiencing either unemployment or inactivity. Unemployment tends to be relatively high for the young and old, possibly reflecting job shopping by younger workers, and a lack of job opportunities as workers approach retirement age. Inactivity is highly concentrated in the upper age bands of the working population. Over 4 out of every 10 men aged 50-64 are inactive (*Labour Market Trends*, 2002). Older workers whose jobs have become redundant may find it difficult to re-enter the labour market because of benefit traps, age discrimination and high wage expectations (Disney, 1999).

Recently, the New Deal has been extended to the over 50s; offering individuals taking up full-time work a £60 per week earnings top-up (capped at £15,000 per annum). However, other policy initiatives will be required for this age group. Although labour market opportunities for older workers in much of western Europe have deteriorated, effective policies in the US offer some encouragement. In 1986, the Congress passed the Age Discrimination in Employment Act (ADEA), which prohibited employers from dismissing workers on the basis of age by stipulating that labour contracts could not specify a termination point based on age. The Act also protects older workers from discrimination with respect to wages and benefits, recruitment, promotion and training opportunities. Given that redundancy is the prerogative of employers, this regulation sent to them a strong signal that unjust treatment of older employees was not acceptable. Historically, similar arguments were made when introducing race and gender discrimination legislation in the UK. Since reform in the mid-1980s, male