



BRIEFING NOTE: THE UNEQUAL SCARRING EFFECTS OF A RECESSION ON YOUNG PEOPLE'S LIFE CHANCES

Summary:

Evidence from previous recessions suggests that those who leave education during difficult economic times:

- are less likely to find a job, especially a full-time job;
- continue to be less likely to have a job for more than 10 years after leaving full-time education;
- may experience a permanent wage penalty throughout their career.

A key reason for this is that individuals who experience spells of unemployment early in their careers face increased risks of further unemployment later in their careers, so-called scarring effects, as well as continued wage penalties, and negative effects on their happiness, health, and job satisfaction, even many years later. These scarring effects also persist beyond one generation, affecting the education and earnings levels of their children. These effects are not felt equally; they are more marked for men; those with lower levels of education; those living in more deprived areas; and those from deprived families.

Policymakers should take action that mitigates these risks to minimise these long-term costs. Action could include high-quality job guarantee schemes, designed to keep young people engaged with the labour market. Policy makers should also consider whether now is the right time to be limiting the supply of places in higher education through caps. Opening opportunities for young people to attend or return to education, through access courses and recovery of apprenticeship opportunities, may soften the blow.

The Issue:

Large parts of the economy were suspended from late March - June 2020 due to the COVID-19 pandemic. The UK economy shrank by 20% in April 2020 as a result (ONS, 2020a). Given a 2% decline in GDP in the first three months of 2020, a severe recession is inevitable. NIESR's main-case scenario is a 7% economic contraction across 2020 (Lenoël & Young, 2020).

The UK Government has sought to buffer the economic effects of this crisis through support such as the Coronavirus Job Retention Scheme (CJRS), allowing employers to place employees on "furlough". However, such schemes are designed to support those already in work, plus likely effects of the increase in employer contributions in August, suggests young people face an extremely challenging job market. Job vacancies were estimated to be 637,000 in February-April 2020; this is a fall of 170,000 compared to the previous 3-month period, which is the largest fall since comparable records began (ONS, 2020b). Henehan (2020) estimates that an additional 640,000 18-24-year-olds could find themselves unemployed this year alone.

This note summarises the evidence on the effects of youth unemployment on later outcomes, of father's unemployment on child outcomes, and the unequal effects of recessions on life chances. It then highlights what the literature suggests about how policymakers could buffer some of these negative consequences, and why this may save money in the long run.

The Scarring Effects of Unemployment:

A substantial literature attempts to quantify the causal effect of experiencing spells of youth unemployment on later life outcomes. So-called 'scarring' as a result of unemployment may result from "depreciation of human capital, or because employers use an individual's previous labour market history as a signal of productivity" (Arulampalam et al., 2000), although this latter 'signalling' effect may be less marked where it is evidently due to a large economic shock such as COVID-19. Understanding this relationship is important in the current climate because it implies there are likely to be significant costs associated with unemployment caused by external shocks, such as the COVID-19 recession. Gregg (2001) finds that "men who experience an extra three months unemployed before age 23 go onto experience another extra two months out of work (inactive or unemployed) between ages 28 and 33". Using variation from local labour market conditions, this is shown to be a causal effect of early labour market unemployment experiences.

These impacts also extend to an effect on wages: Arulampalam (2001) found that a spell of unemployment carries a wage penalty "of about 6% on re-entry in Britain, and after three years, they are earning 14% less compared to what they would have received in the absence of unemployment"; Gregg & Tominey (2005) document similar findings. Bell & Blanchflower (2012) find "that spells of youth unemployment have harmful impacts on a number of outcomes, such as happiness, health, and job satisfaction, many years later". The timing of the unemployment appears to be crucial, however with youth unemployment being key: "spells of unemployment experienced after age 23 have little bearing on later well-being" (Bell & Blanchflower, 2012) highlighting the importance of considering differential effects of the COVID-19 shock on different generations. These findings appear consistently in many contexts, too, with similar findings of long-lasting effects of

unemployment on well-being in a German context (Clark et al., 2001) and evidence from Tumino (2015) that scarring effects have occurred in the early 1990s, the early 2000s and the 'Great Recession' period.

There is a smaller related literature on the intergenerational impact of parent's unemployment experiences on their children's education and labour market outcomes, suggesting that these scarring effects have long-term implications beyond the current generation. Oreopolus et al. (2008) show that adult children whose fathers were displaced due to firm closures experience wages that were 9% lower than those whose fathers did not experience an employment shock. Bratberg et al. (2008), Rege et al., (2011), Stevens & Schaller (2011), Gregg et al. (2012), Hilger (2016), and Ruiz-Valenzuela (2020) all find negative impacts of father's job displacement on children's educational outcomes.

The Unequal Impacts of Recession:

There is also a vast literature on the unequal effects of recessions on outcomes. In the US, Kahn (2010) finds that college graduates leaving education into a labour market with a 1%pt. higher unemployment rate earn 7% lower wages: this negative effect declines over the coming years but remains at 2.5% fifteen years later. Clarke (2019) finds similar effects from graduating in the 2008-09 recession, noting greater effects for those with less education. Taylor (2013) finds that for men leaving full-time education into a labour market with "a one-point higher unemployment rate reducing the probability [of being in a job in the next year] by almost 2 percentage points"; results for women are rather more mixed, but are substantially less negative. Schwandt & von Wachter (2019) show that in contrast for those leaving school before college, there are persistent reductions (lasting at least 10 years) in earnings, employment and wages from entering the labour market during a recession, and that these are substantially larger for the less advantaged. Macmillan (2014) and Gregg & Macmillan (2020) show that the impact of high unemployment is particularly pronounced for those from deprived families with low levels of education, compounding to put disadvantaged young people at the back of the queue for jobs when work disappears. Scarring effects on employment and earnings are also shown to be worse for ethnic minorities (Zucotti & O'Reilly, 2018; Li & Heath, 2020).

These inequalities can, in part, be driven by differential responses to recessions. Burgess et al. (2003) explore variation in employment linked with year-to-year variations in the labour market conditions faced by those leaving education in Britain during the 1980s and 1990s. They found highly variable responses with low skilled individuals seeing adverse effects on later employment, but positive effects for the higher skilled who use the experience to upskill, exacerbating existing inequalities. Oreopoulos et al. (2012) suggest that recessions make it more likely for workers to begin their careers at lower paying employers; they catch-up over subsequent years with peers who graduated during more prosperous times by moving to higher paying firms. However, advantaged college graduates are much better placed to make these moves: as such, "less advantaged graduates recover at much slower speeds, if they recover at all".

There may also be less obvious and counterintuitive effects. Bianchi (2013) finds that graduates who entered the workforce during economic downturns were more satisfied with their jobs both early and later in their careers than those who entered during stronger economic times, even when they earned less money, perhaps because they "were less likely to fixate on ways they might have done better and more likely to feel grateful for the jobs they held" (Bianchi, 2013). Giuliano & Spilimbergo (2009) find long-lasting effects increasing support for government redistribution and voting for left-wing parties.

Effective Interventions:

Bell & Blanchflower (2012) find that active labour market policies tend to work best during period of strong labour demand and those targeting younger people are less effective, highlighting the challenges faced helping this group in the current circumstances. So, what can policymakers do to mitigate the negative effects of entering the labour market in a recession?

Previous well-designed schemes show that effective intervention is possible. It is particularly key for interventions to avoid negative "lock in" effects and ensure direct engagement with employers (Gregg, 2009). The New Deal for Young People was a multifaceted programme with supported job search (Van Reenen, 2003) and subsidised employment (Dorsett, 2006) elements, which were found to have positive effects. Job guarantees, as in the promising Future Jobs Fund (Work and Pensions Committee, 2010; Fishwick et al., 2011; DWP, 2012), have been advocated as an effective approach to avoiding the worst scarring effects of long spells of unemployment (Bell & Blanchflower, 2012; Henehan, 2020; Layard, 2020). Given the excess demand for teaching support in schools as they try to re-open with social distancing restrictions, there is an opportunity to meet both policy needs by providing the opportunity for displaced young people to support qualified teachers.

Decisions to stay in further education and training may be affected by economic conditions (Taylor & Rampino, 2014; Tumino & Taylor, 2015) and, as highlighted by Burgess et al. (2003), may buffer scarring effects. Policy should support such decisions across the range of educational routes, including freeing up supply of university places, offering more access courses for those wishing to upskill, and aiding the recovery of apprenticeship opportunities after the initial hit to these as part of the response to COVID-19 (Linford, 2020).

While such policies appear expensive in the short-run, the long-run costs of high levels of youth unemployment are larger. Causal effects of scarring mean that large rises in persistent unemployment will increase government spending associated with unemployment, and reduce tax income, long into the future. Even in the short-run, the DWP (2012) found that although the Future Jobs Fund had a net cost of £3,100 per participant, on average employers derived estimated benefits of £4,400 per participant and participants themselves gained over £4,000 in increased wages.

Summary and Implications:

There are substantial negative implications of a recession on the life chances of young people, particularly resulting from the short- and long-term 'scarring' effects of periods of unemployment during entry to the labour market. However, there are steps that policymakers can take to mitigate this damage, such as through job guarantee schemes that are designed to keep young people engaged with the labour market, and ensuring that further education options are available as an alternative for those wishing to upskill during this period.

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Prepared by: Jake Anders & Lindsey Macmillan

Contact for further information:

Centre for Education Policy & Equalising Opportunities (CEPEO)
cepeo@ucl.ac.uk

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Centre for Education Policy & Equalising Opportunities (CEPEO)
University College London, 20 Bedford Way, WC1H 0AL
www.ucl.ac.uk/ioe/cepeo