

# The Jobs Gap

## A Statement from

# The Work Foundation

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## Executive Summary

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- Work Foundation analysis has found that the expected cuts in public sector employment could be absorbed by growing employment in the private sector – but only if the pace and scale of change is well-managed and in line with the recovery of the private sector. The prerequisite is a strong growth in private sector jobs with the government supporting key potential areas of growth innovation and job creation activity.
- However, if cuts are too big and implemented too soon, the private sector will be swamped, with severe problems in the regions and amongst ex-public sector workers whose skills and experience may make it hard for them to take new private sector jobs. New job seekers with the least skills and experience will find it even tougher to find work, threatening persistently high levels of unemployment among the under 25s.
- Drawing on past experience and the latest growth forecasts from the Office for Budget Responsibility (OBR), we estimate that cuts of around 500,000 over five years could be more than matched by growth in the private sector and would return employment to pre-recession levels. But cuts of up to one million public sector jobs would overwhelm any plausible private sector job growth and make the overall recovery in employment far more drawn out.
- Whatever the level of job loss in the public sector there will be major challenges in the regions and among some groups of public sector workers. The cuts will inevitably have a proportionately greater impact on regions outside the Greater South East which tend to have average levels of public sector employment and weak private sectors that showed slow rates of recovery from the previous recession.
- Unemployment will start to fall if job cuts in the public sector are more in line with the lower estimate of public sector job losses, but it will take much longer to get unemployment back down if cuts are closer to the top end of our estimates. Unemployment in any scenario is likely to remain above pre-recession levels for many years as the number of jobseekers is expected to

grow. Unemployment gaps between the stronger and weaker regions will grow.

- There are many uncertainties surrounding these numbers. Private sector job creation in the 1990s recovery was artificially boosted by reclassifying some public sector jobs in higher and further education as private sector, and in the 1980s private sector numbers were also lifted by large scale privatisations. The government's intentions in this area are still unknown.
- The forecasts from the OBR are based on the spending plans of the previous Labour government. Next week's Budget will announce sharper spending cuts. The deficit is three times that of the 1990s. Everything else being equal, we could expect such cuts to push down the short term growth forecasts. This is likely to suppress the job creation potential of the private sector, and the scale of public sector cuts which growth could absorb.
- The fundamentals of the economy may have changed since the previous recession. Two factors suggest that the 1992-1997 private sector jobs growth story may not be directly repeated now:
  - Due to greater levels of public sector outsourcing the private sector is likely to be more directly impacted by public spending cuts in the next few years than it was in previous recessions. Therefore the implications of cuts on private enterprise may be more immediate; and
  - The policies of labour hoarding identified in many private sector organisations during the recession may mean that the current recovery may be 'jobless', compared to that of the 1990s.
- The Work Foundation thus urges a 'growth first' cuts strategy focusing on investment and bank reform as ways of improving the opportunities for faster growth in the private sector and suitable speed limits (especially with regard to regional impacts) on public spending cuts.
- The government has argued for a deficit reduction strategy heavily biased towards public spending cuts rather than tax rises (in a ratio of 4 to 1). We think this leans too strongly towards spending cuts. The evidence base to support the 80-20 ratio is not extensive, and the government needs a strong

rationale to justify taking up such a position. We would urge a more even balance between cuts and tax rises.

The Work Foundation also recommends that the government should:

- Establish local Comprehensive Spending Reviews as a way of ensuring that decisions that may have asymmetric impacts across the country are dealt with at the right level of decision-making.
- Where success has been achieved, government must quickly learn from such success and seek to replicate it elsewhere. This means reforming or replacing RDAs with city - based Innovation Panels to, among other things, manage city- based Innovation Funds to support industrial clusters and specific knowledge generation. This proposal chimes well with the Coalition's idea to establish Local Enterprise Partnerships (LEPs), supporting each city to have a "Total Innovation" strategy in order to realise their potential for 'market-making'.
- Establish business banks regionally and focus local business advice and support services on fast growing small businesses with the biggest potential to create new jobs.

## **1. Will recovery from recession solve our unemployment woes?**

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The Work Foundation has argued that the government's austerity agenda must be framed by a clear analysis of actions that will first support economic growth. The Coalition government will be judged, in large part, by its success in achieving levels of growth that help reduce unemployment back towards the levels of 2007 and below.

During the recession the economy has shed 735,000 jobs. The public sector is braced for substantial cuts in Chancellor Osborne's first Budget and the planned comprehensive spending review in the Autumn. However, GDP data from the Office for National Statistics now tells us that we are just out of recession. The newly formed independent forecasting body (the Office for Budgetary Responsibility OBR) has predicted that growth will quickly return, climbing to 2.8% p.a. by 2012<sup>1</sup>.

The question remains however – will the growth in the economy create enough jobs to meet the needs of those who left employment in the recession, and to offer employment to those pushed out of the public sector by spending cuts?

## **2. How many new jobs could a private sector recovery create?**

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Looking back to the previous recession of the 1990s, it is possible to make a baseline estimate for how a recovery in the output of the economy (GDP) will impact on jobs growth. We have looked back to the five year period of recovery between 1992 and 1997 which followed the last recession. Over this period a GDP growth rate of 3.1% supported the creation of 1.8m new jobs in the private sector – a rate of employment growth of 1.6%. This period is a particularly relevant comparator since this was also a period of public sector spending restraint, although total public spending did increase during this period.

The OBR now predict that across the five years following the 2008/09 recession, GDP growth will average 2.4% p.a. Based on the experience of the 1992-1997 recovery, this would suggest that private sector employment will grow at 1.3% p.a. It is worth noting at this point that this forecast has been produced based on the

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<sup>1</sup> [http://budgetresponsibility.independent.gov.uk/d/pre\\_budget\\_forecast\\_140610.pdf](http://budgetresponsibility.independent.gov.uk/d/pre_budget_forecast_140610.pdf)

previous government's planned spending cuts. The prediction therefore already includes the not inconsiderable implications of Labour's planned spending cuts – estimated at £47 bn by the IFS.<sup>2</sup>

If these forecasts do prove correct then this rate of growth would result in the private sector creating 1.5m new jobs in the next five years. This figure can perhaps be best thought of as the economy's job creation potential.

### **3. Room for public sector job cuts?**

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If the job creation potential of the economy can be estimated, and the number of jobs lost during the recession is known, then it is possible to estimate how many further public job cuts the labour market could stand while also returning the economy to pre-recession levels of employment. There is a magic figure of approximately 750,000 jobs – cut deeper than this in the next five years, and despite economic growth, the labour market will be in a worse position than before the recession.

- Cuts totalling 500,000 public sector jobs – could potentially be absorbed by the growth of the private sector;
- Cuts totalling 750,000 public sector jobs – could potentially be matched by the growth of the private sector over the next five years; but
- Cuts of 1,000,000 or more would be likely to swamp the potential of private sector growth to improve the condition of the labour market.

This is certainly a very blunt analysis. This comparative statistics approach cannot take account of how a shift between public and private employment would occur in practice. The shift would involve many hundreds of thousands of individuals successfully making the transition between working in public and private sector organisations. This will demand the adaptation to new cultures and a change in the skills set for many people. In this way, the analysis offers only a top-level comparison, illustrating the headline implications of the transition facing the economy.

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<sup>2</sup> [http://www.ifs.org.uk/election/launch\\_tetlow.pdf](http://www.ifs.org.uk/election/launch_tetlow.pdf)

#### 4. How much can we rely on this number?

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There are reasons to believe that this magic number of 750,000 may well prove to be based on a best case scenario of growth over the next five years:

- Many of the jobs created in the private sector in the previous recovery were in reality driven by the transfer of employment from the public sector – such as the reclassification of approximately 180,000 jobs in higher and further education as private enterprise. Transfers of this nature are not expected to play as major a role in the next five years and their absence will in effect dampen the job creation potential of the private sector compared to that seen in the recovery of the 1990s. It could be a case of comparing apples with pears.
- As noted above, the forecasts from the OBR are based on the spending plans of the previous Labour government. We have, however been led to believe that next week's Budget will announce sharper spending cuts. We will need to see how the revised public spending forecasts impact the OBR's projections next week but everything else being equal, we could potentially expect such cuts to push down the short term growth forecasts. The worry is that this could suppress the job creation potential of the private sector and hence the scale of public sector cuts which growth could absorb.
- The fundamentals of the economy may have changed since the previous recession. Two factors suggest that the 1992-1997 private sector jobs growth story may not be directly repeated now:
  - The private sector is likely to be more directly impacted by public spending cuts in the next few years than it was in previous recessions. Across the OECD, governments are increasingly using private and non-profit entities to provide goods and services directly to citizens<sup>3</sup> which means that public spending cuts may have more immediate effects on private enterprise; and
  - The policies of labour hoarding identified in many private sector organisations during the recession may mean that the current

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<sup>3</sup> As noted by the OECD (2010) Restoring Fiscal Stability: Lessons for the Public Sector

recovery may be ‘jobless’, compared to that of the 1990’s.

- Finally, and perhaps of greatest significance, these national figures are masking very different regional stories. This is the focus of the next section.

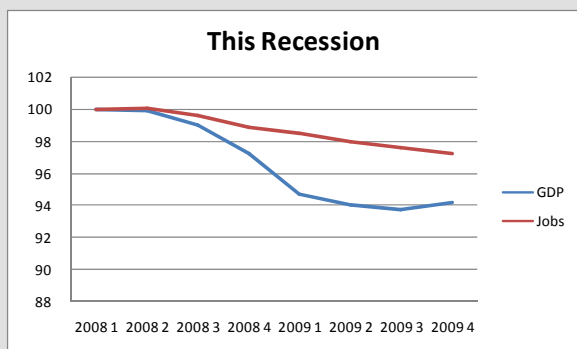
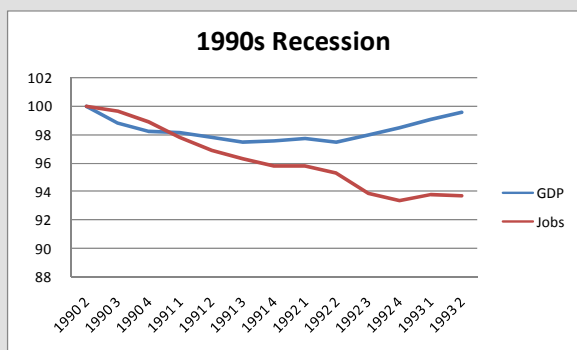
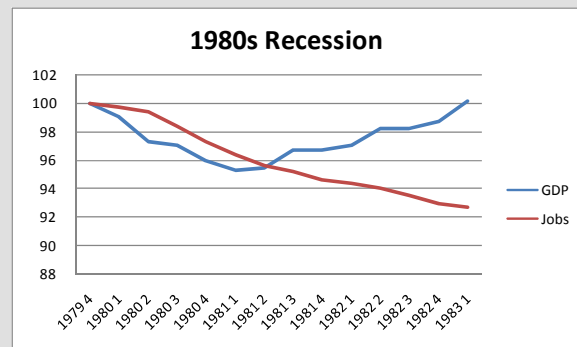
### Box 1: A Jobless Recovery

#### A Jobless Recovery?

As we entered recession many commentators noted that, given the scale of the fall in GDP, employment had not contracted as far as we might have expected. The three graphs on the right illustrate this point – in the previous two recessions, the fall in GDP was less than the decline in employment. This certainly has not been the case to date.

The leading explanation for this break with the past has been that private sector firms have been hoarding labour through this recession. In the past two decades, economic performance has shifted towards a greater dependence on workers’ highly specific skills and relationships – the knowledge economy story. For many more firms it is now cheaper to hold onto current staff through the recession, than incur the increased costs of hiring during the recovery.

If this is the case, then the private sector will be more able to increase output (GDP) without expanding employment than was the case in the 1990’s recovery. Put simply, if more companies have held onto excess labour through the recession, then the recovery will not necessarily be associated with as large a jobs growth as predicted above.



## 5. A worrying regional picture

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Even if the government succeed in finding the right balance at the national level, and manages to hit this magical jobs target, the labour market in much of the country is likely to remain in very poor shape.

As noted above, our analysis has defined a magical figure of approximately 750,000 public job cuts. This is the maximum number of additional workers which the private sector ought to be able to accommodate through growth, while also returning employment to pre-recession levels over the next five years. However, this estimate is based on a national understanding of the economy. Analysis at the level of individual regions shows a very different picture – these cuts would leave the labour markets in much of the country in a very poor shape.

We have looked to estimate the growth potential of the private sector in each region, as well as the likely scale of challenge experienced in the labour market. Presented in Table 1 below, the job creation potential of the national private sector has been divided between the regions on the basis that the recovery will follow the same regional pattern as the recovery of the privately dominated industries<sup>4</sup> during the 1990's recovery. The labour market need to replace jobs lost during the recession has been calculated based on regional job losses in the recession. Finally, the national figure of 750,000 public sector jobs cuts has been distributed between the regions based on the distribution of public sector dominated industries.

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<sup>4</sup> In contrast to the National Accounts definition of the private and public sectors used above, this group of activities excludes the publically dominated industries of health, education, and public service related activities such as emergency services, defence, social work and regulatory bodies. It is therefore not an indicator of the precise size of the public sector, but a proxy for the importance of public sector spending to a region's economy. In this analysis the definition is drawn from TWF analysis of ABI employment data from the Office for National Statistics.

**Table 1: Regional Jobs Gaps**

	North East	North West	Yorkshire and Humber	East Midlands	West Midlands	East of England
Implied Growth Potential	7,980	58,174	93,261	117,374	128,602	211,684
Emp Decline	14,200	37,528	41,585	53,756	73,027	67,955
Share of Public Cuts	33,403	85,304	64,309	50,717	63,841	60,697
Total Need	47,603	122,832	105,893	104,472	136,868	128,652
<b>A Jobs Gap</b>	<b>39,622</b>	<b>64,658</b>	<b>12,633</b>	<b>( 12,902 )</b>	<b>8,265</b>	<b>( 83,031 )</b>

	London	South East	South West	Wales	Scotland	GB Total
Implied Growth Potential	310,341	351,723	145,473	31,348	( 12,169 )	1,443,791
Emp Decline	67,955	100,412	79,112	57,813	123,740	718,095
Share of Public Cuts	93,822	96,319	64,558	39,264	73,463	725,696
Total Need	161,777	196,731	143,670	97,077	197,203	1,443,791
<b>A Jobs Gap</b>	<b>( 148,564 )</b>	<b>( 154,993 )</b>	<b>( 1,803 )</b>	<b>65,729</b>	<b>209,371</b>	<b>-</b>

Note: Northern Ireland excluded from regional analysis due to data availability issues.

This regional picture is of very great concern. It shows very clearly that, even if the government get the balance between private sector growth and public sector job cuts right nationally, large parts of the country are a very long way from balance.

The Greater South East (London, the East, and the South East of England) could be expected to fare particularly well under the scenario illustrated in Table 1. This is because their private sectors drove a large part of the 1990's recovery.

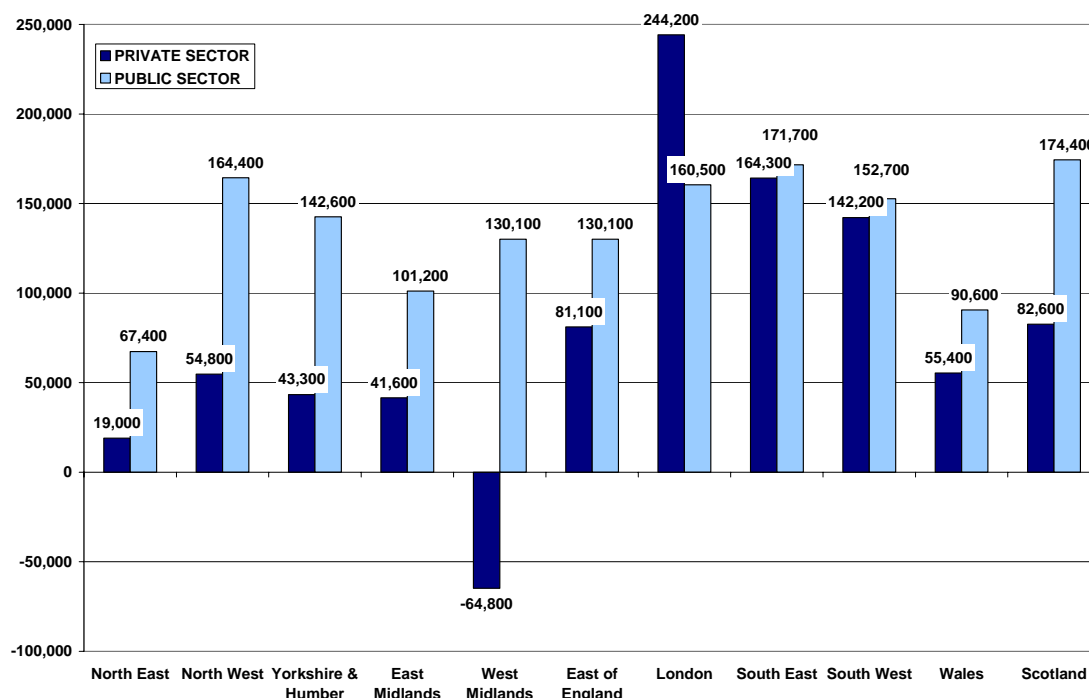
In contrast, labour markets in the North of England, Wales, and Scotland are likely to perform poorly during any recovery. These regions captured a small share of the recovery in the 1990s, and so are predicted to capture a small proportion of the potential job growth. In addition, their economies are more heavily concentrated on public sector dominated industries than the national average. This implies that they will be more adversely affected by any public sector jobs cuts.

Our analysis of the economic performance of these regions in the decade since the recovery period (i.e. 1998-2008) confirms this worrying story. Investment in public services played a key role in driving national employment growth over the past decade: of the 2.3 million net new jobs created in Great Britain between 1998 and 2008, 1.5 million or 63.2% were created in public services and just 863,800 or 26.8% in the private sector. Yet as Figure 1 shows there is a stark divide between the Greater South East where, broadly speaking, private dominated industries were responsible for the greatest share of employment growth and the rest of the country

where public sector employment growth outstripped private sector growth by some margin.

Employment growth trends over the past decade suggest that the East and West Midlands in particular may fare less well in the recovery than the 1992 – 1997 recovery might suggest. Despite the favourable macroeconomic circumstances, the number of jobs in the private sector in the West Midlands fell by 64,800 in real terms between 1998 and 2008 whilst 70.8% of the 142,800 new jobs created in the East Midlands were in publically funded activities. At local level the picture can be even more severe, for example the number of jobs available in Stoke-on-Trent fell by 16,900 in real terms with a 3,700 net increase in public sector jobs being offset by the net loss of 20,600 private sector jobs over the last decade. In this context, it would be unreasonable to expect private enterprise to be as strong in the coming decade as the 1992 – 1997 recovery might indicate.

**Figure 1: Public and Private Sector Job Creation 1998 – 2008**



Source: Annual Business Inquiry – Workplace Analysis (1998 – 2008)

## 6. Implications and Recommendations

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### National

In our recent statement, *Cut, Tax, Grow?* we argued strongly for a strategy based on growing the private sector both nationally and in the regions, focused on four key knowledge economy growth areas (advanced manufacturing, low carbon economy, cultural and creative industries, and high tech and intermediary services).

We argued that the government should wait for the recovery in private sector employment to firmly establish itself before making significant cuts in public sector headcounts. Having an effective strategy in place to grow the private sector was all the more important in those regions most dependent on public sector employment. Both considerations impose “speed limits” on the timing and depth of cuts in public service employment.

We also argued that the spending priorities had to reflect the growth strategy - so for example areas such as innovation, science and technology, higher education, skills development and the digital and physical infrastructure should all be given a high priority within the next spending review.

The government has argued for a deficit reduction strategy heavily biased towards public spending cuts rather than tax rises (in a ratio of 4 to 1). We think this leans too strongly towards spending cuts. The evidence base to support the 80-20 ratio is not extensive, and the government needs a strong rationale to justify taking up such a position.

We have found only one study – published by Policy Exchange in 2009 - that suggests this was the ratio achieved in previous periods of successful fiscal consolidation in some economies<sup>5</sup>. The OECD itself has published a study in May 2010 looking at a wider range of fiscal consolidations that came to a somewhat different conclusion:

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<sup>5</sup> Lilico, Holmes, Sameen *Controlling Spending and Government Deficits*, p.9, Policy Exchange, November 2009

*“In non-euro area countries, where consolidation gains have been most persistent, on average half of the consolidation was due to expenditure cuts, half of which were related to capital expenditure. In euro area countries, on average across all consolidation episodes three quarters of the adjustment was on the revenue side”<sup>6</sup>.*

The Institute for Fiscal Studies (IFS) has estimated that in the last period of fiscal consolidation in the UK the ratio between spending cuts and tax rises was closer to 1 to 1 – on the face of it in line with the OECD conclusion<sup>7</sup>.

It may be that these studies employed different methodologies and approaches so we should be cautious in our assumptions. However, we urgently need this question to be resolved, given the importance of the spending and tax decisions that rest on the answer. The new Office for Budget Responsibility should be asked to review the evidence and provide the Coalition government with impartial advice.

An OECD Working Group looking at budget consolidation noted that even with an 80/20 mix: *“this rule of thumb may not apply in all cases: important factors affecting the mix include the state of the domestic and global economies and the monetary policy stance”<sup>8</sup>*. The Working Group also urged implementation should be gradual, especially if the adjustment was large: *“in countries undertaking large fiscal adjustments, more gradual implementation has often led to better macro-economic effects. A gradual phase-in usually allows for a more orderly adjustment, which is particularly important politically and economically when the amount of the adjustment required is large.”*

Both points seem good advice. The UK is in a more difficult position than other economies faced with large fiscal problems in the past. The main market for UK goods, the euro-area, is suffering low growth and an uncertain future. There is no scope to cut interest rates, in contrast with the 1990’s recovery when rates were cut very rapidly as inflation collapsed.

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<sup>6</sup> OECD Economic Working Paper *The Political Economy of Fiscal Consolidation*, p 27 May 2010

<sup>7</sup> IFS 2010 Pre-Election Briefing, *Not Filling the Hole*. The IFS estimate refers to the plans published in the 1993 Budgets.

<sup>8</sup> *Restoring Fiscal Responsibility: Lessons for the Public Sector* OECD Public Governance Committee, Working Party of Senior Budget Officials, OECD April 2010.

The impact on employment of an 80-20 mix is ambiguous for the national economy. A bigger emphasis on spending would imply a much bigger drop in public sector employment than in the past. However, more moderate tax rises could mean more jobs in the private sector than would otherwise be the case. What is less ambiguous is that leaning so strongly towards spending cuts results in a much bigger impact on regions outside Southern England where the share of public sector jobs is higher and where the main source of employment growth has been public sector based. As we show below, past experience suggests the private sector recovery has been strongest in regions that had a strong base to start with.

The mix also throws a much bigger burden of adjustment on the labour market. As we show above, the UK labour market overall has coped with previous contractions in public sector employment because there was strong recovery in private sector employment. However, such adjustments are not painless. As well as the regional imbalance, the new private sector jobs may well require different skills and aptitudes than the jobs being lost in the public sector.

It would be complacent in the extreme to suggest that the private sector can effortlessly absorb large numbers of public service workers. Without great care, the new government could be creating a new set of structural problems in the labour market that will persist well into the recovery. The government should have in place adjustment and support policies to ease the transition, especially in areas where finding alternative work is going to be difficult.

## **Regional**

The story outside London and the South East, as has been mooted above, is grim. It is clear that the public sector cannot maintain these places in the long term, but managing change in what the public sector does will be important to minimising the impacts of these cuts. Regionally local authorities need to focus outwards and support private sector employment growth – if the Knowledge Economy of these places is bound up in the public sector, then thinking about how to exploit this will be central to their future success.

Where success has been achieved government must quickly learn from such success and seek to replicate it elsewhere. This means among others things

reforming or replacing RDAs with city-based Innovation Panels to, among other things, manage city - based Innovation Funds to support industrial clusters and specific knowledge generation. This proposal chimes well with the Coalition's idea to establish Local Enterprise Partnerships (LEPs). Supporting each city to have a "Total Innovation" strategy in order to realise their potential for 'market-making'. This means that cities will create demand for innovative products such as low energy street lighting or updated IT packages. These 'buy' signals will then encourage private sector investment, production and distribution of new technologies, services and products.

Public sector spending cuts thus need to match the speed limits of private sector growth locally as well as nationally. Businesses will need help to diversify. That means paying attention to managing the changing role of the public sector in specific places – perhaps through the creation of local Comprehensive Spending Reviews covering public services, jobs, spending and the support offered to the economy through intermediate institutions.

Finally we need to fix the businesses finance gap that exists outside of London and the South East. Only 3 per cent of all bank lending has gone to manufacturing over the last 10 years. Indeed lending through the last 12 months has been chronically insufficient to enable business to grow.

The government must encourage the growth of a more diverse range of financial institutions in the regions – as many innovative local authorities have already demonstrated. A new network based on LEPs that create the business advice networks businesses actually want should be developed. These should be public/private partnerships utilising the knowledge from existing Business Angel networks, chambers of commerce and elsewhere. Their focus is in helping businesses to grow.

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The Work Foundation

We provide:

Research  
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Partnership

**The Work Foundation is the leading independent authority on work and its future. It aims to improve the quality of working life and the effectiveness of organisations by equipping leaders, policymakers and opinion-formers with evidence, advice, new thinking and networks.**

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