OFFICE OF FAIR TRADING

Job Insecurity for the Vulnerable: Is it increasing?

Appendix 3 of
Vulnerable Consumers and Financial Services

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Executive Summary

Financial products such as pensions, insurance and mortgages require regular payments to maintain and in some cases maximise benefits such as tax relief. The reliability of a certain level of income is vital to the ability to make regular payments. Survey evidence shows that employment, and movements into and out off, are the key determinants of income volatility. Stable employment is therefore crucial. The 1980s were a period of dramatic change for the UK labour market. Some, such as the decline in union power, were policy-induced and others, such as technological advancements, were part of wider changes in the world economy. As part of their Vulnerable Consumers report, the Office were interested in analysing how these changes have effected labour market conditions for the Vulnerable - which previous research has put at the bottom income groups - and in assessing the common claim that *jobs for life* are now a thing of the past.

In this paper we use job tenure rates to measure job insecurity; we can derive an implicit probability of unemployment from data on how long a job lasts for[1]. While this is only one way to measure job insecurity (Burchell *et al* 1998), we believe it is the best given our focus on the vulnerable / low income who are more likely to be going into unemployment or another low paid job, rather than a better job. We show that job insecurity - as proxied by job tenure rates - and other labour market conditions have deteriorated for low income groups in relative terms *and* over time. As we show in the conclusion, this leads directly to a number of policy recommendations concerning the design of financial products.

[1]Formally, the expected duration of a job ("tenure rate") is the reciprocal of the probability of losing that job: T=1/P(losing job). eg. if there is a 5% probability of an individual losing their job each month, then the expected tenure would be 1/0.05=20, ie months.

1. The UK labour Market

1.1 The last two decades have seen dramatic changes to the structure of the UK labour market. There have been significant changes to both supply and demand, and key institutions. Along with all developed countries, the UK has seen a marked reduction in demand for unskilled and uneducated labour, and towards skilled and educated labour. Partly as a result there has been a movement into part time and self-employment. Whether this shift is due primarily to changes in technology, industrial structure or international competition has been hotly debated in the literature, but does not concern us here (Reich 1991; Wood 1994). To the extent that these changes are related to greater use of technology and international trade it is unlikely they will reversed significantly in the future. Various pieces of legislation also moved the UK towards a more flexible US-style labour market. Legislation reducing workers' rights regarding dismissal and legal minima for redundancy payments have made it easier for firms to dismiss workers. Social security reforms since 1979 have also reduced the level *and* coverage of benefits (Atkinson 1994): unemployment benefit as a proportion of income fell from 36% in 1979 to 25% in 1995 (Hills 1995). At the same time the supply of skilled labour has increased dramatically - as reflected by increasing numbers in full-time education after 18.

1.2 There were also changes to wage setting institutions, associated with policies to free-up the labour market. Two institutions-the Wage Councils and Fair Wage Resolution-were dismantled. To some extent this will be reversed by the imposition of the national minimum wage. Trade union power and influence was also eroded by a series of legislative reforms. The % of workers belonging to a union now stands at 36% (WERS 1998), compared to 53% in 1980. The fall in union density understates the decline in union power (Metcalf 1994). At present, there are no reasons to think that these changes will be significantly reversed in the future.

2. Tenure Rates: Theoretical Background

2.1 A job contract is an agreement between two parties and can be terminated by either an individual quitting a job or being laid off [2]. The first decision, when it is optimal for an individual to leave a job, can be analysed using search models. The second area has led to analysis of dynamic labour demand models where traditional models are augmented by hiring and firing costs. Combining these models is more problematic. As we are not attempting to build a structural model of separations, we only look briefly at these issues. For an in-depth analysis see Mortenson (1986).

2.2 **Dynamic Labour Demand Models**. Taking quits as given, the driving force behind layoffs is the demand for labour. In the neo-classical model of labour demand, each profit maximising firm employs labour up to the point where the marginal product of that worker is equal to the wage. Assuming diminishing marginal product we get the well-known downward sloping labour demand curve. Demand for labour will be pro-cyclical over the business cycle, depending on macro-economic conditions. In a dynamic framework the simple model will be complicated by costs associated with redundancy and training. A firm may find it cheaper to keep a worker following a fall in demand if, for example, they had to retrain a new worker when demand picked up again. In

[2] Retirements and disciplinary actions are taken as constant.

the general dynamic model, firms will adjust their labour force to the *desired* level, taking into account these *hiring* and *firing* costs. The speed of adjustment will be inversely related to such costs. The demand for labour for group I will be of the form:

$$\underset{\;\;-}{D_{it}}=D(\underset{-}{W/p_{it}},\underset{+}{Y_t},\underset{?}{\alpha_t},\underset{-}{H_{it}},X_{it}) \qquad (1)$$

Where W/P are real wages; Y output; α technology; H hiring and firing costs; and X a vector of individual groups characteristics.

2.3 **Search Models**. In the simple model, job search is actively associated with unemployment (Stigler 1962). An individual will adopt a reservation wage strategy to job search and will reject offers as long as the wage falls below the reservation wage. The reservation wage will emerge from an appraisal where individuals compare the cost of continued search with the benefit. In practice around 60% of individuals leave a job with one already lined up. The simple model can be extended to look at direct job-to-job quits. In this case, an individual will quit their existing job if the reservation wage from a new job is above the existing wage. The probability per period of an individual in group I quitting a job for another job or unemployment in time T is given by the function:

$$Q_{ti}=\underset{+\;+\;+}{Q\,(\theta_{it},P_{it},B_t,X_i)} \qquad (2)$$

Where θ is the probability of an individual receiving a job offer; P the probability they will accept it; B the average level of benefits; and X a vector of individual characteristics. We would expect quits to be pro-cyclical.

2.4 The distribution of job tenure rates in an economy will therefore depend on a number of factors, including the industrial structure, age structure, education levels and, perhaps most importantly, the business cycle. During a boom we would expect hiring and quits to increase putting more into the lowest tenure bands; in a recession we would expect hiring and quits to fall so fewer people are in short tenure jobs. Problems emerge in trying to model a separation from two potential determinants. There is no direct data on quits in the UK - only separations. There are a number of ways one could approach this: quits could be modelled by some form of regression analysis, or one could simply argue that quits drive separations and layoffs are trivial, or vice-versa.

2.5 The Vulnerable are, however, a well-defined group, characterised by low income (OFT 1998). If such groups are in a job they have made the decision it is worth their while to work, given fixed costs of working and foregone benefits - which will be important for low income groups. Given their low probability of finding another job (θ), longer unemployment durations and recent changes in the benefit structure (B), we would expect the return to quitting into unemployment to be low. Indeed, very few people choose to become unemployed (Layard *et al* 1991). We would expect most of the variation in tenure rates for this part of the population, both directly and indirectly, to be determined by demand side factors. Data on total job separations, redundancies and flows into unemployment suggest that quits tend to be concentrated among more educated

workers moving in to better paid jobs. More than half of all quits in the USA are individuals who work in wholesale and financial professional services (Kletzer 1998).

2.6 Adopting this framework we get a clear prediction about tenure rates for vulnerable/low income groups: the fall in demand for unskilled labour, arising from changes in technology, competition and the industrial structure, combined with the *freeing up* of the labour market (reductions in benefits and union power), should, over the cycle, have increased job insecurity for these groups. These changes would also have reduced the incentive to hoard labour. To many these changes have signalled the end of *jobs for life.* The 1994 conference of the Institute of Personnel Management said,"the concept of a steady job had disappeared under competition from technology...creating a new industrial peasantry." To evaluate these claims we need to go beyond anecdotal observations and look at empirical data.

Empirical Modelling

3.1 Most of the empirical work on tenure rates in the UK come from responses to survey questions like: *how long have you been with your present employer for?* Responses are typically split between male and female[3] and grouped into bands for different periods: eg. less than 3 months, 3 to 6 months etc. Such a broad question quickly runs into problems - not least because the bands have seen several changes over the years. We are obviously interested in the distribution of completed tenure rates, whereas surveys can only ask about incomplete (*elapsed*) tenure rates. Even if we had this data, looking at average tenure rates would not be particularly helpful either. Individuals have different entry times into the labour market; it is simply not possible for (say) a 20 year old to (legally) have more than 4 years tenure. In this paper we look at two ways to analyse tenure rates:

- compute *completed* tenure rates from data on *uncompleted* rates (by statistical methods) for a *core* group; or

- simply proxy the *degree* of job tenure: e.g., look at the % of people who have been in their job for the last three months, 10-20 years, etc.

3.2 The link between completed and elapsed tenure rates have been explored by Burgess and Rees (1996). They overcome the problem of not having data on completed tenure rates by using renewal theory to link them to uncompleted job tenure rates. Renewal theory involves making assumptions on the probability density functions of completed rates. The precise details do not concern us (see Lancaster 1990). Using renewal theory, they find the mean value of elapsed rates, derived from surveys, to be approximately half that of completed tenure rates.

3.3 Using this method, Burgess and Rees analyse elapsed tenure rates by income quartile from the *General Household Survey* for the UK between 1979 and 1992. Despite common perceptions, they find that mean tenure rates have not changed significantly in this period. Elapsed tenure rates

[3]Female tenure rates are complicated by factors such as child care See 3.11.

for the male 31-50 group were over 10 years in 1992 and almost 7 years for women; or in line with renewal theory around 20 and 14 years respectively for completed rates. Most individuals in the UK can still expect to spend a large part of their working life in one job. The data - in line with other international experience (Diebold *et al* (1994), Newmark *et al* (1997) for the USA, Burgess *et al* (1997) for Italy) - does not support the claim that dramatic technological changes and labour market deregulation have brought around a new industrial peasantry. From a vulnerability point of view, however, important results emerge.

The Vulnerable

3.4 Within the overall picture of stability, there are significant differences in tenure rates between those at the top and bottom of the income distribution:

- mean elapsed tenure rates for the Core male group in the bottom income quartile were 7 years in 1992, compared to nearly 12 years for those in the top quarter. Doubling these numbers, in line with renewal theory, implies completed tenure rates of 14 and 24 years respectively; and

- tenure rates among those in the bottom quartile have fallen over time. Mean elapsed tenure rates for the core male group were almost 9 years in 1975, compared to 7 years in 1992 - a fall of around 20%. Exploiting renewal theory would suggest a decline from 18 to 14 years respectively.

3.5 To quantify these changes, exponential[4] time *trends* were fitted to elapsed tenure rates for income quartiles (derived from the *GHS*) for the Core 31-50 age group between 1975 and 1992. Whilst there may be some cyclical component (see 3.4), we are interested in isolating secular trends. We expect these results to mirror aggregate data. The following OLS regressions where ran:[5]

$$\text{Ln (Tenure)}_t = a + b\,T + U_t \qquad (3)$$

Ln (Tenure) is the logarithm of elapsed job tenure rates for a specific income quartile in time T; T a time trend; and U a disturbance term that is normally distributed and not subject to autocorrelation. More complex modelling is beyond the scope of the paper.

3.6 While one should be careful in using the term *trend*, interesting results do emerge - which proved highly significant in the statistical sense. It should be remembered that the sample was based on a period of great change in the UK labour market; we would not necessarily expect rates to continue to decline at this rate in the future. The following results were found:

[4] Given the function $Y=ae^{bt}$, Y is an *exponential* function of t; b is an estimate of the *proportional* growth rate. Taking natural logarithms gives us the expression in (1).

[5] I am grateful to Dr Burgess of the University of Bristol for providing me with the data.

Group	b*	se	t-stat	Significant	DW	R^2
Lower quartile Men	-0.014	0.0018	-7.95	0.1%	1.25	0.8
Upper quartile Men	-0.0019	0.0011	-1.76	10%	2.95	0.16
Lower quartile Women	-0.004	0.00202	-1.72	-	1.98	0.16
Upper quartile Women	0.0042	0.00180	2.36	10%	0.86	0.26

*on 16 degrees of freedom
**estimation method: OLS

3.7 These results confirm a secular decline in elapsed tenure rates for the (core) lower income male quartile: rates have been falling at highly significant rates (around 1.5% annually[6]). For males in the upper quartile this trend is on the margins of statistical significance. For women in the lower income quartile, this trend is also on the margins of statistical significance, whilst for those in the upper quartile tenure rates have actually risen - a finding consistent with Gregg and Wadsworth (1997).

Other Groups

3.8 We are also interested in how rates of particular groups have changed in relative terms. Female tenure rates are generally lower than males, as participation is complicated by care for children and the elderly, and legislation affecting maternity rights (Joshi 1992). Trends were fitted to the ratio of male to female tenure rates. This differential has been remarkably consistent in recent years - as reflected by the insignificant trend.

3.9 As well as establishing that tenure rates have fallen for low income groups, we are also interested in how they have changed relative to those in top income bands. Ethnic groups, who were also cited as vulnerable (OFT 1998), also tend to be over-representation in semi and unskilled jobs. The *LFS* (1994) reports that Indian and Black males earned on average 10% less than white males, and Pakistanis and Bangladeshis one-third less. Ethnic minorities will find their employment prospects will be closely related to that of low income groups (Ginsburg 1992). The ratio of upper to lower income groups has grown at statistically significant rates over time, again confirming a relative deterioration in tenure rates for the low income *and* ethnic groups.

Group	b*	se	t-stat	Significant	DW	R^2
Male upper/lower	0.0123	0.0022	5.53	0.1%	1.68	0.65
Male /Women(median)	0.0008	0.0021	0.37	-	1.29	0.008

*on 16 degrees of freedom
**estimation method: OLS.

[6]The Durban-Watson statistic could neither accept nor reject the null hypothesis of autocorrelation for lower quartile men, and accepted it for upper quartile women. Standard Cochrane-Orcutt regression were ran to correct for this. Not surprising, the coefficients were similar. The Coefficients were (t-stats in parentheses) : -0.015 (-6.49) for lower quartile men and .0032319 (1.690) for upper quartile women.

3.10 Another way to analyse tenure rates is to proxy the *degree* of job tenure in the labour market by analysing the % of employees, by occupation, falling into various tenure bands. Since 1992 the *Labour Force Survey* has asked such questions. We expect vulnerable groups to be concentrated in unskilled and partly unskilled occupation groups. The proportion of full time employees who have been in their current job for less than 3 months could proxy *short* tenure, while between 10-20 years could be proxy *long* tenure. The following table is taken from responses to the *Labour Force Survey* between 1992 and 1997. Thus, of professionals questioned between 1992 and 1997, on average 3.1% were in their job for less than 3 months, compared to 9.8% of unskilled workers. The numbers in the 10-20 year category were 19.3 and 14.3 respectively.

Labour Force Survey Responses 1992-7

	Less than Three months		*10-20 years*	
	Mean (%)	Standard deviation	Mean (%)	Standard deviation
Professional	3.3	0.5	19.3	0.5
Intermediate	2.83	0.37	22.3	0.7
Non manual skilled	6.5	0.5	16.3	0.9
Manual skilled	4.8	0.372	21.2	0.7
Partly skilled	9.6	0.471	14.5	0.5
Unskilled	10.2	1.06	14.3	0.7

Source: LFS and author's calculations.

3.11 Ideally, we want to test the null hypotheses that there are no differences in the proportions falling in to each tenure band: e.g., the % of professionals in the less then 3 months and 10-20 year category are the same as unskilled. If we could reject this we could begin to establish differences in tenure rates across occupation groups. Unfortunately, the small sample period prevents us from attaching too much weight to formal statistical tests. Despite this, the conclusions are the same: those in professional jobs are more likely to have longer tenure rates than the unskilled and the partially unskilled.

4. Implications and Other Issues Relating to Vulnerability

4.1 This work confirms that Vulnerable/Low income groups are increasingly more likely to lose their jobs. Back of the envelope calculations suggest that they are roughly one and a half times more likely to lose their jobs as those in the top quartile[7]. These results are consistent with the

[7] An individual in the bottom decile had an average completed tenure rate of 14.24 in 1992 and 23.4 in the top decile in 1992. These would correspond to average annual probabilities of losing jobs of 0.07 and 0.042

common view that deregulation has caused flexible jobs to become more flexible. This could reflect the polarisation of the labour market into *Primary* and *Secondary* sectors (Gregg and Wadsworth 1997), with vulnerable groups concentrated in the latter. This could explain why low income groups who succeed in finding new jobs are likely to find it compares poorly with their last one (Gosling *et al* 1997; Gregg and Wadsworth 1994). Even with unchanged tenure rates we would expect the fears of the consequences of job insecurity to be greater. That job insecurity is a major cause of ill-health is now well established (Burchell et *al* 1994). Not only have benefits recently become less generous (see 1.2), but unemployment spells have become longer.

4.2 Increasing numbers of Long Term Unemployed (LTU) - defined as those unemployed for more than one year - characterised the UK labour market in the 1980s. The proportion of those unemployed for more than one year increased from 20% to 40% during the 1980s. The reasons behind LTU have been well-discussed in the literature (Layard *et al* 1991; Bean 1992): employers may use long periods of unemployment as signal to reject applications, while prolonged periods of unemployment could lead to a deterioration of human capital. Data shows that the unskilled, as well as being more likely to become unemployed, are highly vulnerable to periods of long term unemployment. The Government's *New Deal* should help to arrest these numbers.

4.3 Another important feature of the UK labour market over the last 30 years has been the increasing division of households and families between *work rich* and *income poor* - as more married women have joined their husbands in the workforce and the growth of no-earner households increase. This can be explained by the tendency for men and women of the same socio-economic class to marry (sometimes known by the term *assortive mating*). In 1979 there were 1.2 million households where no adult worked, compared to 3.3 million in 1995 (Gregg and Wadsworth 1995). These developments would tend to enforce job insecurity at the household level. The growth in divorce and single parent families has also been important. As the majority of single parent families are led by females, we would expect their employment history and income to be more volatile. Recent data shows that over 60% of lone parents are in the bottom income decile (ONS 1997). These issues are outside the remit of the paper, but are important in understanding vulnerability.

5.Wage Inequality

5.1 From a vulnerability viewpoint, as well as how long a job lasts for, we are also interested in how much it pays. Perhaps the single most important social change in the UK over the last decade been the massive increase in wage inequality, defined by either weekly or hourly earnings. Wage inequality can be explained remarkably well by a simple relative supply and demand framework (Gosling *et al* 1994). Demand has increased for skilled individuals by a greater degree than supply. There is nothing special about the UK in this regard; all countries have experienced a shift in demand away from the unskilled to the skilled. Where wages are relatively flexible, or where

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respectively. For 1975 these numbers were 0.057 and 0.41 respectively.

labour markets have been *freed-up*, this has translated into greater relative unemployment for the unskilled *and* a shift in wages against them.

5.2 Wage inequality is not only higher in the UK than in many other European countries, it is at levels without historical precedent. The growth in wage inequality in the UK is significant however we measure relative wages*:* e.g., earnings of the top decile compared with the bottom decile (90/10 ratio), the top decile to the median (90/50 ratio) or the variance of wages. In 1979 the 10th percentile for male earnings was 64% of the median; by 1995 this ratio had fallen to 45% (OECD 1996). In 1979 a person in the bottom earnings decile earned around 40% of a person in the top decile. This is now under 30%. Relative wages have not only turned against the low paid, they have also fallen in *real* terms after housing costs (Machin 1996). It will be interesting to see what impact the minimum wage will have in reversing these trends.

5.3 The increase in wage inequality is symptomatic of a more general increase in *income* inequality, where the latter includes investment income, pensions etc. Analysing these trends are outside the scope of the report-interested readers should consult Goodman, Johnson and Webb (1995). In any case it should be remembered that non-wage income will be highly correlated with wages.

6. Income Mobility

6.1 If all periods of low income were accounted for by one-off *blips,* the OFT would be less worried about low and volatile income as a source of exclusion from financial products. There are strong theoretical reasons to believe why the shorter tenure rates and wage inequality outlined above will effect the ability of individuals to move out of persistent low income. Wages are typically the largest single source of income, and there is a robust empirical relationship between wage growth and tenure rates (Topel 1991).

6.2 After a comprehensive improvement in the quality of data, researchers now have access to an increasing set of British longtitudional data in the form of the *British Household Panel Survey*. The standard way to measure income mobility is by a transition matrix, which shows the % of people who move particular income group over a given period. If there was complete immobility each individual would stay in their initial group; complete mobility would mean that an individual's place in the distribution would be purely random (or a *lottery*). A transition matrix, based on the first four waves of the *BHPS* (1991-5), is shown below. The concepts of *immobility* and *mobility* can be interpreted in the following 5*5 matrix. Complete mobility would correspond to each entry in the matrix being 20, and complete immobility to each cell in the leading diagonal being 100.

Transition Matrix for the UK 1991-1995

	Income Group 1995				
Income Group 1991	**1**	**2**	**3**	**4**	**5**
1	**63**	20	9	5	4

2	22	**40**	20	11	7
3	10	25	**36**	20	10
4	6	10	23	**41**	21
5	3	5	10	28	**54**

Source: BHPS: ESCR research Centre on Micro-social Change.

6.4 The table shows that over half the individuals in the bottom quintile in 1991 are still there in 1995, with 82% remaining in bottom two categories; only one-fifth move further than this. Whilst there is mobility in the UK, the table confirms that most of it is short range and confined to the middle of the distribution. Jarvis and Jenkins' analysis of the first *BHPS* (1997) finds that 36% are on the leading diagonal (complete immobility) and 10% on the mobility (or lottery) path. Overall, their work suggests that around one-third of low income is transient, but two-thirds is not.

6.5 As well as establishing that mobility is lower at the bottom of the income distribution, we also want to know about its dynamics. One approach is to analyse the mobility paths of individuals in each of the four waves of the *BHPS* (1991-1994). Hills (1997) defines five trajectories for those in low income groups: *flat*, *rising out of poverty*, *falling into poverty*, *blips out of poverty* and *other*. He concludes that, given dynamics, 80% of those on low income are in *problem* trajectories.

6.6 Unfortunately, there is no *BHPS*, or equivalent, before the 1990s. Analysing the dynamics of mobility before this date can only be done indirectly. Dickens (1997), for example, constructs a mobility index for the year-on-year changes in the earnings distribution over 1975-94 using the *New Earnings Survey* and *BHPS*. He shows that, adjusting for inflation, the mobility index for males has declined by 22% and 11% for females over the last 20 years. Another way to measure mobility is to look at the numbers claiming income support. Many of the poorest in society depend on this to maintain a minimum standard of living; we would expect that an increase in mobility would see a fall in the absolute numbers claiming it for *long* periods of time. Over the last decade this has not happened. There has been a rise in the absolute number of non-pensioners claiming income support for long periods (Hills 1997).

6.7 All of these methods come to similar conclusions: there is considerable persistence in low income which recent developments to the labour market have done nothing to change. On the contrary, they appear to have made it more difficult for low income individuals to move up the income ladder.

Conclusion

7.1 At the launch of the OFT enquiry in to *Vulnerable Consumers*, the DGFT said that many consumers were denied access to financial products because their incomes were "low, uncertain and couldn't be guaranteed." Analysing recent trends in the UK labour market has shown that job insecurity for a section of the population, that can be described as vulnerable, has increased. We show that other labour market developments, such as wage inequality and the growth of no-earner households, has led to a further deterioration in the conditions of the vulnerable, in both relative

terms *and* over time. Such results are well understood and robust, and have attracted relatively little controversy in the literature. From a vulnerability point of view, these developments have reduced the ability of certain groups to buy financial products, particularly those that require regular premiums. For low income consumers that already own financial products there is an increased probability that they will have to terminate them. In both cases - exclusion and early termination - there is likely to be a welfare cost or consumer determinant.

7.2 Providers of financial products will increasingly have to ask whether their financial products have adapted to the more fluid and flexible labour market. In fact there are already some encouraging signs. In the recent debate about savings products, the inadequacies of existing products such as TESSAs and PEPS for those on low income were recognised (Banks *et al* 1997). TESSAs and PEPs required regular monthly contributions (around £50) and minimum holding periods (5 years) to maximise benefits. It was not surprising, given what we have analysed, that ownership was skewed to higher income groups. The new Individual Savings Accounts aim to overcome these problems and provide low income groups with savings vehicles. Whether they will do so is a moot point; what is encouraging is that inadequacies have been realised *and* policy responses made. Similar initiatives are needed in other areas such as mortgages and insurance to meet the changes we have outlined above.

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