The Global Financial Crisis: The Victims of the Recession

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1. Introduction

The aim of this paper is to study the likely impacts of the Global Financial and Economic Crisis on the Australian labour market. We argue that the impact of the global crisis on the Australian economy is likely to be a continuing increase in unemployment and long term unemployment. The impact of the recession leads to a significant fall in GDP and GDP growth that would lead to a worsening of conditions of living for a large number of people. This increase in unemployment is likely to have significant long term impacts on the well being of Australian people in terms of prospects for employment in the future, on wages subsequent to finding work, on health, and on family relationships. We argue that besides the policies introduced to date in terms of loosening of monetary policy and the fiscal stimulus, we need to target policies towards the unemployed, especially the long term unemployed.

The Global Financial Crisis (GFC) has now become a Global Economic Recession. The Australian economy has so far done better than most other OECD countries, however, we cannot escape the recession. Evidence is now accumulating that the Government’s stimulus packages have helped to maintain consumer and business confidence. The First Home Owners grants have helped to keep the housing market from collapsing and compared to the USA or the UK our housing market has been very strong. The combined effects of the Federal Government’s fiscal stimulus packages, the financial guarantees provided to banks, and the Reserve Bank of Australia’s timely loosening of monetary policy have helped to slow down the impact of the Global Economic Recession. Indeed the resilience of the Australian economy to external shocks has been quite remarkable. Just as we managed to avoid a recession as a result of the Asian Financial Crisis of a decade earlier, we seem to be avoiding a deep recession as a result of the GFC.

2. The Costs of the Recession

A recession has significant costs to society in terms of lost GDP, unemployment, long term unemployment, lower real wage increases, breakdown in family relationships, increased physical and mental health problems, and impacts negatively on the development of children of the unemployed, and those on low incomes. A period of high unemployment not only has a negative impact on the unemployed but also on the employed who become concerned about losing their job, leading to increased stress and anxiety. In an attempt to avoid being made redundant many of the employed workers may increase their work effort, and increase the amount of unpaid overtime, etc. In this recession we see that many workers have accepted shorter working hours and smaller wage increases to avoid redundancies.

When a firm closes down the building starts to fall into disrepair, the machinery is left to rust and depreciate, and the workers are made redundant. The plant and equipment

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1 I am grateful to Rob Wells and Cedric Hodges for excellent research assistance. They are not, of course, responsible for remaining errors.
may find a new buyer, or the machinery may be sold to the Third World, or it may be recycled. But these are inanimate objects: they do not think.

The redundant workers skills also “rust” and become obsolescent. But they think! They become disheartened, dejected, they may fall ill with continuing unemployment. The household income drops significantly, problems arise in the household, arguments take place between the worker and spouse, and children get upset as they have to do without many things that their friends enjoy. Life becomes difficult for the entire family. Sometimes, unemployment leads to family breakdown, some unemployed workers may enter into criminal activities, and some may lapse into depression and illness.

Unemployment and underemployment rise during a recession. Many workers lose their jobs, some are forced onto part time work (e.g., three day shifts), and part time workers have their hours of work cut back. The recession hits some people harder than others: the young, the unskilled, the poorly educated, migrants with less experience, and women are likely to suffer. This has led to some people being forced to sell their homes and look for rental properties.

Small business usually suffers during a recession: the fall in demand means a loss of revenue and they find that larger firms delay paying their bills, and some of them go into bankruptcy. The Global Financial Crisis (GFC) has led to a large fall in the value of equities and superannuation funds. Pensioners have found the value of their superannuation funds cut dramatically leading perhaps to changes in retirement plans for some. This recession has also hit the old who were living on private incomes: they have had their superannuation assets suddenly drop by about thirty percent.

However, some people benefit during a recession. People who have regular wage/salary employment as they find the mortgage payments fall, inflation slows down so that their real disposable income increases.
3. The Impact of the Recession on Gross Domestic Product

Although some economists and journalists define a recession in terms of two consecutive quarters of negative GDP growth, the National Bureau of Economic Research has a much broader determination of a recession in terms of several indicators that include negative GDP growth, increasing unemployment, etc. The diagram below shows the big fall in GDP growth in the early 1980s compared to the 1990s recession although the impact on unemployment was much greater in the 1990s compared to the 1980s.

**Figure 1: GDP Growth in the Recession of the 1980s and 1990s**

![GDP Growth Chart](image)

*Source: ABS*

Although the recessions in terms of GDP growth were short, the 1980s recession was deeper but did not last as long as the 1990s recession. However, the labour market response is slower and much longer. Unemployment increases rapidly but comes down very slowly. For males (females) there is a big increase in the unemployment rate and in the early 1980 recession it takes almost six years (five years) for the unemployment rate to get back to its previous level before the recession began. The 1990s recession is much worse for the unemployed: it takes almost 13 years for the male unemployment rate (and nine years for female unemployment rate) to return to its previous level before the start of the recession.

The present recession that was caused by the GFC and the world recessions has so far only led to one quarter of negative GDP growth and a slow increase in unemployment. However, most forecasts of GDP growth show much slower growth for a few years. In Figure 2 below we show the projected levels of GDP if the Australian economy had grown at the average growth rate of the past decade (or past five years) compared to the forecasts made by the Federal Government in the Budget Statement No. 1 and the latest Reserve Bank of Australia forecasts in August 2009. The gap shows the potential loss of GDP from the recession as the levels of GDP after the recession do not return to the levels that would have occurred if the growth of the
past decade had continued. What is clear from the figure is that there is a huge gap that opens up as a result of the recession and it takes a very long time before the level of GDP would catch up with what it might have been in the absence of the recession.

Table 1: The Potential Loss of GDP

<table>
<thead>
<tr>
<th>Source</th>
<th>Dec-09</th>
<th>Mar-09</th>
<th>Jun-09</th>
<th>Sep-09</th>
<th>Dec-09</th>
<th>Mar-10</th>
<th>Jun-10</th>
<th>Sep-10</th>
<th>Dec-10</th>
<th>Mar-11</th>
<th>Jun-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury GDP Gap</td>
<td>0</td>
<td>215.5</td>
<td>408.5</td>
<td>784.5</td>
<td>13047</td>
<td>15213</td>
<td>14201</td>
<td>14331</td>
<td>15676</td>
<td>15736</td>
<td>14690</td>
</tr>
<tr>
<td>RBA Forecasts</td>
<td>27.3429</td>
<td>27.3515</td>
<td>27.4051</td>
<td>27.3921</td>
<td>27.3791</td>
<td>27.5292</td>
<td>27.6792</td>
<td>27.8372</td>
<td>27.9851</td>
<td>28.2870</td>
<td>28.5788</td>
</tr>
<tr>
<td>RBA GDP Gap</td>
<td>0</td>
<td>37</td>
<td>623</td>
<td>2999</td>
<td>7621</td>
<td>7281</td>
<td>6941</td>
<td>7681</td>
<td>10741</td>
<td>9021</td>
<td>7301</td>
</tr>
</tbody>
</table>

Source: Our estimates

Figure 2: Estimated and Forecasts of GDP

Source: Budget Papers No. 1, RBA (2009), ABS

The forecasts that the Federal Government had made at the time of the budget are more pessimistic compared to the RBA forecasts that are based on more recent data which suggest that the Australian economy is more resilient than the other OECD economies. Hence the potential loss of GDP that we estimate from the Federal Treasury is much larger than that estimated from the RBA. However, note that even 11 quarters later we still do not approach the levels of GDP that would have occurred if we had continued to grow at the average growth rate of the past decade.
4. The Impact of the Recession on Unemployment

In a recession firms usually follow this pattern:
(i) Stop hiring new workers
(ii) Put full time workers on part time
(iii) Part time workers have their hours cut
(iv) Start laying off workers/redundancies

This staged response of the employers to the recession means that unemployment rates begin to rise after six to twelve months after a fall in GDP. As is often said, unemployment is a lagging indicator of a recession.

As a result of the halting of new hires, young people who are leaving education (schools, colleges, universities) and entering the labour market for the first time are likely to face unemployment for some time. The young are often early school leavers, and those with little work experience and hence unlikely to be offered employment when there is a pool of well educated and skilled unemployed workers. The young are also more mobile: they tend to attempt to change jobs in their search for their “ideal” occupation or employment. As a result if they leave their employment, they find it difficult to find new employment and hence join the unemployment queue. Older workers who have been made redundant usually face difficulties in finding a new job, partly as a result of age discrimination, and partly because their skills may be out of date. In general, older workers who are made redundant or who are long term unemployed give up looking for work and join the not in the labour force category, the retired.

Workers who are employed full time have faced increasing pressure to accept a cut in their hours of work and as a result they have a fall in incomes and are “under-employed”. Male and female full time employment has fallen and part time employment has increased. Similarly, part-time workers (many of whom are women) find that they are offered fewer hours of work. In this recession there has been a significant increase in under-unemployment, see ABS (2009). Although employment of persons has remained fairly strong in this recession, the total number of hours worked has been falling consistently since July 2008 on a trend basis, ABS 6202.0 (July 2009).

As firms face a decrease in demand for their products, they begin to lay-off workers. This is especially in those industries that are most hit by the recession: construction, hospitality, tourism, etc. Good human resource management would suggest that the more skilled and specialised workers would be the last to be made redundant, but if the recession continues more workers are made redundant. The workers who are most susceptible to being made redundant are the less skilled workers (as employers believe they can be re-hired or re-placed easily when the recovery comes), the young because they are the last to have been hired (last-in-first-out, industrial relations practice), recent migrants who have less work experience in Australia, and the older workers who can move from employment to early retirement. Sometimes the firm goes bankrupt and closes down and all the workers are made redundant.

To summarise, those most at risk of unemployment are the young, early school leavers, the unskilled, recent migrants, and older workers. Older workers who are
made redundant or who are long term unemployed tend to leave the labour force and retire early. Unemployment is a very “undemocratic” punishment!

Table 2: Unemployment Rates of the Young and Old

<table>
<thead>
<tr>
<th></th>
<th>UR, 15-19</th>
<th>UR, 20-24</th>
<th>UR, 55-59</th>
<th>UR, 60-64</th>
<th>UR All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-2008</td>
<td>13.2</td>
<td>6.1</td>
<td>2.6</td>
<td>3.0</td>
<td>4.3</td>
</tr>
<tr>
<td>Apr-2009</td>
<td>16.7</td>
<td>8.6</td>
<td>2.8</td>
<td>3.9</td>
<td>5.6</td>
</tr>
</tbody>
</table>

Source: ABS

As the data in Table 2 show the unemployment rates of the young increased significantly during the recent recession, while the unemployment rate of older workers did not increase by much, presumably because of early retirement.

Figure 3: Unemployment of the Young during Recessions

When a recession hits the labour market youth unemployment rates (20-24 year olds) increases rapidly but it takes a very long time before the unemployment rate returns to the pre-recession levels. In the 1980s recession it took 25 quarters before returning to the pre-recession level, and in the 1990s recession it took 57 quarters (!) before it returned to pre-recession levels. The period of the 1990s in fact saw rapid economic growth but despite that youth unemployment rates remained at high levels.
For older workers (55-59 year olds) recessions are bad news! In the 1980 recession unemployment rates just about returned to the pre-recession levels before they were hit by the 1990s recession. In the 1990s recession it took 52 quarters (13 years!) before it returned to pre-recession levels. Again, although the economy was growing rapidly in the 1990s unemployment rates for the elderly were stubbornly refusing to fall.

Table 3: Australian and Migrant Unemployment Rates

<table>
<thead>
<tr>
<th>Year of Arrival</th>
<th>Feb-Apr. 2008</th>
<th>Feb.-Apr. 2009</th>
<th>Percentage increase 2008-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Migrants arrived 2006 and later</td>
<td>9.4</td>
<td>13.5</td>
<td>43.6</td>
</tr>
<tr>
<td>Migrants arrived 1996-2005</td>
<td>5.1</td>
<td>7.4</td>
<td>45.1</td>
</tr>
<tr>
<td><strong>By year of arrival and English speaking background</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Migrants arrived 1996 and later from MESC</td>
<td>4.3</td>
<td>6.6</td>
<td>53.5</td>
</tr>
<tr>
<td>Migrants arrived 1996 and later from non-MESC</td>
<td>7.4</td>
<td>11.3</td>
<td>52.7</td>
</tr>
<tr>
<td>Migrants arrived pre-1996 from MESC</td>
<td>3.1</td>
<td>4.0</td>
<td>29.0</td>
</tr>
<tr>
<td>Migrants arrived pre-1996 from non-MESC</td>
<td>4.1</td>
<td>5.2</td>
<td>26.8</td>
</tr>
<tr>
<td>Australian born</td>
<td>4.3</td>
<td>5.6</td>
<td>30.2</td>
</tr>
<tr>
<td>Total</td>
<td>4.4</td>
<td>5.9</td>
<td>34.1</td>
</tr>
</tbody>
</table>

*Source: Department of Immigration, private communication.*

*Notes: MESC is Mainly English Speaking Countries, what used to be called ESB, English Speaking Background countries.*
The data clearly show that there is a big increase since February 2008 in unemployment rates for migrants who arrived after 1996, compared to migrants who arrived before 1996 or compared to the Australian born.

Figure 5: Male Unemployment during the Recessions

Source: Based on ABS Labour Force Australia 6202.0.55.001

Figure 6: Female Unemployment during the Recessions

Source: Based on ABS Labour Force Australia 6202.0.55.001
For the 1982 recession it takes males six years for the unemployment rate to get back to pre-recession levels and it takes thirteen years for the unemployment to return to the pre-recession levels after the 1990 recession. For the 1982 recession it takes females five years to return to the pre-recession levels and ten years for unemployment to return to the pre-recession levels in the 1990 recession.

To summarise, a recession has a significant and long term impact on unemployment.

Research has shown that a period of unemployment leads to increasing proportions of the unemployed who are long term unemployed (unemployed for twelve months or longer). There are two reasons why an unemployed worker is unlikely to find a new job easily. Firstly, the employer treats a person who is unemployed as potentially unemployable (s/he treats unemployment as a signal of some poor work characteristics) and prefers to hire someone who is moving from another job. Secondly, a period of unemployment leads to the unemployed worker losing his/her skills and work habits. This “skill atrophy” would lead the employer not to hire a worker who has been unemployed for a period of time. Thirdly, an unemployed worker who has suffered a long period of unemployment loses motivation to find another job.

There has been much research that suggests that unemployment leads to “scarring”: a person who has faced a spell of unemployment is more likely to have repeat spells of unemployment and also face lower wages in the future.

As a result there is much evidence to suggest that unemployment increases rapidly in a recession but comes down very slowly. Long term unemployment increases after a lag, and then comes down very slowly.
Figure 7: Male Long Term Unemployment during Recessions

![Male Long Term Unemployment Graph]

Figure 8: Female Long Term Unemployment during the Recessions

![Female Long Term Unemployment Graph]

Source: ABS

The long term unemployed (LTU) are those workers who have been continuously unemployed for 12 months or longer. After the 1980s recession the percentage of those unemployed for more than 12 months never got back to the pre-recession period! Another recession hit the economy. After the 1990s recession it took LTU
almost 15 years for males and 12.5 years for females to return to the pre-recession period.

5. Impact of the Recession on Society (to be completed)

A recession has significant impacts on society besides its impact on the labour market and unemployment, see Junankar (1987), Junankar and Kapuscinski (??). There is some evidence that unemployment leads to a breakdown in marriages, increases in family disputes etc. There is also evidence that unemployment leads to an increase in depression, mental health problems, increases in physical ailments, and an increase in mortality.

An increase in bankruptcies during a recession has significant impacts on several people who have employment or business dealings with the bankrupt company. The Global Financial Crisis has led to many finance houses going bankrupt and people losing their life savings. The collapse of the financial sector has also led to a significant fall in the superannuation assets of workers. For self funded retired people the financial collapse has led to a fall in their living standards.

\section*{Number of divorces and crude divorce rate, 1901-2006}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{divorce_rate.png}
\caption{Number of divorces and crude divorce rate, 1901-2006}
\end{figure}

\textit{Source:} Australian Institute of Family Studies,
\url{http://www.aifs.gov.au/institute/info/charts/divorce/numberdivorces.html}
All ages age-adjusted rates of suicide by sex, deaths registered in Australia 1964–2006

Suicide Rates

Source: AIHW (2009)
Crude Divorce Rates

Source: Australian Institute of Family Studies,
6. Policies to Tackle the Crisis in the Labour Market

The Global Financial Crisis has led to most OECD governments introducing a set of measures to stabilise the financial sector by various means. Governments, in effect, partially nationalised financial institutions, introduced measures to guarantee deposits, and provided help to ailing financial institutions. The Central Banks introduced crisis measures and lowered interest rates (in some cases like the USA) to almost zero percent, and increased liquidity for the financial sector. Governments, including many conservative governments, introduced massive Keynesian stimulus packages to help to stabilise the macroeconomy. This coordinated action has helped most of the OECD countries to lower the impact of the downturn. Australia has come out surprising well with only one quarter of negative GDP growth. France and Germany appear now (August 2009) to be coming out of the recession with positive GDP growth. There are signs that the US economy is also beginning to turn with business and consumer confidence returning.

However, in addition to the macroeconomic fiscal stimulus and the “loose” monetary policy we need specific policies targeted to the unemployed and the long term unemployed. As discussed earlier, we know that unemployment and long term unemployment lags behind changes in GDP and, more importantly, continue to increase or not fall for several years afterwards. In the recession of the 1990s, Keating introduced a package of policies under Working Nation. What we need now are the following policies targeted at the unemployed and the long term unemployed:

1. Active Labour Market Programs that provide certified training to unemployed people, especially early school leavers who are most susceptible to long term unemployment. These training programs could be run by TAFEs or VETs. It is
important that the training programs last for say six months and trainees are provided with a certificate of successful completion.

2. A Job Guarantee scheme for all those unemployed people who have been unemployed for six months or longer. These jobs would have to be provided by the public sector in (say) energy conservation, water saving practices, etc. This work could be provided by State governments, local councils, etc. The Federal government should subsidise work for these unemployed people in, for example, insulation of houses, adding solar panels, replacing single flush toilets in homes, replacing halogen down lights with energy saving down lights, etc.

7. Conclusions

This paper has argued that the Global Financial Crisis has led to increase unemployment and long term unemployment that is likely to persist for several years after the economy (in terms of GDP growth) has recovered. It showed that in past recessions when unemployment and long term unemployment went up suddenly it took several years before it returned to pre-recession levels. This was true even when the economy was growing very rapidly, as it did during the 1990s and early 2000s. We argued that because of the large social costs involved in continuing unemployment and long term unemployment, the Government should introduce targeted labour market programs to tackle this serious problem. There is much work to be done, but we must begin this work immediately.
References


