Long-Term Unemployment in the Great Recession

Testimony for the

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by

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Overview – The Jobs Deficit and the Long-Term Unemployment Problem

The past two and a half years have been particularly trying ones for American workers and their families. Labor market conditions have deteriorated dramatically since the start of the Great Recession in late 2007 making this the severest labor market downturn since the Great Depression of the 1930s. The unemployment rate more than doubled from 4.8 percent in the fourth quarter of 2007 to 10.0 percent in the fourth quarter of 2009 and remains at 9.7 percent in early 2010. The unemployment rate today is even higher than the 10.8 percent postwar unemployment peak in the 1982-83 recession once one adjusts for changes in the age-structure of the labor force (Elsby, Hobjin, and Sahin 2010). The conventional unemployment rate understates current labor market distress and misses the huge growth in underemployment (involuntary part-time work) and a substantial increase in discouraged workers no longer counted in the labor force.

Payroll employment recorded a precipitous decline of 8.4 million jobs (or 6.1 percent) from December 2007 to an apparent employment trough in February 2010. We finally saw some modest employment growth of 160 thousand in March 2010. Since we would have needed a net increase of 2.4 million jobs from December 2007 to March 2010 just to keep up with civilian population growth, we have a *current Jobs Deficit of 10.6 million.* In other words, we would need 10.6 million more jobs today to get back to the employment rate (employment-population ratio) prevailing before the start of the Great Recession in late 2007.

Although there are increasing signs of a nascent economic recovery in the latest GDP and labor market data, we still face an enormous job creation challenge even if we get a strong economic recovery. For example, to get back to something approximating normal labor market conditions (the employment rate of late 2007) by January 2014 would require a net payroll employment expansion of 14.9 million jobs to make up the current 10.6 million jobs deficit and to absorb the 0.8 percent per year normal labor force growth projected by the Bureau of Labor Statistics. In other words, we need over 332 thousand net new jobs per month sustained for the next 45 months (or 2.9 percent per year employment growth) to make up for the two years of severe job losses in the Great Recession. This would require even stronger employment growth than the 2.4 percent per year in the robust 1993 to 2000 recovery and expansion.

Unemployment increases in the Great Recession have disproportionately affected men, workers from goods producing industries, young workers, and non-college workers. But this downturn has been so severe that it has had adverse impacts on almost every group of workers and all regions of the country in terms of both substantial unemployment and stagnant wages.

Two particularly worrisome signs suggestive of longer-term structural labor market problems and persistent costs of unemployment from this recession are the concentration of the rise in unemployment among permanent job losers and the huge increase in long-term unemployment. Permanent job losers (job losers not on temporary layoff) increased from 1.7 percent in November 2007 to a peak of 5.6 percent in October 2009 and remained at 5.0 percent in March 2010. The previous post-World War II high for permanent job losers as a share of the labor force was 4.4 percent in November 1982, during the depths of the 1982-3 recession. The number of long-term unemployed (those unemployed 27 weeks or longer) reached over 6.5 million in March 2010 representing 44.1 percent of the unemployed. The long-term unemployment rate (those unemployed 27 or more weeks as a share of the labor force) has increased from 0.9 percent in November 2007 to 4.3 percent March 2010 well above the previous postwar peak of 2.6 percent in June 1983. And the current long-term unemployment rate of 4.2 percent understates our actual long-term joblessness problem by not capturing the large number of discouraged and marginally attached workers (equivalent to another 1.4 percent of the labor force in March 2010) who continue to desire work but who no longer are actively searching for work and thereby are not counted in the official unemployment rate.

Much research demonstrates that permanently displaced workers and the long-term unemployed face particularly difficult labor market adjustments (Arulampalam, Gregg, and Gregory 2001; Jacobson, LaLonde, and Sullivan 2003; Couch and Placzek 2010). Workers displaced from long-term jobs in the early 1980s recession faced large earnings declines upon re-employment and still had 20 percent earnings losses at 15 to 20 years after displacement (Von Wachter, Song, and Manchester 2009). The health consequences of permanent job loss from long-term jobs are also severe for with a 50 to 100 percent increase in mortality the year following displacement, 10 to 15 percent increases in mortality rates for the next 20 years, and an implied loss of life expectancy for a worker aged 40 at displacement of 1 to 1.5 years (Sullivan and Von Wachter 2009). The health problems and mortality increases from job loss are strongly positively associated with larger permanent earnings losses. A substantial number of permanent job losers also end up moving onto the disability insurance rolls as they become discouraged in searching for new jobs and often have many health problems (Autor and Duggan 2003). Parental job loss also appears causally related to adverse impacts on children including poorer schooling outcomes and worse labor market outcomes as adults (Oreopoulos, Page, and Stevens 2008; Stevens and Schaller 2009). Thus, policies designed to help displaced workers transit to new jobs, gain valuable new skills, and reduce their earnings losses will be necessary to try combat the potential for huge and potentially persistent human costs associated with today's long-term unemployment. Such policies have upfront costs but if effective can actually be fiscally

responsible over the long-term in raising the taxable earnings of displaced workers, improving their children's economic prospects, and reducing the growth of the disability rolls.

Cyclical and Structural Unemployment Problems

The labor market deterioration from late 2007 to early 2009 followed the historical cyclical negative relationship between job openings (vacancies) and unemployment (i.e., moving down the Beveridge Curve with rising unemployment and falling vacancies). In other words, rising unemployment through around May 2009 looked like a severe but normal cyclical unemployment increase. But the unemployment rate continued rising in 2009 after the job openings rate stabilized and the unemployment rate is now much higher than would be implied by the historical Beveridge curve (Elsby, Hobjin, and Sahin 20010). This pattern suggests the potential emergence of structural unemployment problems of mismatches between the unemployed and potential new jobs and/or the exacerbation of the longer-term U.S. labor market trends of rising wage inequality and declining employment opportunities in traditional middle-class jobs.

Although the apparent outward shift of the Beveridge curve indicates some increase in structural labor market problems, there is no doubt that we still have a huge cyclical unemployment problem with a continued severe shortfall of aggregate demand and real GDP still well below its potential (trend) level. Most of the rise of long-term unemployment reflects the cyclical collapse of aggregate demand and labor demand. When hiring rates remain low for a sustained period, job losers (as well as labor market new entrants and reentrants) are unable to find work quickly and have a much greater risk of becoming long-term unemployed. The job openings (vacancy) rate declined from 3.2 percent in November 2007 to 1.8 percent in April 2009 and remained at only 2.1 percent in February 2010. With 5.5 unemployed job seekers per job opening (as of February 2010), cyclical problems swamp structural problems in terms of the source of unacceptably high overall and long-term unemployment. The long-term unemployed often tend to be at the end of queue in terms of gaining employment when labor demand starts picking up again. While the origins of the large recent rise in long-term unemployment are predominantly cyclical in nature, targeted policies to assist the labor market adjustments of the long-term unemployed are likely to be necessary even once a jobs recovery is underway.

A key component of policies to assist the long-term unemployed and their families is the continuation of (emergency) extended unemployment insurance (UI) benefits. Some analysts -- such as Mulligan (2010) – argue that the disincentive effects of the UI extensions themselves have contributed to rising long-term unemployment. But the most compelling research suggests

only modest impacts of UI extensions on the search effort and duration of unemployment of unemployment insurance recipients (Card and Levine 2000; Schmieder, Von Wachter, and Bender 2009). Furthermore, previous estimates of larger impacts of unemployment durations of UI extensions for the United States (Katz and Meyer 1990) are based on data from the 1970s and early 1980s in with much of the responsiveness coming from firms and industries using temporary layoffs and the sensitivity of recall dates to unemployment insurance benefits. This layoff-recall process is much less important today than it was in the 1970s and early 1980s downturns. Unemployment insurance extensions also have important consumption smoothing benefits for the unemployed (Gruber 1997) and much of the impact on job search comes from reducing liquidity (credit-constraint) problems rather than traditional job search disincentives (Chetty 2008). Traditional microeconomic estimates of the impact of UI on the unemployment durations of UI recipients further tend to overstate the aggregate impact by ignoring the spillover effects of shorter unemployment spells for the other unemployed workers no receiving UI benefits (Levine 1993). They also ignore the macroeconomic stimulus impacts of increased consumption expenditures by the unemployed from UI raising aggregate demand and labor demand during a deep recession as well as the gains from keeping more of the long-term unemployed attached to the labor market rather than moving onto disability programs.

Although unemployment insurance extensions are not a major source of current structural unemployment problems, some features of the current U.S. labor market are suggestive of potentially persistent structural problems. Regional labor market problems and geographic disparities in the location of job seekers and potential job openings may be an underlying source of structural unemployment problems. Relative to those in other nations Americans have always been highly-mobile and their moves in pursuit of new opportunities have enhanced U.S. economic dynamism. High rates of geographic labor mobility have allowed the United States to recover more rapidly from adverse economic shocks and to have smaller regional unemployment differences than European nations with less mobile work forces (Blanchard and Katz 1992).

But American geographic mobility has declined over the last two decades and has fallen sharply in the Great Recession since 2007 (Frey 2009). First, the housing market crisis and large house price declines in many regions potentially generate a geographic lock-in effect. Homeowners with negative equity are hesitant to sell their houses at a loss thereby reducing mobility from distressed areas (Ferreira, Gyourko, and Tracy 2009). Second, the subprime crisis has created economic distress in typically fast-growing areas, such as Florida, California, and Nevada, further acting to slow the labor mobility from declining to expanding regions that ordinarily helps drive U.S. job recoveries. Third, lingering credit market problems, especially for potential new start ups, hinder job creation in economically vibrant locales slowing labor

mobility to these areas. Finally, greater educational attainment has been the traditional way young Americans acquire the skills demanded by growing occupations and regions. Greater federal aid to higher education may be necessary, given the budgetary problems of most states and many families, to maintain access and allow young Americans to gain the skills to move in pursuit of their American dreams.

The sharp cyclical downturn of the Great Recession comes on the heels of a three decade increase in U.S. wage inequality and educational wage differentials. The large rise in wage inequality has been associated with rapid skill biased technological change associated with computerization and a slowdown in the growth of U.S. educational attainment (Goldin and Katz 2008). The finance boom of the 1990s to 2007, some aspects of globalization and offshoring, and weakening U.S. labor market institutions have exacerbated these wage inequality trends. Current Population Survey data indicate that wage inequality (as measured the ratio of the earnings of 90th to the 10th percentile worker) and the college wage premium (driven by those with higher degrees) continued to increase from 2007 to 2009.

The last twenty years has also seen a twisting of technological change and a rise in offshoring that have lead to a *polarization of the U.S. labor market* with strong growth in high-end, high-skill jobs and in traditionally lower-wage jobs in the in-person service sector but particularly weak demand for traditional middle class jobs such as manufacturing production jobs and middle management positions (Autor, Katz, and Kearney 2006, 2008). The typical high-wage jobs of non-college men and many middle class jobs for those with college training have been hard hit. The housing market boom and bubble of 2002 to 2006 hid some of these trends in buoying demand for non-college men in construction. The Great Recession has reinforced the longer-term jobs polarization and wage inequality trends with huge declines in construction, manufacturing, and middle management employment.

These long-term structural labor market problems suggest that substantial mismatches between the skills and aspirations of job losers (especially the long-term unemployed) and the skill requirements and compensation packages of new job openings are likely to emerge as the economy recovers from the Great Recession. Many job losers from sectors such as construction and manufacturing may face difficulties in making the psychological and financial adjustments as well as gaining the training and education required for the new jobs available in the growing (primarily service) sectors .

The bottom line is that the U.S. economy faces two major jobs challenges. The first is the need for strong economic recovery to increase vacancy creation, hiring, and create a sustained

jobs expansion. The second is the need for policies to address structural labor market problems to improve the matching of job seekers to new job openings, to assist in the labor market adjustments of the long-term unemployed, and to deal with our long-term job quality problem.

An open question as we see initial signs of some economic recovery is whether we are likely see "jobless recovery" as following the recession of 1990-91 and 2001 or a sharp jobs recovery and labor market reversal as following the recessions of the 1970s and 1980s. The greater depth of the current recession could mean a faster jobs recovery and there are some recent signs of employers indicating plans to increase hiring. But several factors suggest we may be in for a slower jobs recovery than those following the deep recession of the mid-1970s and early 1980s. First, firms appear to increasingly use downturns to improve organizational efficiency and productivity and reduce the need for new hiring for some time (Gordon 2010). Second, the much higher share of permanent layoffs to temporary layoffs in this downturn tends to delay a job recovery as firm won't be quickly expanding by recalling previously laid off workers as in the 1970s and 1980s recoveries. Third, the large share of workers who are part-time for economic reasons means firms can expand output for some time in raising hours and effort of existing workers before doing new hiring. Thus, we need policies to stimulate job creation in the short-run to insure a robust jobs recovery and reduce the increased suffering that will occur in a jobless recovery.

Job Creation Policies

Both the continued fragility of the economy and the possibility of a sustained jobless recovery represent calls to action for immediate policy steps to expand employment and incentivize job creation. Several promising components of such a jobs creation package include increased aid to fiscally strapped states, enhanced short-run tax incentives for increased private sector employment expansion, and incentives for facilitating investments with high long-run payoffs in energy efficiency (such as some form of a "cash for caulkers" program) and infrastructure. The extremely high current unemployment rate and continued rise in long-term unemployment also make a strong humanitarian and economic case for increasing aid to the unemployed and for a longer-than-normal duration of benefits through the continuation of emergency unemployment compensation.

A net job creation tax credit (as opposed to the recently enacted tax credit for new hires of unemployed workers) could provide a useful incentive to speed up private sector employment growth as the economy starts to recover. The best available evidence indicates that firms do respond to short-run reduced (marginal) wage costs by moderately expanding employment (e.g.,

Card 1990). Recent analyses suggest a net job creation tax credit could have a reasonably high effectiveness in terms of employment expansion per dollar of budgetary cost (Bartik and Bishop 2009; Congressional Budget Office 2010). The main problems with the previous 1977-78 New Jobs Tax Credit of the lack of knowledge of the policy by many small firms, high complexity, and lack of timeliness of payments can be addressed by better marketing and information campaigns, attention to the design, and allowing a quarterly payment option. An advantage of a tax credit for net employment and payroll expansion is that it focuses the incentives on firms that are on the margin of expanding and likely to expand in the future so that needed labor reallocation to growing firms is expedited and the added jobs are more likely to persist after the credit expires. The large importance of new start ups for net job creation means new firms should also be eligible for some employment expansion credit. A key design issue is whether such a net job creation tax credit should be capped such as in Obama Administration's proposed Small Business Jobs and Wage Tax credit with a $500,000 dollar cap per business. Such a cap can blunt the incentives and effectiveness for larger growing firms. Nevertheless, the elimination of a cap per business on such a tax credit could create perverse incentives for many firms to do their new hiring through temporary help firms rather than hire workers into more permanent positions. Such hires would be net employment expansions for temporary and receive a tax subsidy even when hiring the worker into a permanent position would not represent a net employment expansion at the original employer.

Policies for Structural Labor Market Problems and to Help the Long-Term Unemployed

The U.S. labor market is likely to continue to have persistent structural unemployment problems from mismatches between job seekers and job openings even in the face of a robust economic recovery. Permanently displaced workers and the long-term unemployed are likely to face difficult times gaining suitable new employment and face many years of lower earnings and financial difficulties without steps to help their labor market adjustments. Longer-term trends of rising inequality and job market polarization exacerbate these adjustment problems. The dismal state of the youth labor market requires direct action in providing more employment opportunities for youth and young adults in distressed areas and in making sure all young people have the financial resources to gain valuable post-secondary education and training and appropriate guidance for making sensible educational and training choices.

Labor market policies to combat these problems that merit serious consideration include[1]:

[1] See Babcock, Congdon, Katz, and Mullainathan (2009) for more details on these proposals.

- *Wage Insurance for permanent job losers with high tenure in their previous jobs*. Permanent job losers often are reluctant to accept new job offers below their pre-separation wage and often take a long time searching for jobs like their previous one even when prospects are much brighter in other sectors and for other types of jobs. This leads to a form of long-term "retrospective wait unemployment," particularly for high-tenure workers displaced from declining sectors. And much evidence finds large financial and health costs of such persistent unemployment on these workers and their families. A promising policy to address these issues and supplement unemployment benefits for likely permanent job losers is wage-loss insurance (also called wage insurance) which (at least temporarily) subsidizes worker earnings upon reemployment when the wage they receive on their new job is less than that of their old job. Wage-loss insurance offers a way of assisting individuals with the psychological adjustment to changing labor market conditions and addresses likely biases in wage expectations that impede job search incentives. It also helps buffer the financial adjustments of moving into an initially lower-paying position. Wage-insurance could be designed to provide nearly full insurance immediately upon reemployment, and declining over time possibly in a manner linked to typical wage growth patterns on new jobs.

- *Improving Employment services, job search assistance, education, and job training systems*. The evidence from a wide range of evaluations suggests that employment services and job search assistance can be cost-effective in helping dislocated workers and disadvantaged workers to obtain employment more rapidly and can raise earnings at least in the short-run (Meyer 1995; O'Leary 2004). The economic returns to further education and training at community colleges that lead to degrees and certificates are also high for dislocated workers (Jacobson, LaLonde, and Sullivan 2005). The economic returns to post-secondary education remain extremely high for young workers and there is also much evidence that well-functioning job training and education programs – such as the Job Corps and the National Guard Youth Challenge – can improve the labor market and social outcomes of disadvantaged youth.

  But the existing employment service programs and job training systems through the Workforce Investment Act (WIA) are fragmented and difficult for many workers to navigate. First, we need to make sure dislocated workers and young workers have sufficient resources (Pell grants, individual training accounts) to invest in high-quality education and training and to offset the current lack of part-time work opportunities that are typically used to self-finance continuing education. Second, efforts need to be made to provide more accessible and meaningful information about labor market conditions and occupational projection and to simplify program take-up, navigation, and completion, and provide user-friendly

information on the quality of training providers. Third, a supplementary approach to ensuring that individuals qualifying for job training services receive effective guidance and assistance would be to experiment with creating a structured market for providers of counseling and advice. A demonstration project should experiment with creating markets for advice in which providers are rewarded based on meaningful performance measures (employment and earnings outcomes) instead of just the use of services.

- *Sectoral Employment Programs.* Sector-focused training programs (also known as sectoral employment programs) have emerged over the last fifteen years as a particularly promising approach to workforce development. Sectoral employment programs work closely with local employers to create industry-specific programs that prepare and connect unemployed and under-skilled workers to employers seeking to fill skilled vacancies such as for allied health professions, information technology, and skilled manufacturing jobs. Successful examples include Project Quest in San Antonio, the Wisconsin Regional Training Partnership in Milwaukee, Per Scholas in New York City, and the Jewish Vocational Service in Boston. These sectoral employment programs, originally initiated by nonprofit, community-based organizations, have developed strong connections to employers and to the broader community. The early evaluations suggest that well-run versions of these programs can be quite successful in placing workers into high-quality jobs and in improving hourly and annual earnings (Maguire et al., 2009). Investments to expand access to and the development of high-quality sectoral employment programs appear to be warranted as a crucial additional tool for improving the labor market prospects of the long-term unemployed and of disadvantaged workers.

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