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Testimony before the Joint Economic Committee
Long-Term Unemployment: Consequences and Solutions

Kevin A. Hassett
John G. Searle Senior Fellow
Director of Economic Policy Studies
American Enterprise Institute
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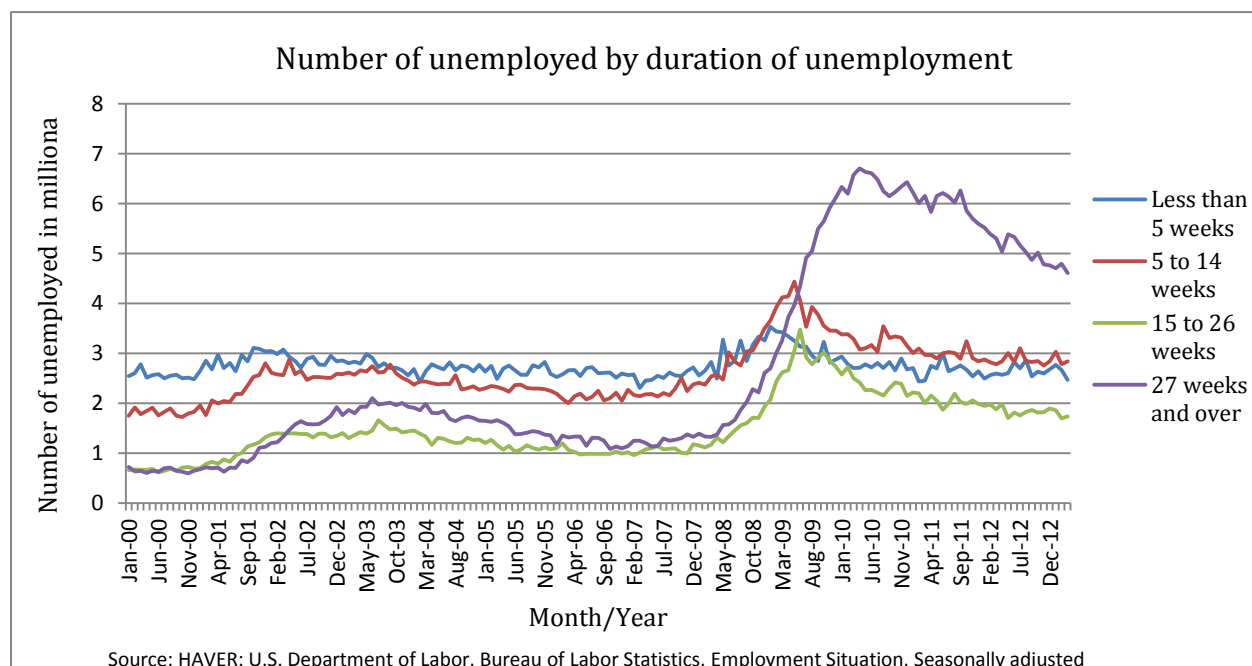
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Chairman Brady, Vice Chair Klobuchar, and Members of the Committee, thank you for inviting me to appear today to discuss the problem of long-term unemployment. In the testimony that follows, I will discuss the current status of the long-term unemployment crisis, review recent attempts to explain it, and then turn to possible policy options.

I. Long-term unemployment today

In December 2007, at the start of the Great Recession, the number of the long-term unemployed stood at 1.3 million, or 17.3 percent of all unemployed workers. Over the course of the recession the U.S. experienced an increase in the number of individuals unemployed for 27 weeks or more, a trend which continued after the recession's close in June 2009. The number of the long-term unemployed peaked in April 2010 at 6.7 million, making up 43.9 percent of all unemployed workers. Currently, there are 4.6 million workers who are considered long-term unemployed, which comprises 39.3 percent of all unemployed workers.

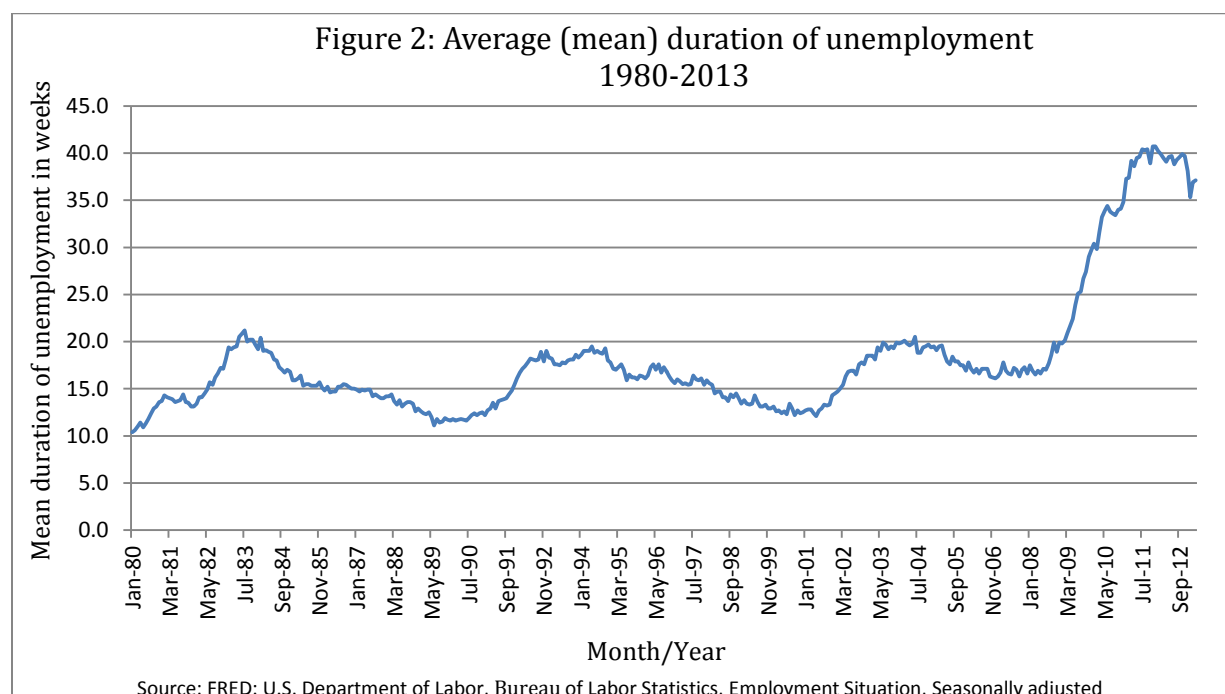
Figure 1 shows the number of unemployed persons (in millions) by different durations of unemployment. Prior to the recession, the number of individuals unemployed for 27 weeks and over is relatively low and surpasses only those unemployed for 15 to 26 weeks. During and after the recession, there is an especially sharp increase in long term unemployment and by June 2009, the number of persons experiencing long-term unemployment exceeds numbers in every other category. Today, persons unemployed for 27 weeks and over continue to significantly outnumber their counterparts in each category.



Given the figure above, it is not surprising that average unemployment durations have also been increasing. In December 2007, the mean duration of unemployment stood at 16.6 weeks. By December 2011, this number had increased to 40.7 weeks, the longest duration documented since

World War II. Today, the average duration of unemployment is around 37.7 weeks, still above the 27 week threshold.

Figure 2 shows the average length of unemployment from 1980 to 2013. The average unemployment duration rose between the mid- 1980s and the mid- 2000s, but this is largely attributed to changing demographics in the labor force – specifically, surges in female labor force participation and the aging of the U.S. population. Aaronson, Mazumder, and Schechter (2010) point out that these demographic factors only partially account for the dramatic increases since the Great Recession.¹ They focus on weak labor demand and, to a smaller extent, extensions in unemployment insurance benefits as possible explanations for the rise in unemployment durations.



They conclude that while average length of unemployment had been rising for two decades before the beginning of the recession in 2007, this was largely due to changing demographics in the labor force – specifically, the greater participation of women in the labor force and the aging of the overall population in the U.S. However, the increase since the great recession can only partly be attributed to these demographic factors.

II. The high cost of unemployment

Unemployment undoubtedly has many costs, and while its financial impacts may be more obvious, research has shown that it has many subtle negative effects on wellbeing as well. A report by Johnson and Feng at the Urban Institute details the financial losses to workers who experienced long-term unemployment between 2008 and the end of 2011; for workers who were out of work

¹ Aaronson, Daniel, Bhashkar Mazumder, and Shani Schechter, 2010. "What is behind the rise in long-term unemployment?" *Economic Perspectives*, Federal Reserve Bank of Chicago: 28-51.
<http://qa.chicagofed.org/digital_assets/publications/economic_perspectives/2010/2qtr2010_part1_aaronson_mazumder_schechter.pdf>

for six months, half experienced declines in per-capita family income by 40 percent or more. The financial hardships were felt especially by African Americans and Hispanics, along with workers who did not have more than a high school education and unmarried workers who could not rely on a spouse's income². In addition, once workers who were previously unemployed find jobs, their earnings are persistently lower than before their unemployment spell³. In addition to these financial burdens, unemployed workers have been shown to have an increased risk of death and a potentially shortened life expectancy⁴, along with a heightened risk of suicide that increases with the length of unemployment.⁵ Perhaps unexpectedly, unemployment also seems to increase the mortality of men from cancer, especially lung cancer.⁶

In addition to the negative effects that unemployment can have on an unemployed worker's wellbeing, it can also be detrimental to his or her family. Stevens and Schaller demonstrated that parental unemployment can increase the probability that a child will have to repeat a grade in school, an effect that was especially important for children of parents with lower educational attainment.⁷ One spouse's job loss also increases the probability of divorce.⁸ While not all of these studies examine the effects of long-term unemployment specifically, it's clear that experiencing a long period of unemployment can have significant negative impacts on a worker's financial stability and overall wellbeing, along with those of his or her family. As further evidence of this, a 2010 report from the Pew Research center showed differences in how workers who had been unemployed for six months or longer reported family strain and other measures of personal wellbeing, compared to employed workers and those who had been unemployed for shorter durations.⁹ Long-term unemployed workers were more likely to report that they had lost some self-respect, that the recession would have a big impact on their career goals, and that the recession brought "major changes" in the way they live.

III. Causes of the current long-term unemployment crisis

While some of the costs of unemployment have been thoroughly described and are somewhat easy to pinpoint, the causes of the recent increase in the number of long-term unemployed workers are harder to disentangle. Understanding the causes is necessary, however, in order to choose policies that may be effective in addressing the current unemployment situation. A few theories have been

²Johnson, Richard W. and Feng, Alice G. "Financial Consequences of Long-term Unemployment during the Great Recession and Recovery." Urban Institute Brief #13. April 2013. <<http://www.urban.org/UploadedPDF/412800-Financial-Consequences-of-Long-Term-Unemployment-during-the-Great-Recession-and-Recovery.pdf>>

³Jacobson, Louis S., Lalonde, Robert J., and Sullivan, Daniel G. "Earnings Losses of Displaced Workers." *The American Economic Review* Vol. 83(4), pg. 685-709. Sept. 1993

⁴ Sullivan, Daniel and von Wachter, Till. "Job Displacement and Mortality: An Analysis Using Administrative Data." *Quarterly Journal of Economics*, Vol. 124(3), pg. 1265-1306. August 2009.

⁵ Classen, Timothy J., and Dunn, Richard A. "The Effect of Job Loss and Unemployment Duration on Suicide Risk in the United States." *Health Economics*, Vol. 21(3), pg. 338-350. March 2012.

⁶ Lyng, E. "Unemployment and Cancer: A Literature Review." In *Social Inequalities and Cancer*. Kogevinas, M., Pearce, N. Susser, M., and Boffetta, P., eds. IARC Scientific Publications No. 138. 1997.

⁷ Stevens, Ann Huff, and Schaller, Jessamyn. "Short-run Effects of Parental Job Loss on Children's Academic Achievement." *Economics of Education Review*, Vol. 30(2), pg. 289-299. April 2011.

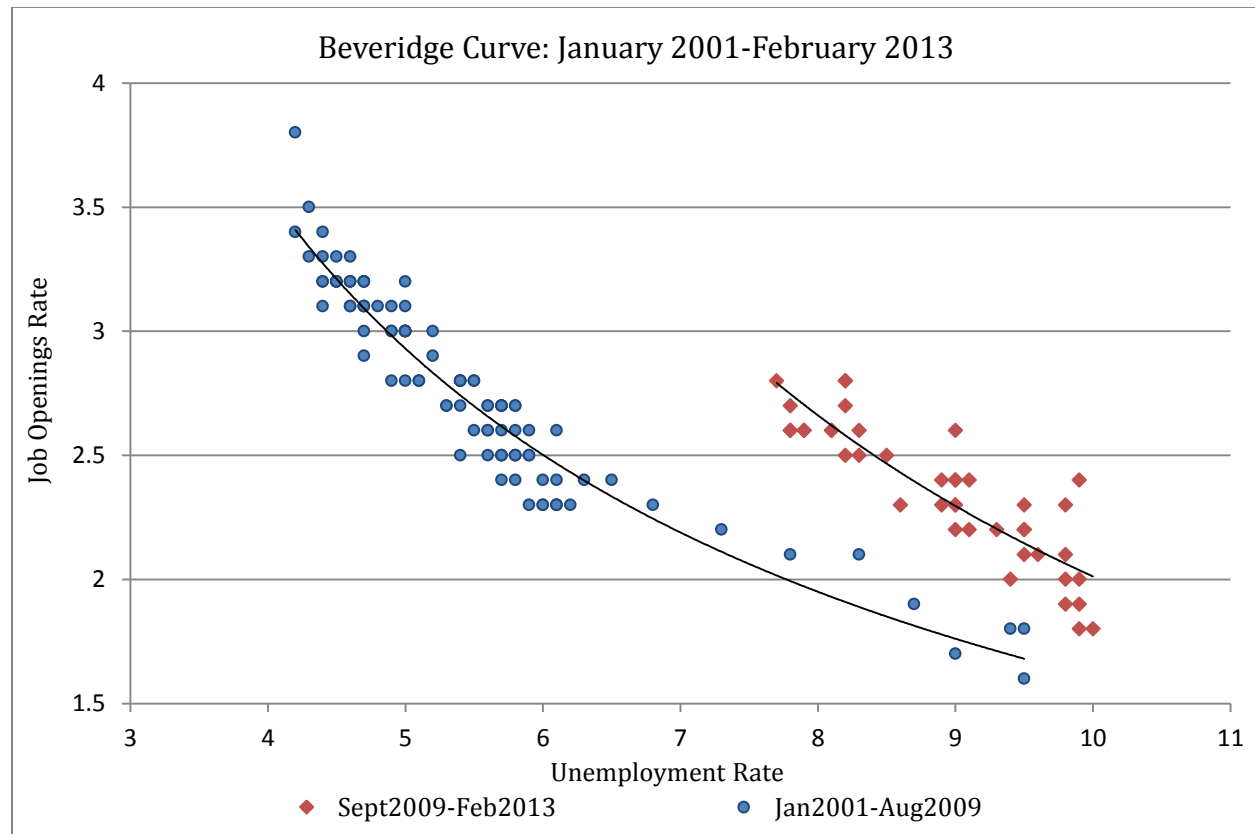
⁸ Charles, Kerwin Kofi, and Stephens, Melvin. "Job Displacement, Disability, and Divorce." *Journal of Labor Economics*, Vol. 22(2), pg. 489-522. April 2004.

⁹ Morin, Rich, and Kochhar, Rakesh. "The Impact of Long-term Unemployment: Lost Income, Lost friends – and Loss of Self-respect." Pew Research center Report, July 2010. <<http://pewsocialtrends.org/files/2010/11/760-recession.pdf>>

put forth for the persistence of the large amount of long-term unemployment in the U.S. following the recent recession, including skills mismatch, “scarring” of the long-term unemployed that makes them less employable, and economic and policy uncertainty.

One reason to believe that some of these factors may be causing an increase in the amount and duration of unemployment and, specifically, long-term unemployment, is a shift in the relationship between the number of unemployed workers and the amount of job vacancies in the years since the recession. This relationship is called the Beveridge curve, and it is used by economists to shed light on the state of the labor market. In an idealized perfectly functioning economy, there is no unemployment because market prices adjust to set labor supply equal to labor demand. If a job listing occurs, prices and workers adjust to instantly fill it. In a more realistic economy, filling a position can take time, and the Beveridge curve is an indicator of how smoothly the matching process occurs. If a high level of vacancies is visible in the data for a given level of unemployment, it is a sign that the market is not matching unemployed persons to vacancies well. Causes of market frictions may include long term unemployment, skill mismatches, and geographic mismatches, to name a few.

Normally, when job vacancies are higher, unemployment is lower, and vice versa. As can be seen in the graph below, however, in the years following the recession, towards the end of 2009, there has been a shift outward in the curve, implying that there is a higher level of unemployment at a given level of vacancies. This shift suggests the labor market is becoming less efficient at matching available jobs and unemployed workers.



This change in the relationship between job vacancies and the unemployment rate may have different causes than the original increase in long-term unemployment directly following the recession. Most research has pinned the increase in unemployment and unemployment duration during and directly following the recession on weak aggregate demand¹⁰, with an additional influence of extended unemployment insurance benefits.¹¹ While these may still be factors in the current labor market, the increase in job vacancies combined with smaller declines in unemployment points to an inefficiency in the labor market that may have a cause outside of the weak recovery.

There are many possibly stories for the degradation of the job matching function of the economy. Policy and economic uncertainty may be making employers more cautious in hiring, leading them to leave jobs vacant for a longer period of time while they wait for an ideal hire or to be sure of the policy atmosphere before committing to employ a worker. Or, it could be that employers find the large stock of long-term unemployed workers less desirable for employment, so these individuals are not filling the new vacancies as unemployed workers in the past would have. The change could also be caused by a “skill gap”, where large numbers of the unemployed do not have the skills that employers with openings are looking for, and therefore the vacancies continue even as there are more candidates to choose from.

Although it is plausible that all three causes are influencing the current high rate of long-term unemployment and inefficiency in the labor market, the best evidence seems to indicate that the largest factor is some form of scarring of the long-term unemployed, with policy uncertainty contributing some to the tepid growth that has kept unemployment still higher than usual. On top of that, a skills gap contributing some, but not much, to the numbers of long-term unemployed.

IV. “Scarring” vs. the “skills gap” and long-term unemployment

There has long been evidence that unemployment has an influence on the risk of future unemployment and earnings of a worker, effects that may partially be attributable to both employers’ perceptions of workers and to workers’ loss of general and specific skills during a period of unemployment.¹² Although it is not fully understood whether this phenomenon is more attributable to a stigma that employers attach to unemployed job-seekers or a decline in skills by the unemployed, many observers and analyses have shown that it is an important factor in the employability of workers. It is thought by many to be a contributing factor to today’s high long-term unemployment rate.

A very recent analysis by Rand Ghayad, cited in multiple news outlets, shows just how much this factor can affect workers searching for jobs. Ghayad ran an experiment where he sent out 4800 fake resumes to 600 job openings, varying different resumes for the same positions on whether an

¹⁰ Elsby, Michael E.L., Hobbijn, Bart, Sahin, Aysegul, and Valletta, Robert G. “The Labor Market in the Great Recession – An Update to September 2011.” *Brookings Papers on Economic Activity*, pg. 353-384. Fall 2011.

¹¹ Aaronson, Daniel, Mazumder, Bhashkar, and Schechter, Shani. “What is Behind the Rise in Long-term Unemployment?” *Economic Perspectives*, Federal Reserve Bank of Chicago. Second Quarter, 2010. <http://qa.chicagofed.org/digital_assets/publications/economic_perspectives/2010/2qtr2010_part1_aaronson_mazumder_schechter.pdf>

¹² Arulampalam, Wiji, Gregg, Paul, and Gregory, Mary. “Unemployment Scarring.” *The Economic Journal*, Vol. 111(475), pg. 577-584. November 2011.

applicant was unemployed and for how long he had been unemployed. He reported that the length of time a candidate had been unemployed was even more important than whether a candidate had experience in the industry he was applying for; candidates who had only recently lost their jobs but who had no industry experience were more likely to be called back than candidates with relevant experience who had been employed for six months or longer.¹³

Focusing on a different potential explanation, Ghayad and William Dickens performed a separate analysis of the U.S. labor market to examine whether a skill gap was to blame for the current high rate of long-term unemployment, and concluded that a skills gap was largely not to blame for the recent inefficiencies in the U.S. labor market as seen in the Beveridge curve since 2009.¹⁴ Their analysis looked at the differences between the Beveridge curves for different types of workers in order to determine if it was likely that a skills gap was causing the shift seen in the Beveridge curve for all workers. A similar shift happened in the 1970s, and this, it is believed, was a result of a gap between the skills of workers and the ones being sought by employers. In the case of the 1970s, the shift happened for both long and short term employed workers, and mostly affected blue-collar workers. The Beveridge curve today, though, is similar for blue and white collar workers, across several industries, and across different age groups. However, while there is an evident shift in the curve for workers who have been unemployed for 27 weeks or more, unemployed workers of shorter durations have experienced no outward shift in the Beveridge curve. They conclude that being unemployed for a longer amount of time has an effect on the chances that a worker will become employed, suggesting that being long-term unemployed is in itself a cause of the persistence in unemployment.

Although the largest problem for the long-term unemployed appears to be scarring as opposed to a skills-gap, that is not to say that some form of training may not help the employment prospects of the long-term unemployed. One cause of scarring may be the loss of soft skills that comes with a longer period of unemployment, something that may be addressed in job training programs. Additionally, if employers view job training as beneficial for prospective employees and view the long-term unemployed more favorably if they are engaged in training instead of sitting idle, then job training programs may be useful for helping the long-term unemployed return to work.

V. Job Training

Job training programs in the U.S. have sought to increase employment and improve displaced workers' earning losses through various forms of schooling, classroom vocational training, facilitated job searches, and subsidized on-the-job training programs. However, the job training system in the U.S. is run by state and local government, fragmented, and difficult for many workers to navigate. A 2011 GAO report found 47 employment and training programs administered across

¹³ O'Brien, Matthew. "The Terrifying Reality of Long-Term Unemployment." *The Atlantic*, April 13, 2013.

<<http://www.theatlantic.com/business/archive/2013/04/the-terrifying-reality-of-long-term-unemployment/274957/>>

¹⁴ Ghayad, Rand and Dickens, William. "What can we Learn by Disaggregating the Unemployment-Vacancy Relationship?" Federal Reserve Bank of Boston Public Policy Brief No. 12-3. 2012.

<<http://www.bostonfed.org/economic/ppb/2012/ppb123.pdf>>

nine different government agencies spent approximately \$18 billion in 2009.¹⁵ The individual programs target different populations and use different metrics to evaluate program success.

The effectiveness of U.S. employment and training programs is difficult to identify because of inadequate program evaluation systems and poorly organized data collection techniques.¹⁶ To properly evaluate an intervention program, an impact study would compare participants' outcomes with and without the program, using a randomly assigned comparison group, to isolate program impact from other factors such as participant background or independent job search efforts. Without controlling for these factors, evaluations could overstate the impact of the programs. The 2011 GAO report found that only 5 of the 47 employment and training programs had conducted studies demonstrating whether outcomes could be attributed to the program since 2004. The results of the 5 studies show that the effects of participation were not consistent across programs, and positive impacts tended to be small or inconclusive.

The Workforce Investment Act (WIA) Dislocated Worker program, which assists workers who have been laid-off, conducted an impact study in 12 states in 2008 and found mixed effects on participants.¹⁷ In five of the states for at least one gender, the effect of the program on the first five quarters of earnings after program participation was negative and significant, indicating that these workers experienced lower earnings than their non-participating counterparts. From 11 to 16 months after program participation, the program had a positive impact on participant earnings except in two states where the impact of the program remained negative. The results imply that program participants have earnings below nonparticipants for an extended period but overtake nonparticipants two to three years after the program. These results demonstrate the ambiguity of job training effectiveness and the need for better data on both long- and short-term program effects in order to pinpoint how the system should be structured to best help the unemployed.

There are clear reasons why job training programs may not effectively help displaced workers. Relatively few participants enroll in these programs for long enough to acquire some kind of credential and those that participate in a subsidized job often receive little or no training other than the employment experience.¹⁸ Additionally, government investments in training are modest compared to the magnitude of the skill deficiencies, resulting in equally modest gains.¹⁹ Employers therefore may not value the time a candidate spent in the program when making employment decisions. A thorough analysis on the best way to target the unemployed should be pursued before allocating more government funds into equivocally useful programs.

VI. Uncertainty and unemployment

¹⁵ U.S. Government Accountability Office. "Multiple Employment and Training Programs." January 2011. <<http://www.gao.gov/new.items/d1192.pdf>>

¹⁶ Heckman, James J., LaLonde, Robert J., and Smith, Jeffrey A. "The Economics and Econometrics of Active Labor Market Programs" In *Handbook of Labor Economics*, eds. Ashenfelter, O. and Card, D. Ed. 1 Vol. 3, N. 3. 1999.

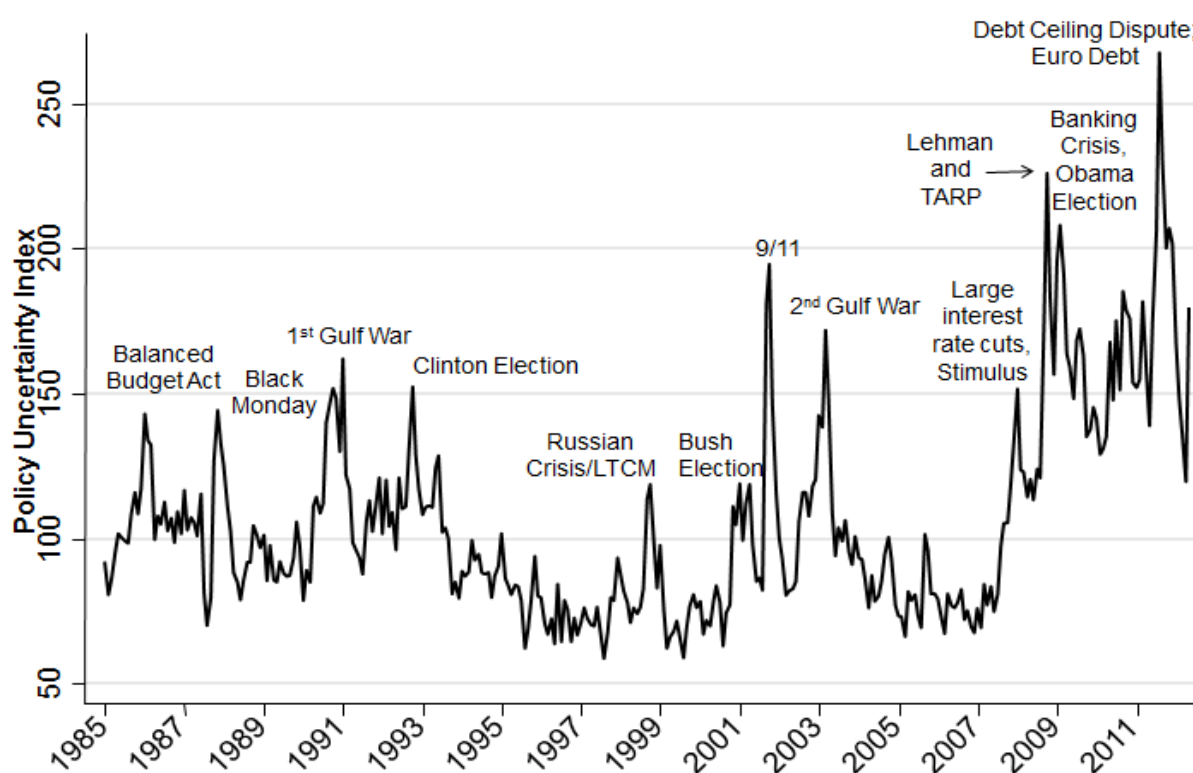
¹⁷ Heinrich, Carolyn, Mueser, Peter R., Troske, Kenneth, and Benus, Jacob M. "Workforce Investment Act Non-Experimental Net Impact Evaluation." IMPAQ International. December 2008. <<http://www.nawdp.org/Content/NavigationMenu/ResearchReports/2009-10-WIANon-ExperimentalNetImpact.pdf>>

¹⁸ Heckman, James J., LaLonde, Robert J., and Smith, Jeffrey A. "The Economics and Econometrics of Active Labor Market Programs" In *Handbook of Labor Economics*, eds. Ashenfelter, O. and Card, D. Ed. 1 Vol. 3, N. 3. 1999.

¹⁹ LaLonde, Robert J. "The Promise of Public Sector-Sponsored Training Programs." *The Journal of Economic Perspectives*, Vol. 9(2), pg. 149-168. 1995.

Policy uncertainty may influence the higher rate of unemployment through two channels: by decreasing the rate of overall growth in the economy as individuals and businesses lower their investments and purchases, and by making employers less willing to hire new employees.

There has been increasing interest in policy uncertainty in the economic and political spheres since the recession, and multiple analyses have shown that uncertainty by individuals and businesses was a contributing factor to the slow recovery following the recession in 2007-2008. Recently, Baker, Bloom, and Davis have developed a measurement of economic policy uncertainty, which they have used to show the increase following the recession.²⁰ They tie this increase to lowered economic activity, and other economists have extended their analysis to show that increased uncertainty following the recession led to a decrease in investment by firms and at the industry level in the U.S.²¹



Source: Baker, Bloom, Davis 2013. <http://www.policyuncertainty.com/media/BakerBloomDavis.pdf>

This decrease in economic activity and investment due to higher levels of uncertainty was a factor in the tepid growth following the recession, and may still be having an effect on economic growth in the U.S. Because of this lowered growth, firms may be reluctant to increase employment, and they may also be more reluctant to hire workers who are perceived as riskier (such as those who have been unemployed for longer durations). This may be one factor behind firms' maintaining more

²⁰ Baker, Scott, Bloom, Nicholas, and Davis, Steven. "Measuring Economic Policy Uncertainty." Chicago Booth Research Paper No. 13-02. 2013. <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2198490>

²¹ Gulen, Huseyin and Ion, Mihai. "Policy Uncertainty and Corporate Investment." Working Paper. 2013. <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2188090>

vacancies over the past three years than they previously did when unemployment was as high as it is today.

VII. Geographic Disparities in Unemployment

One possible cause of persistent long-term unemployment that Ghayad and Dickens do not investigate in their disaggregation of the Beveridge curve is possible geographic differences in employment. Public policy discussions concerning unemployment focus on individuals, but there is also a large difference in unemployment between geographic areas, so it may be necessary to seek more concentrated policies that target areas with high unemployment and higher long-term unemployment. For example, the unemployment rate in the Detroit metropolitan area in February of this year was 10.2, compared to a rate of 5.5 for the Minneapolis-St. Paul area, according to the Bureau of Economic Analysis. Outside of the largest metro regions, there is sometimes greater disparity; the unemployment rate in Yuma, Arizona in February, for example, was 25.6, while in Tucson it was 6.7. Yuba City, California had an unemployment rate of 17.6, compared to 7.1 in the San Francisco area. A different approach may need to be taken towards areas with persistent and high unemployment instead of a broad-based effort.

The US has used targeted measures before to try and encourage growth in distressed areas with high rates of unemployment and poverty, with mixed results. Although previous Enterprise Zone programs, such as the federal Empowerment Zone, Enterprise Community, and Renewal Community programs may have been beneficial²², it is difficult to entangle the causes of economic growth in those areas, especially when government data is sparse.²³ However, there may be other ways to target communities with high unemployment with incentives that are better targeted for investment by individuals and businesses, such as creating a new form of corporation that would receive tax preferences if it invested within a distressed community. In work in progress, I am exploring this option.

VIII. Policy Implications

The impact of long term unemployment on the lives of unemployed Americans and their families is about as negative as anything economists study. It is clear that something terrible happens to individuals as they stay unemployed longer, but that this negative effect is not responsive to normal policy interventions. Accordingly, it is imperative that we think outside the box and explore policies that reconnect individuals to the workforce. As our knowledge of what works is so spotty, this is an area that is crying out for policy experiments that can be rigorously evaluated. A list of policy ideas that may be helpful in this space would include

1) Direct hiring into government jobs. The stigma of long term unemployment may be ameliorated by a short run jobs program that recruits the long term unemployed to assist with the normal

²² Ham, J. C., C. Swenson, A. Imrohoroglu & H. Song. "Government Programs can improve local labor markets: Evidence from State Enterprise Zones, Federal Empowerment Zones and Federal Enterprise Community." *Journal of Public Economics* Vol. 95.7-8 (August 2011) p.779-797

²³ U.S. Government Accountability Office. "Empowerment Zone and Enterprise community Program: Improvements Occurred in communities, but the effect of the program is unclear." GAO 06-727. (Sept 2006).

functions of government. This may allow individuals to look for a new job while employed, a change that may have a large impact on placement.

2) Policies directed at geographic mismatches. These might include improved empowerment zones, and possibly programs to assist workers as they move from areas with weak labor markets to areas with strong labor markets.

3) Privatized training. Our government training programs are a national embarrassment, and the unemployed would be better off if the monies were available to individuals who themselves chose the skills they wish to acquire.

4) Work subsidies. Programs that provide employers with tax incentives to employ the long term unemployed may encourage them to hire them.

5) Work Share programs. The U.S. currently has some programs that allow employers to cut hours of workers in downturns and let them receive some unemployment insurance, but they are very little used. There was also a program in Georgia²⁴ that allowed workers to train and try out employees for a period of eight weeks while they continued to receive unemployment insurance, with the goal of the workers being hired at the end. We need to expand programs like this and experiment with others that may nudge employers towards hiring the long-term unemployed.

²⁴ Lohr, Kathy. "Georgia Jobs Program, Lauded by Obama, Has Critics." NPR, Sept. 2, 2011.
<<http://www.npr.org/2011/09/02/140125260/georgia-jobs-program-lauded-by-obama-has-critics>>