

Presentation for the Conference on Long-Term Unemployment in Industrial Countries,  
University of Wisconsin-Madison, April 28, 2011

# **LONG-TERM UNEMPLOYMENT: CAUSES, COSTS, CURES**

**PRAKASH LOUNGANI, INTERNATIONAL MONETARY FUND | APRIL 28, 2010**

**VIEWS EXPRESSED ARE THOSE OF THE PRESENTER AND SHOULD NOT BE ASCRIBED TO THE IMF.**

I thank Larry Ball and Daniel Leigh for many useful discussions; Joao Jalles for excellent inputs on the topic; and Jair Rodriguez for outstanding research assistance.

# Outline

Facts

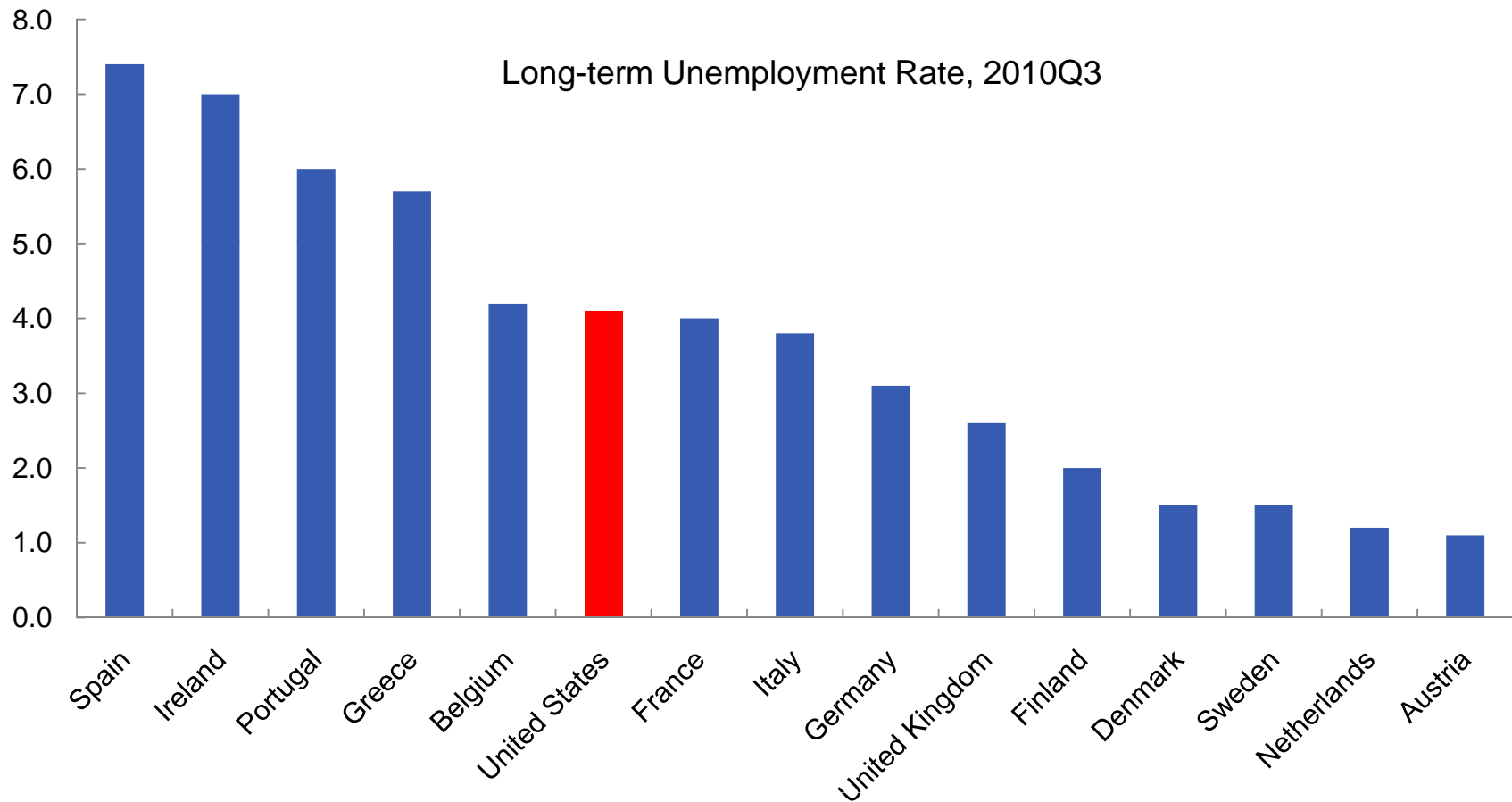
Causes

Costs

Cures

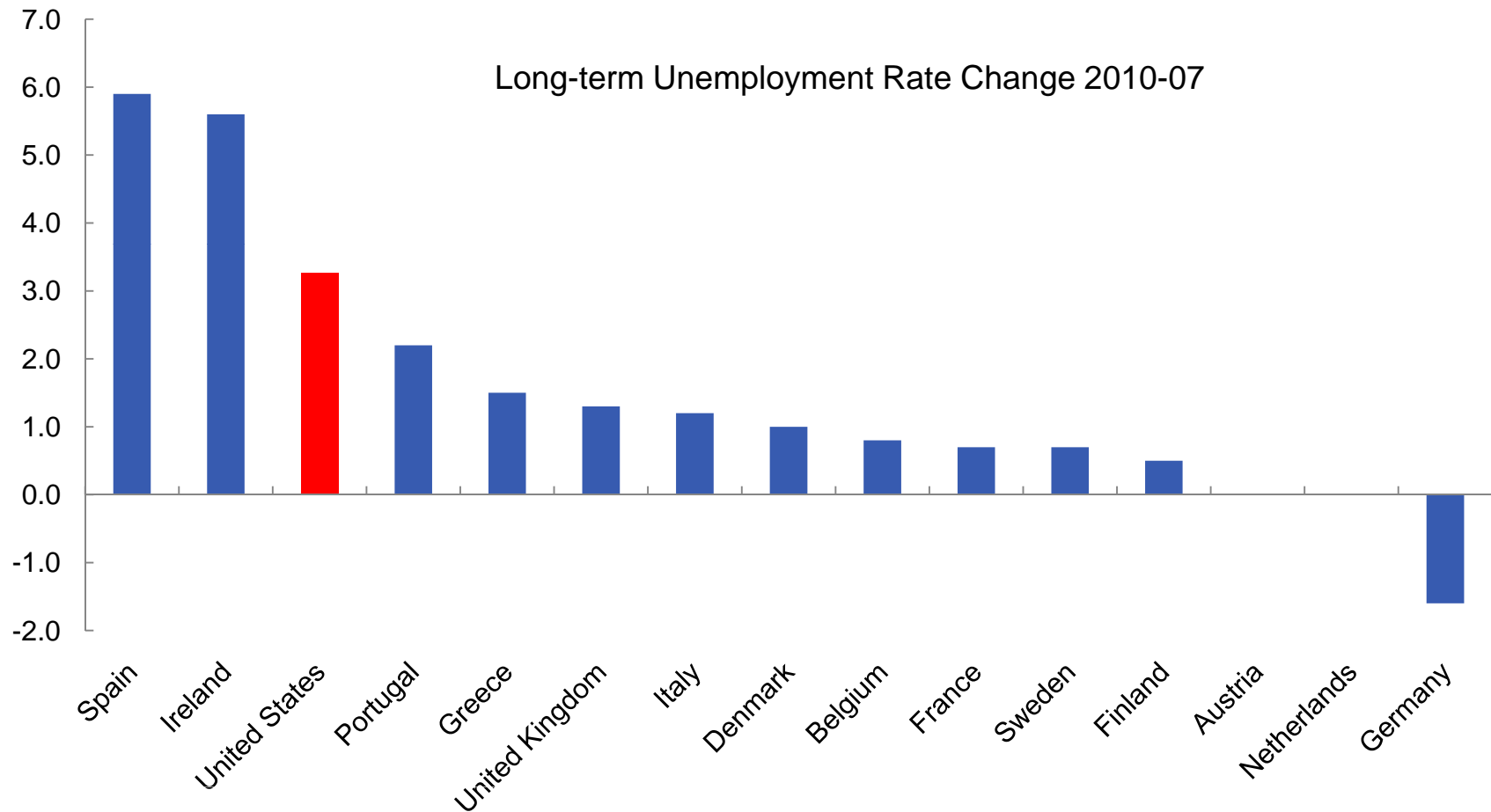
Forecast

# Snapshot of Long-Term Unemployment (LTU)



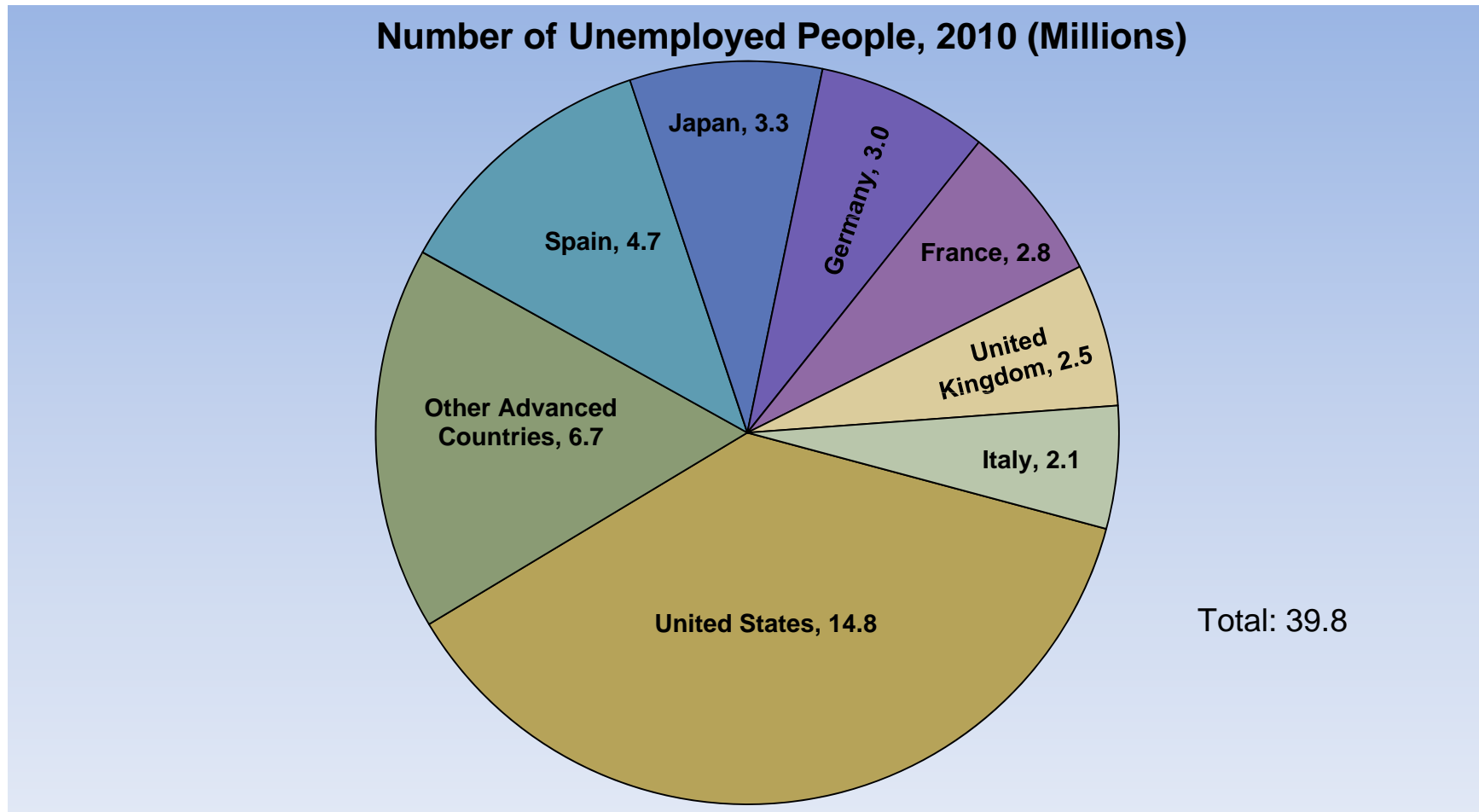
Facts

# Increase in LTU during the Great Recession



Facts

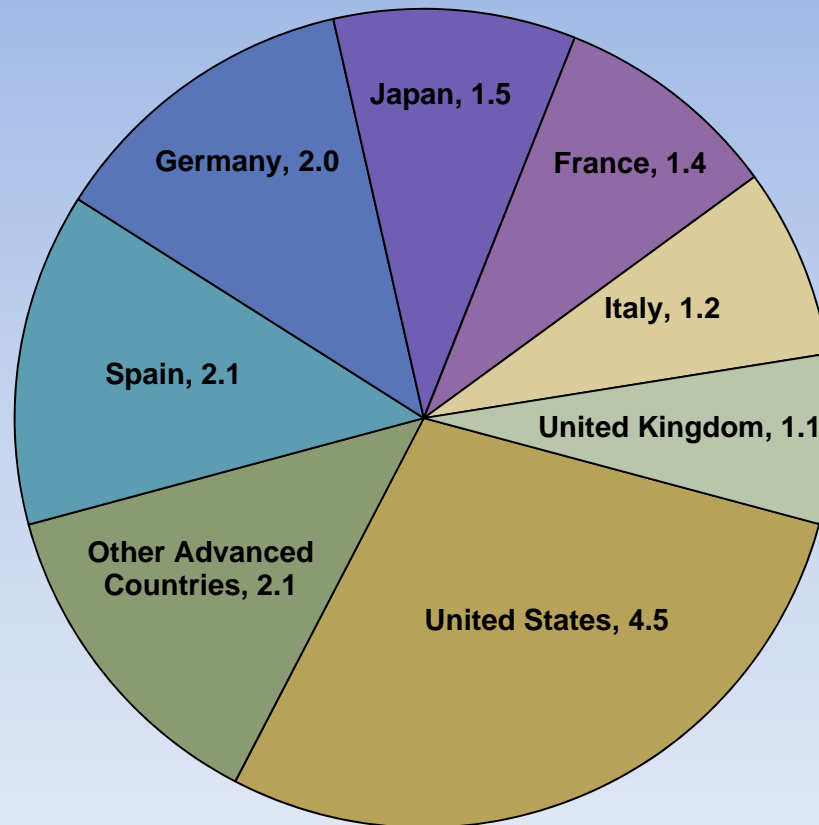
# U.S.: the Epicenter of the Unemployment Crisis



Facts

# The Distribution of Misery

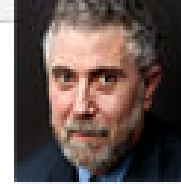
**Unemployed for 27 Weeks and Over, 2009 (Millions of people)**



Total: 15.8

# “It’s Aggregate Demand, Stupid”

## The Conscience of a Liberal



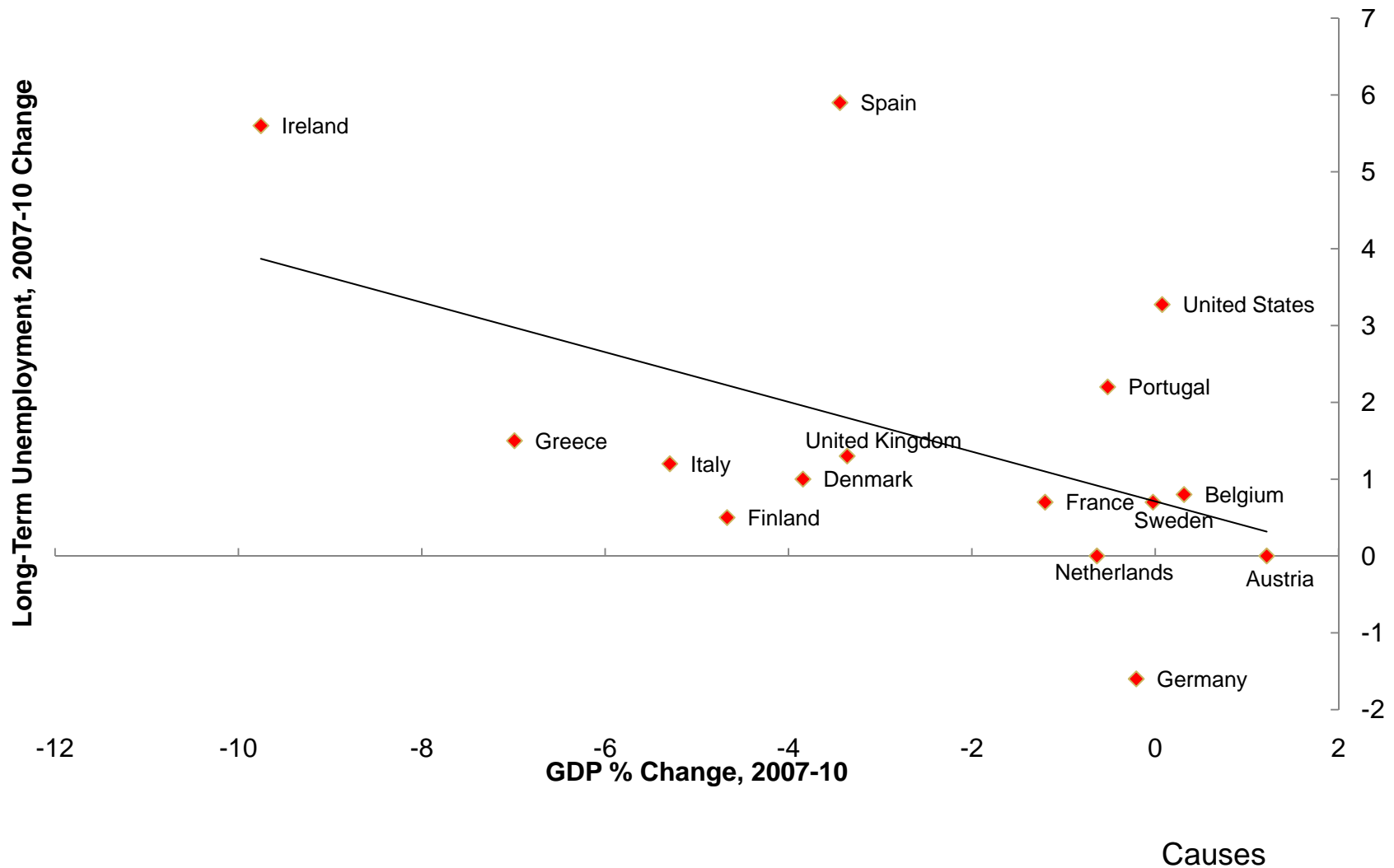
PAUL KRUGMAN

September 14, 2010, 11:08 AM

### The International Monetary Fund Is Not Insane

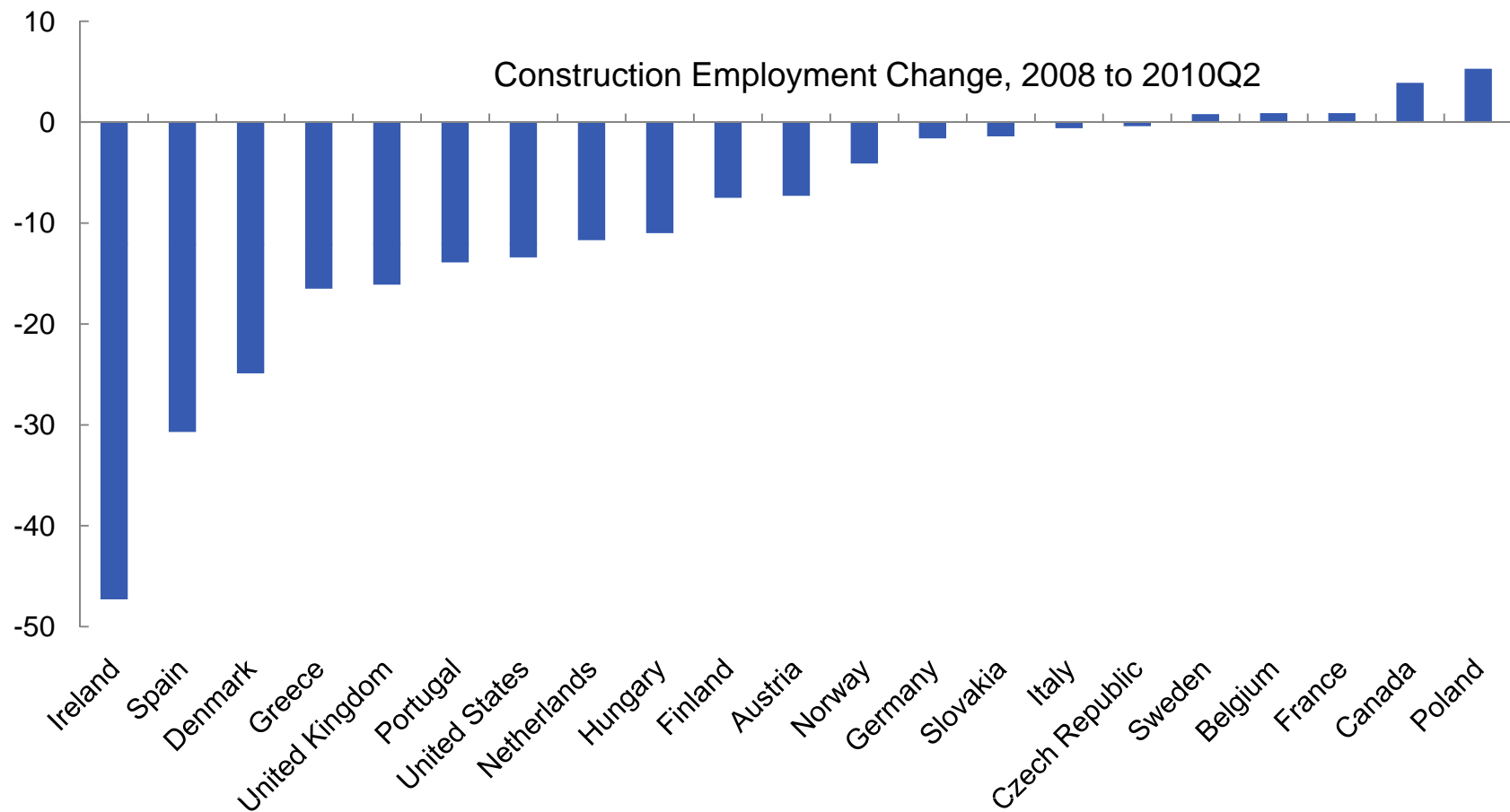
That shouldn't be startling; but these days it is. Given the way [conventional madness](#) has overtaken so many international institutions, the IMF's reasonable, if much too cautious, [new paper on employment](#) (pdf) is actually a welcome surprise. “A recovery in aggregate demand is the single best cure for unemployment” — what a relief to see the Fund actually saying that.

# Demand Drop is the Major Cause

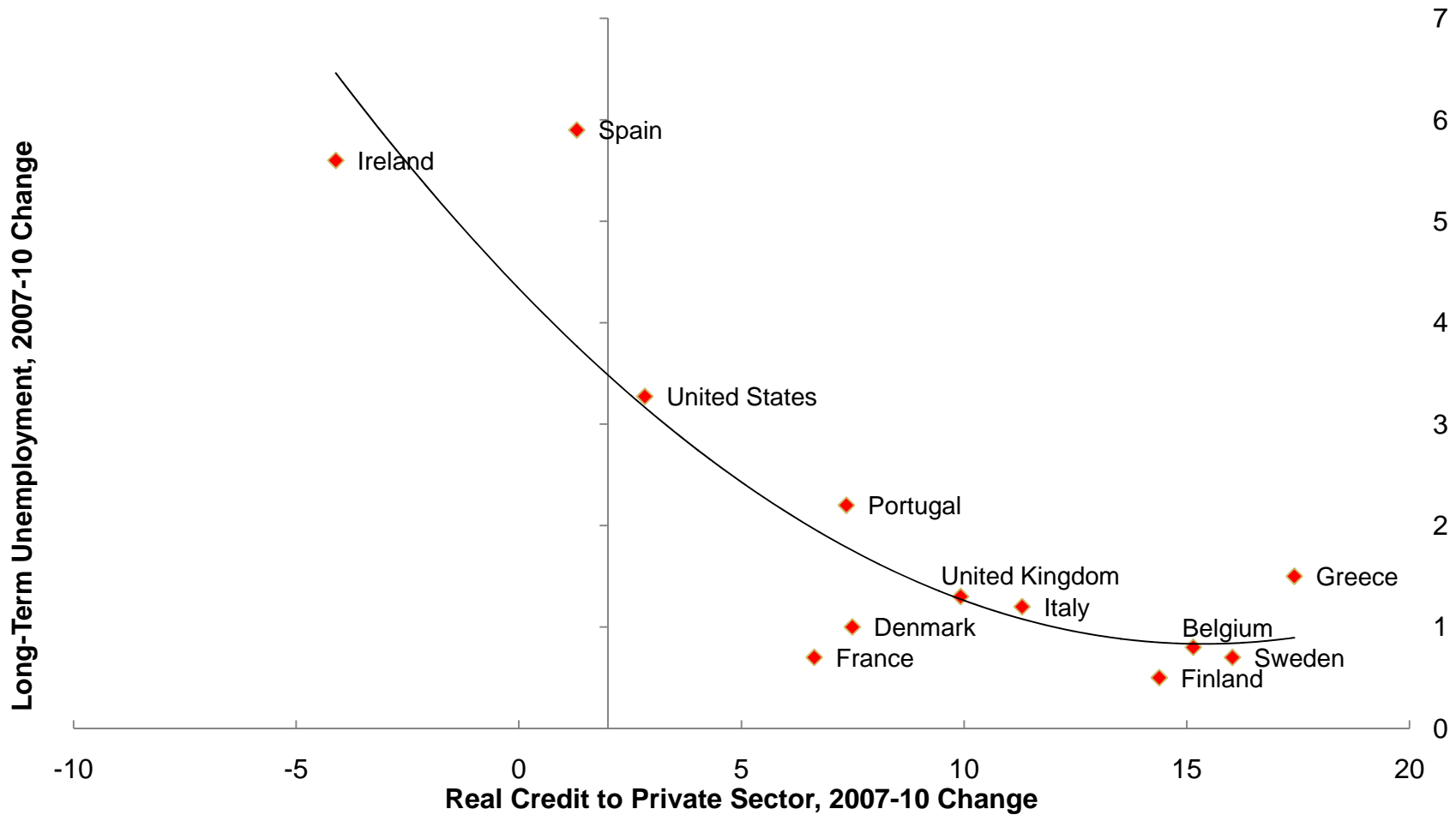




# Stresses in the construction sector

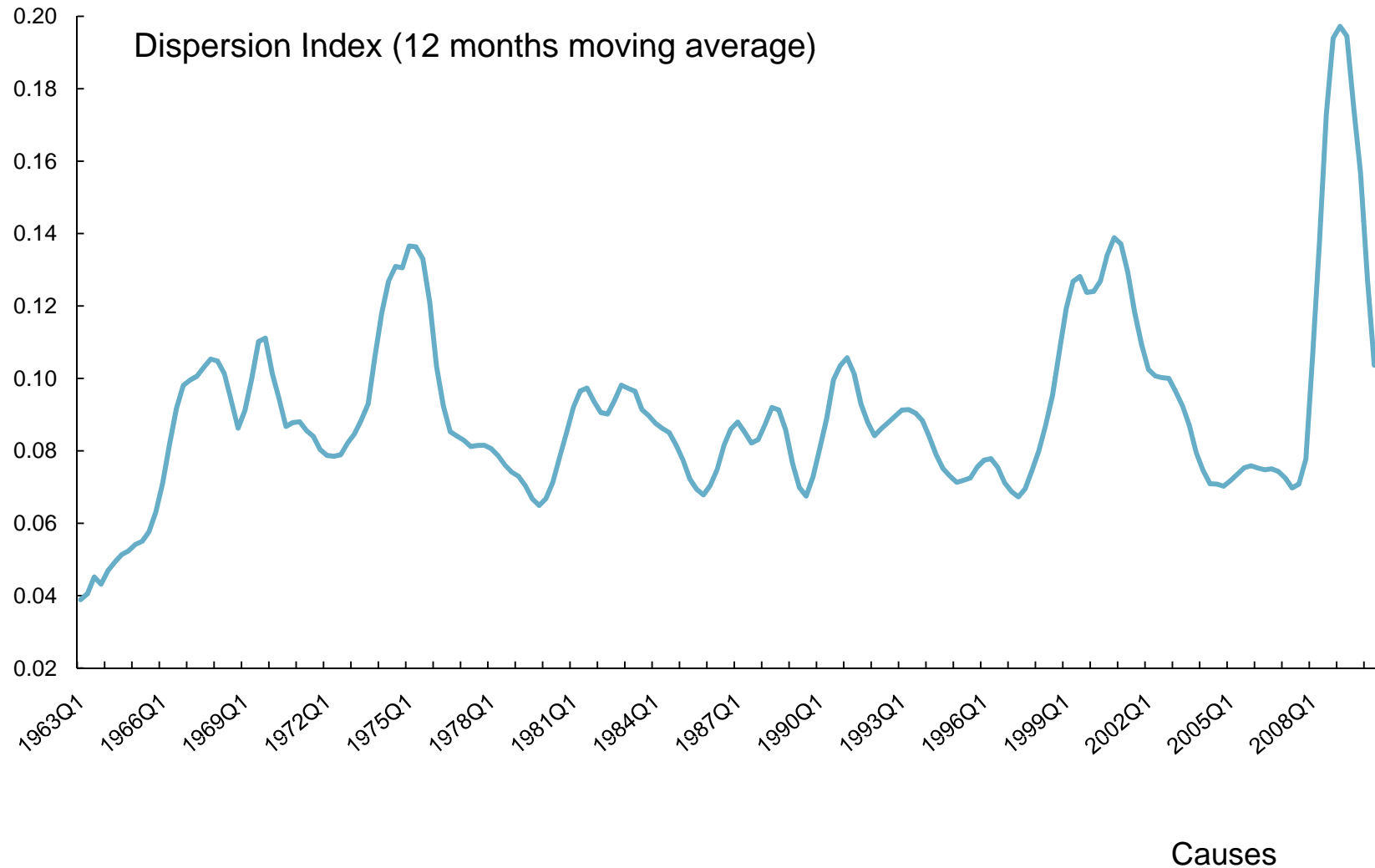


# Credit and Unemployment

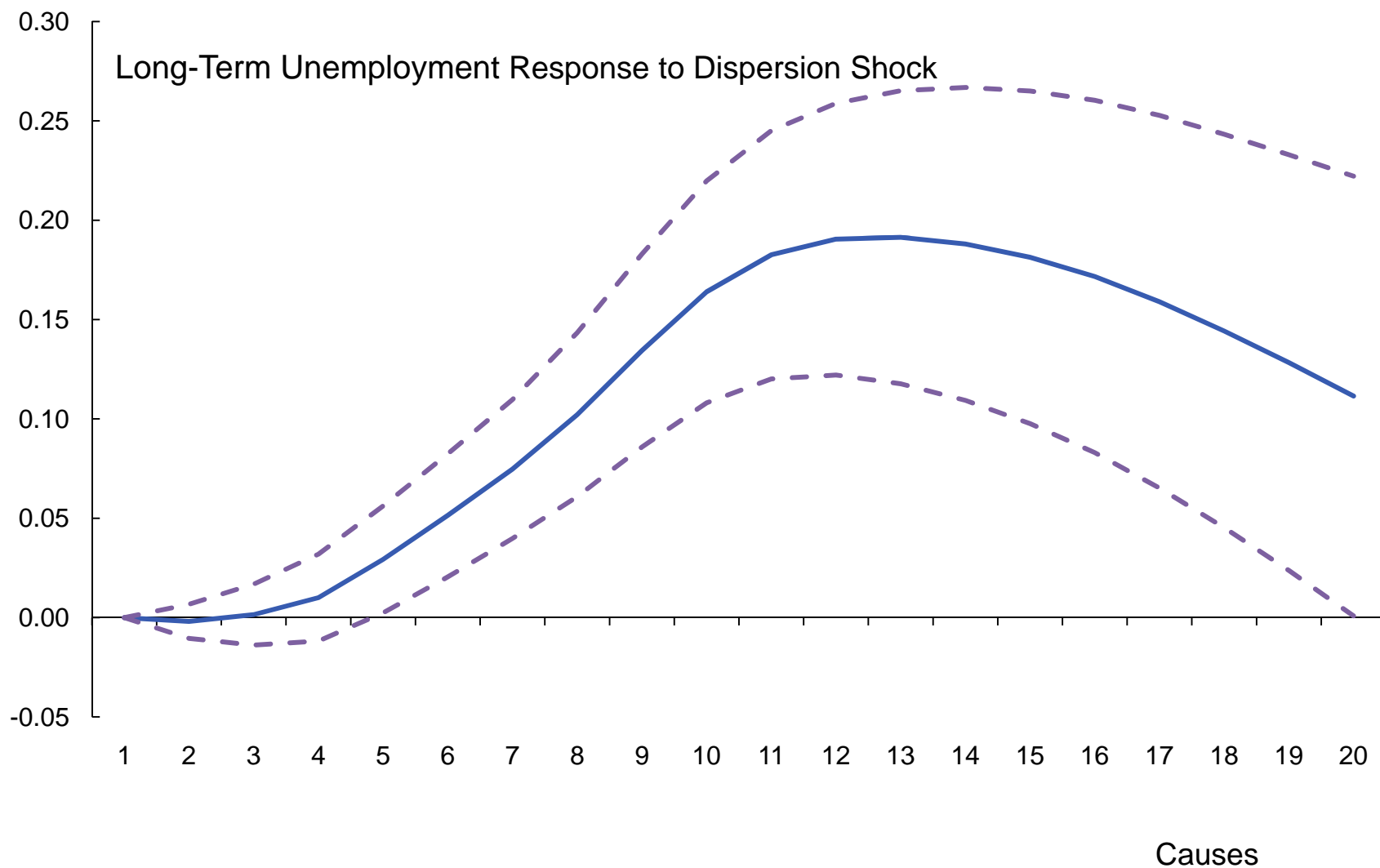


Causes

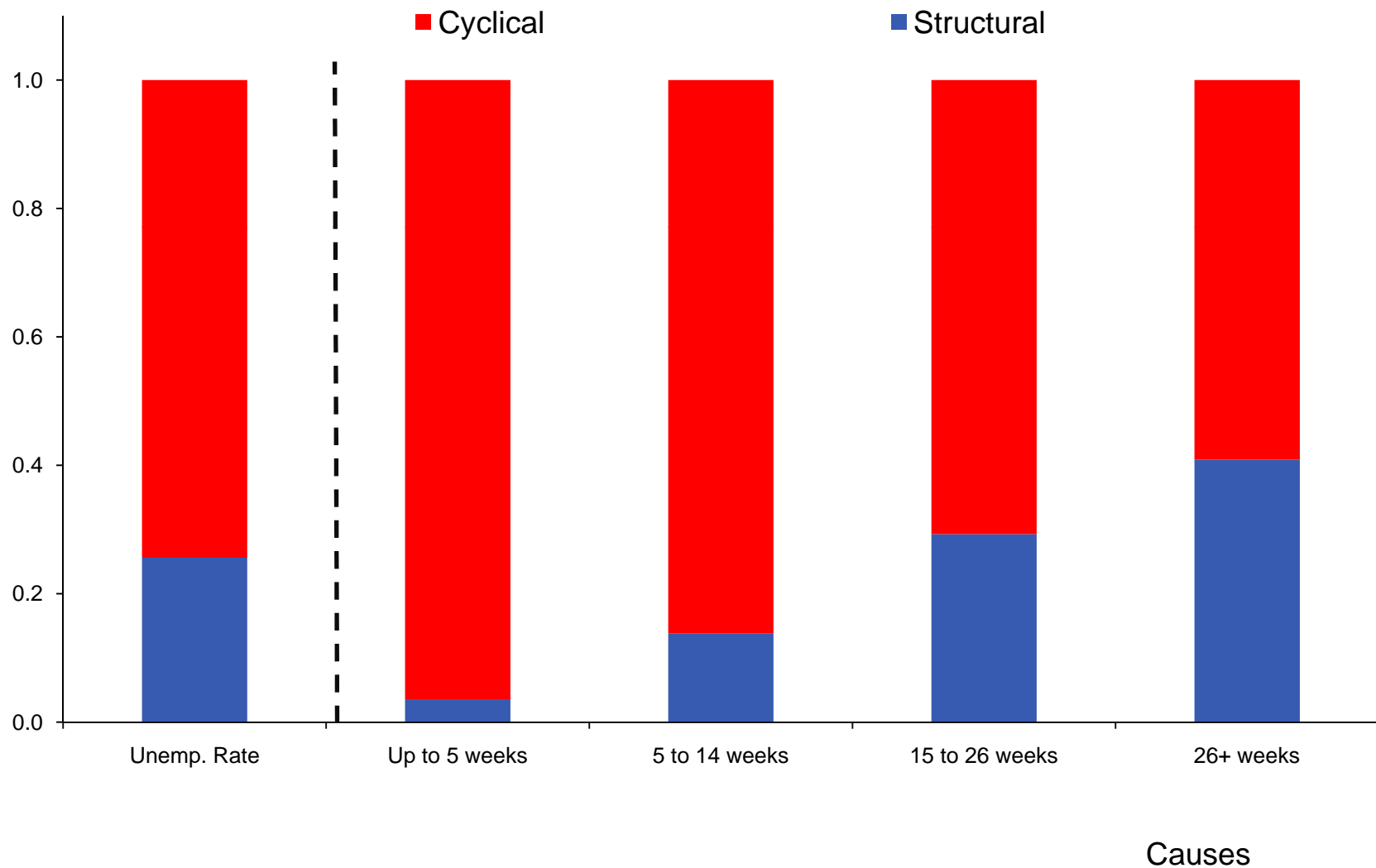
# Structural factors also at work



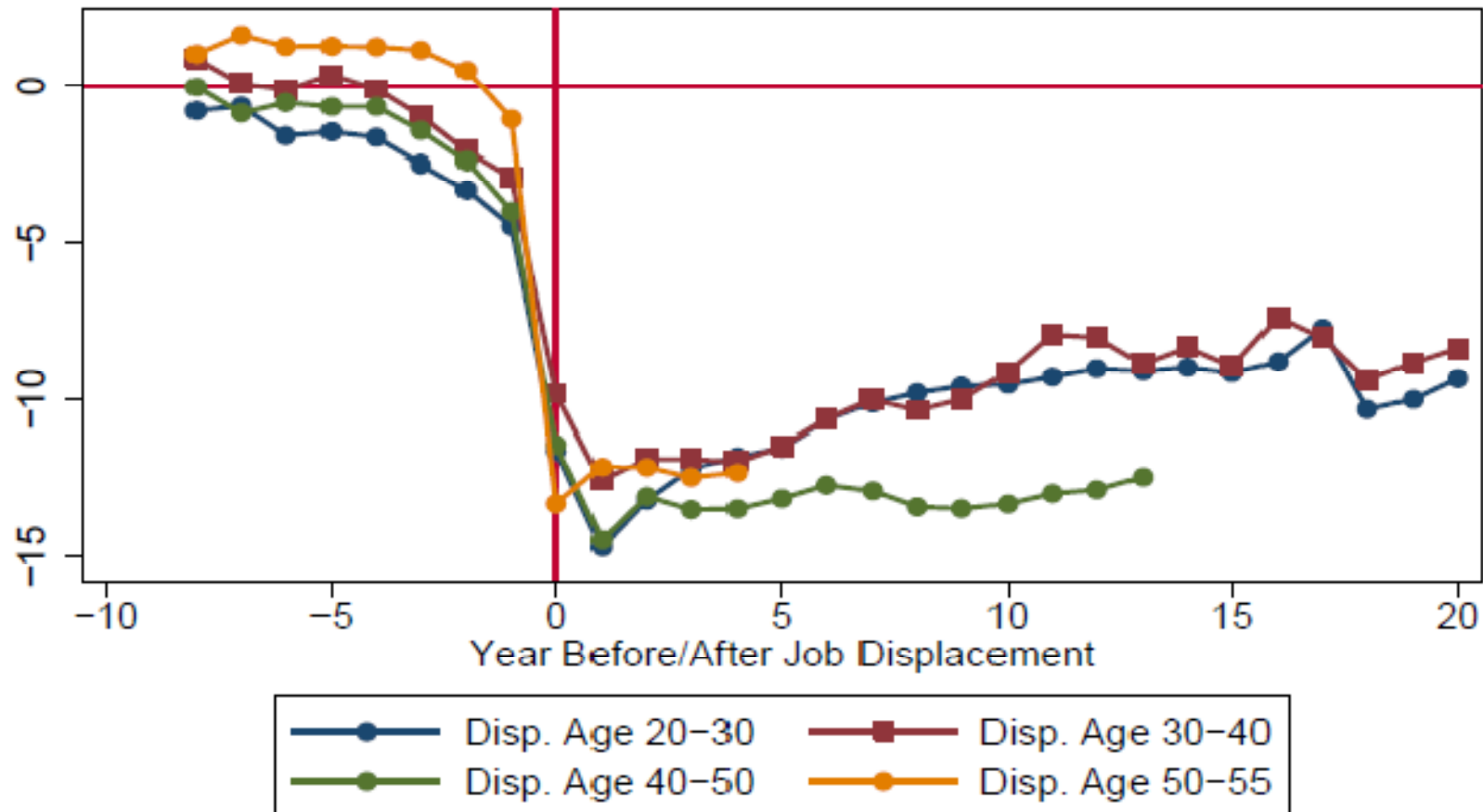
# Response on LTU to structural shock



# Bottom-line: cyclical vs. structural



# Job loss lowers earnings

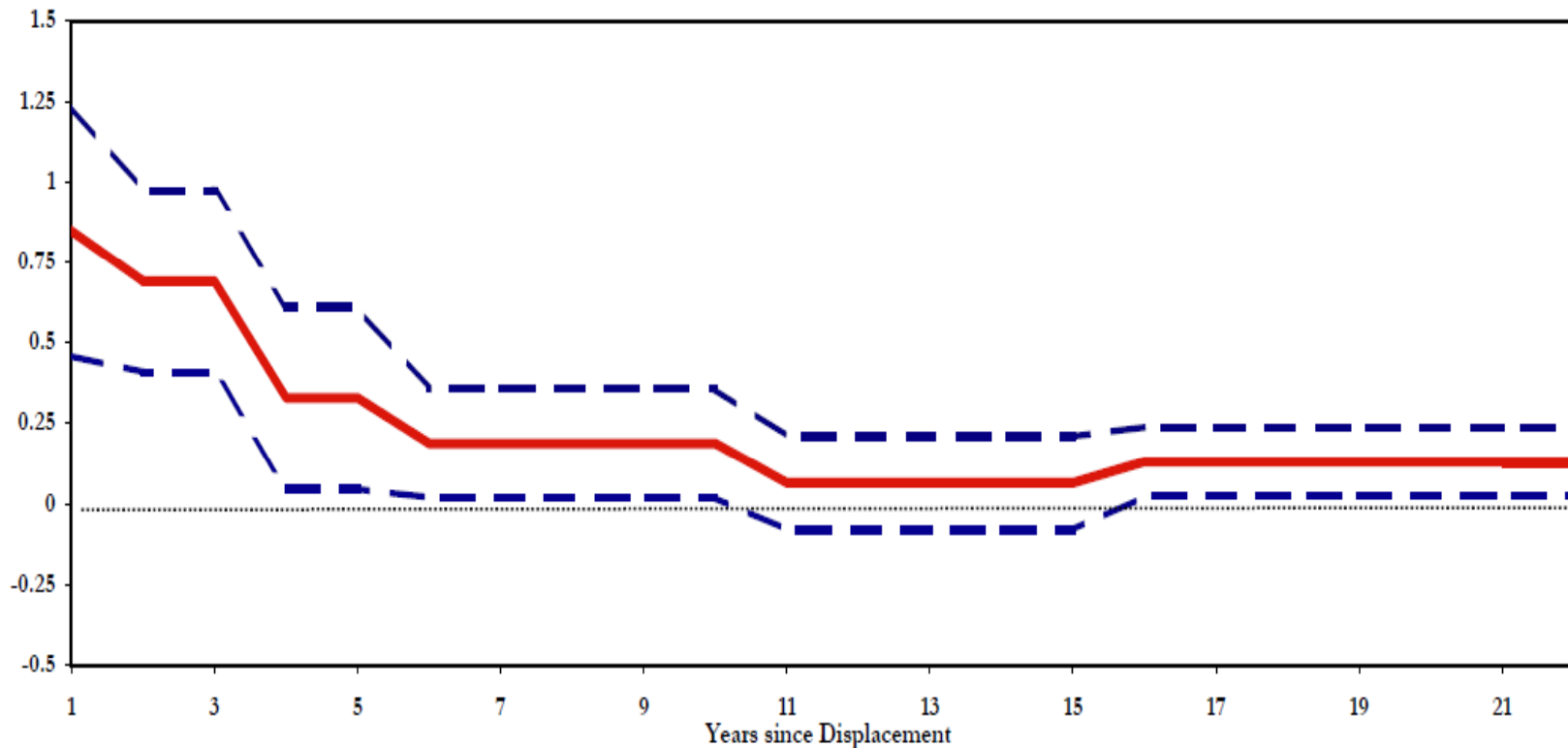


Source: 1% Files of Social Security administrative data (see text). Earnings in 2000 Dollars.

Earnings Losses of Men in stable jobs at and around job separation (t=0) in 1000 USD, from von Wachter et al. (2009)

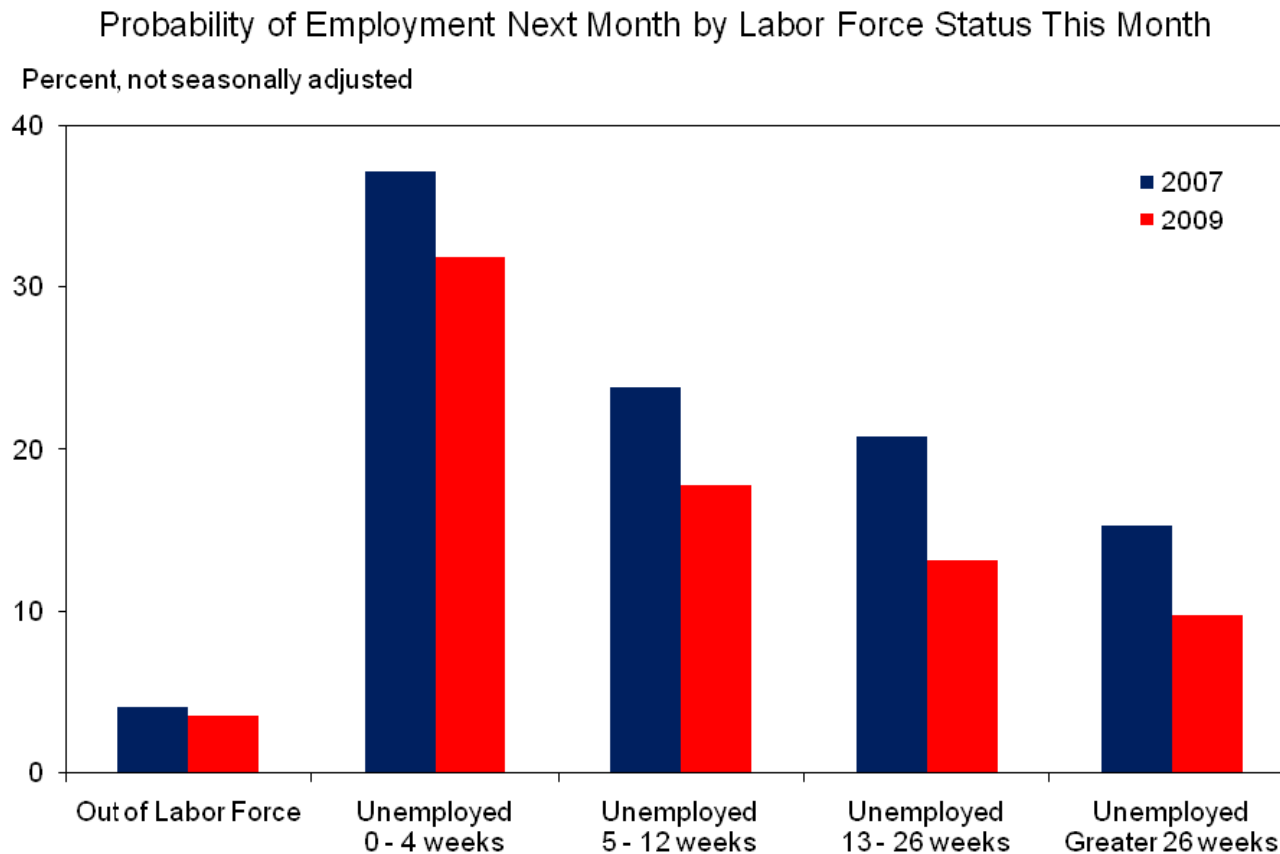
Costs

# Job loss raises odds of mortality



- **Effects on health (Sullivan, von Wachter 2009):** Persistent impacts on health: increase of risk of heart-attack, reduced life expectancy. Graph shows marginal effect of displacement on odds of mortality

# Dwindling hopes of finding a job



Note: Includes civilians over age 20 present in successive months of the data. Includes data from the last quarter of each year.  
Source: Department of Commerce (Census Bureau), Current Population Survey.

Costs



# Policy Responses

## – a bit more complicated

### Econbrowser

Analysis of current economic conditions and policy

[« The fat lady sings](#) | [Main](#) | [What's the Fed signaling?](#) »

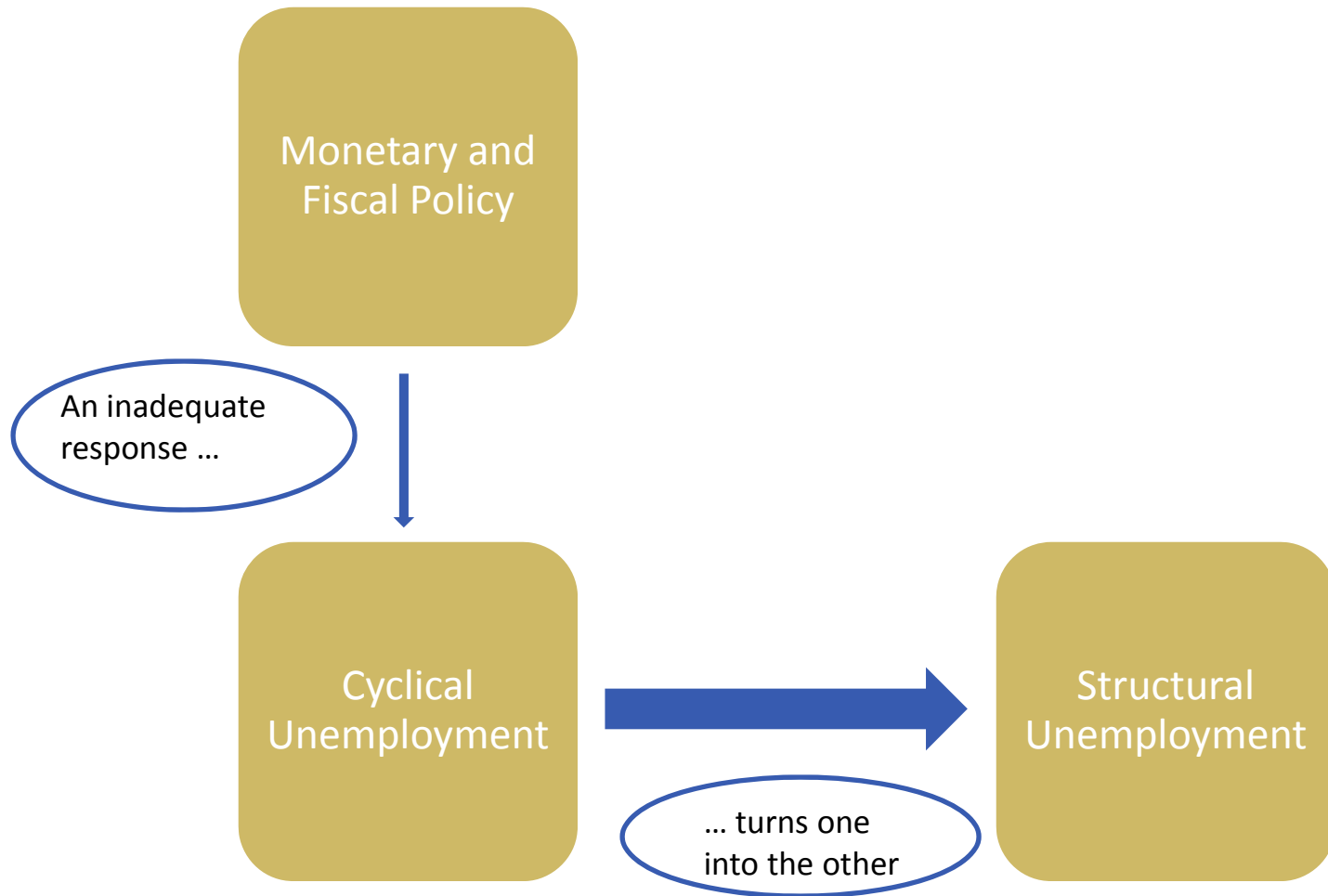
September 22, 2010

#### **Some Policy Implications of the Interdependence of Cyclical and Structural Unemployment**

In terms of implications for macroeconomic policy, I thought this graph was of relevant. It shows that the longer the duration of unemployment, the lower the probability of employment in the next period. Depending upon the interpretation of this correlation, there are important public policy implications. If the extended duration of unemployment implies depreciation of skills relevant to the labor market, then this implies short term (cyclical) and long term (structural) unemployment are related phenomenon.

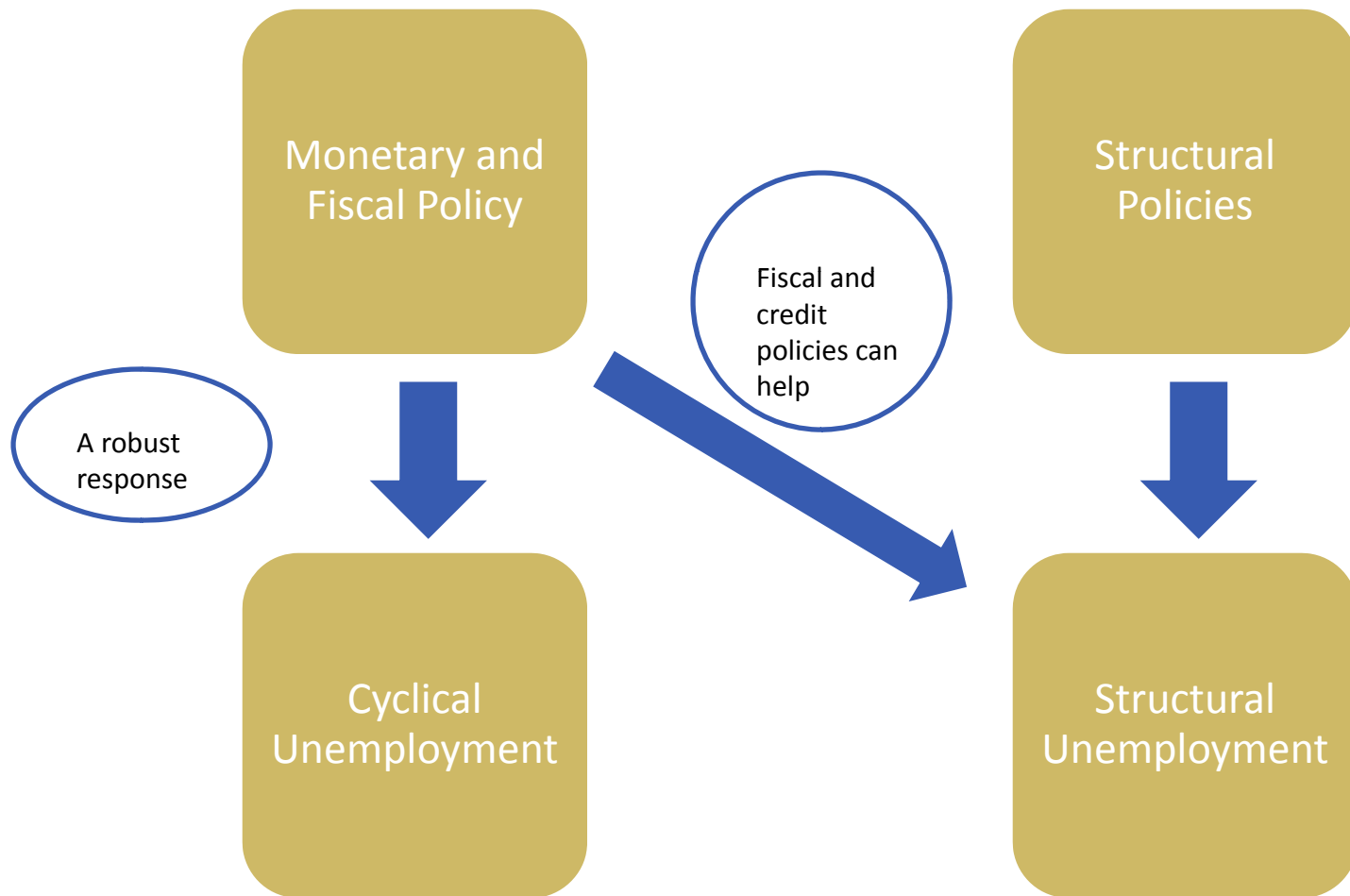
Posted by Menzie Chinn at September 22, 2010 07:40 AM

# What to avoid



Cures

# What to do



Cures

- **Medium-term consolidation, but not too hasty or too harsh**

**Fiscal Policy**

- **Supportive of recovery;**
- **Ready to act if recovery falters**

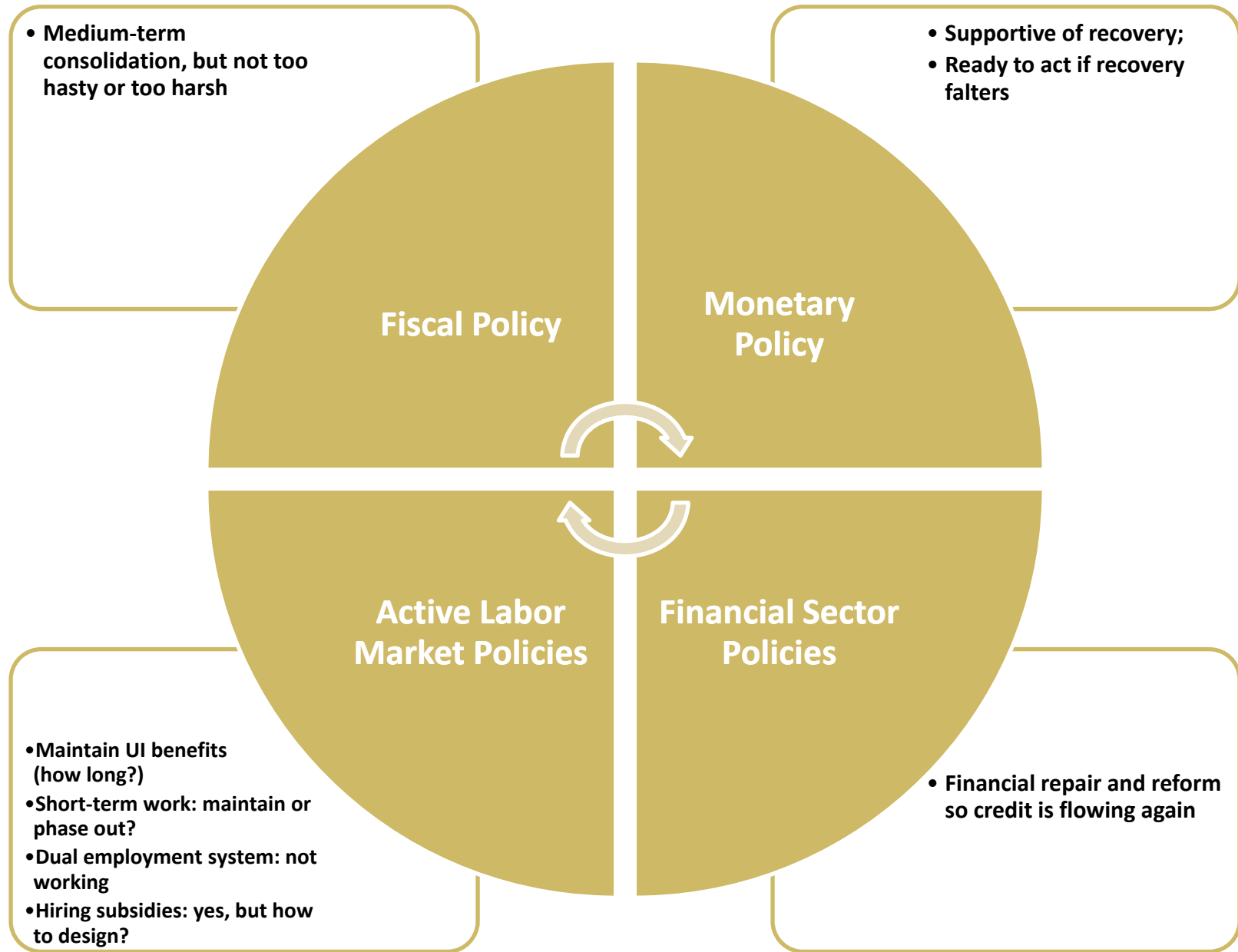
**Monetary Policy**

**Active Labor Market Policies**

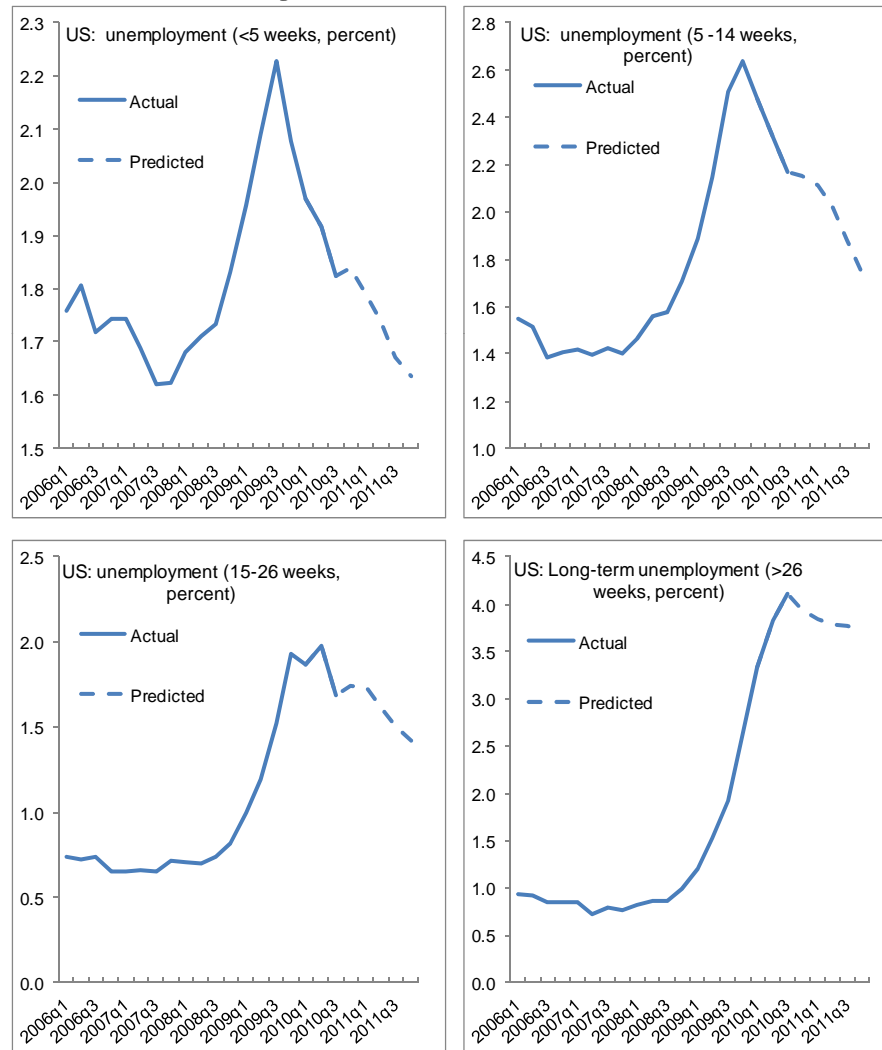
- **Maintain UI benefits (how long?)**
- **Short-term work: maintain or phase out?**
- **Dual employment system: not working**
- **Hiring subsidies: yes, but how to design?**

**Financial Sector Policies**

- **Financial repair and reform so credit is flowing again**



# Forecasts of unemployment, by duration



Forecast

# Forecasts of U.S. unemployment rate

