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.
Snapshot of Long-Term Unemployment (LTU)

Long-term Unemployment Rate, 2010Q3

Spain: 7.0%
Ireland: 6.8%
Portugal: 6.6%
Greece: 5.6%
Belgium: 5.1%
United States: 5.0%
France: 4.6%
Italy: 4.2%
Germany: 3.9%
United Kingdom: 3.5%
Finland: 3.5%
Denmark: 3.2%
Sweden: 2.9%
Netherlands: 2.8%
Austria: 2.8%

Facts
Increase in LTU during the Great Recession

Long-term Unemployment Rate Change 2010-07

Spain 6.0
Ireland 5.0
United States 4.0
Portugal 3.0
Greece 2.0
United Kingdom 1.0
Italy 1.0
Denmark 0.0
Belgium 0.0
France 0.0
Sweden 0.0
Finland -1.0
Austria -2.0
Netherlands -2.0
Germany -2.0

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

Number of Unemployed People, 2010 (Millions)

- United States, 14.8
- Other Advanced Countries, 6.7
- Spain, 4.7
- United Kingdom, 2.5
- Italy, 2.1
- France, 2.8
- Germany, 3.0
- Japan, 3.3

Total: 39.8

Facts
The Distribution of Misery

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

- Germany, 2.0
- Spain, 2.1
- Other Advanced Countries, 2.1
- Japan, 1.5
- France, 1.4
- Italy, 1.2
- United Kingdom, 1.1
- United States, 4.5

Total: 15.8

Facts
“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

Construction Employment Change, 2008 to 2010Q2

- Ireland
- Spain
- Denmark
- Greece
- United Kingdom
- Portugal
- United States
- Netherlands
- Hungary
- Finland
- Austria
- Norway
- Germany
- Slovakia
- Italy
- Czech Republic
- Sweden
- Belgium
- France
- Canada
- Poland

XXX
Credit and Unemployment

Credit and Unemployment

7

Ireland

Spain

United States

Greece

Portugal

United Kingdom

Belgium

France

Denmark

Italy

Finland

Sweden

Real Credit to Private Sector, 2007-10 Change

Long-Term Unemployment, 2007-10 Change

Causes
Structural factors also at work

Dispersion Index (12 months moving average)
Response on LTU to structural shock

Long-Term Unemployment Response to Dispersion Shock

Causes
Bottom-line: cyclical vs. structural

<table>
<thead>
<tr>
<th>Causes</th>
<th>Cyclical</th>
<th>Structural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemp. Rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Up to 5 weeks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 to 14 weeks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 to 26 weeks</td>
<td></td>
<td></td>
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<tr>
<td>26+ weeks</td>
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</tbody>
</table>
Job loss lowers earnings

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

Probability of Employment Next Month by Labor Force Status This Month

<table>
<thead>
<tr>
<th>Status</th>
<th>2007</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Out of Labor Force</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployed 0 - 4 weeks</td>
<td>37</td>
<td>32</td>
</tr>
<tr>
<td>Unemployed 5 - 12 weeks</td>
<td>38</td>
<td>32</td>
</tr>
<tr>
<td>Unemployed 13 - 26 weeks</td>
<td>37</td>
<td>32</td>
</tr>
<tr>
<td>Unemployed Greater 26 weeks</td>
<td>37</td>
<td>32</td>
</tr>
</tbody>
</table>

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.
PolicyResponses
– a bit more complicated

Econbrowser
Analysis of current economic conditions and policy

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

Monetary and Fiscal Policy

Cyclical Unemployment

An inadequate response ...

... turns one into the other

Structural Unemployment

Cures
What to do

Monetary and Fiscal Policy

Structural Policies

A robust response

Cyclical Unemployment

Structural Unemployment

Fiscal and credit policies can help

Cures
• Medium-term consolidation, but not too hasty or too harsh

• Supportive of recovery;Ready to act if recovery falters

• Fiscal Policy

• Monetary Policy

• Active Labor Market Policies

• Financial Sector 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 repair and reform so credit is flowing again
Forecasts of unemployment, by duration

- **US: unemployment (<5 weeks, percent)**
  - Actual
  - Predicted

- **US: unemployment (5-14 weeks, percent)**
  - Actual
  - Predicted

- **US: unemployment (15-26 weeks, percent)**
  - Actual
  - Predicted

- **US: Long-term unemployment (>26 weeks, percent)**
  - Actual
  - Predicted

Forecast
Forecasts of U.S. unemployment rate

US: unemployment

- Actual
- Predicted
- WEO
- Consensus forecast

Forecast