

**Testimony before the Joint Economic Committee of U.S. Congress on
“Long-Term Unemployment: Causes, Consequences and Solutions”**

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**Till von Wachter
Associate Professor of Economics
Columbia University**

Chair Maloney, Vice Chairman Schumer, Ranking Members Brady and Brownback, and members of the Committee, it is an honor to be with you today. The labor market in the United States is recovering from the most severe recession since World War II. As you know, since the beginning of 2008, millions of individuals have lost their jobs, the unemployment rate has nearly doubled, and long-term unemployment is at its highest level since 1945.¹ As the overall economy continues to recover, an important question is the fate of the large number of workers affected by layoffs and lengthening spells of unemployment.

My testimony focuses on the short- and long-term consequences of layoffs and unemployment for affected workers and on potential policy options to ease the burden of adjustment on workers and their families. Judging from experience in past recessions, the consequences of layoffs for job losers are severe and long lasting along several dimensions. The average mature worker losing a stable job at a good employer will see earnings reductions of 20% lasting over 15-20 years. While these earnings losses vary somewhat among demographic groups or industries, no group in the labor market is exempt from significant and long lasting costs of job loss.

A job loss is also typically followed by an extended period of instability of employment and earnings. During this period, job losers can experience declines in health. In severe downturns, these health declines can lead to significant reductions in life expectancy of 1 to 1.5 years. The consequences of job loss are also felt by workers' children, who can suffer from the consequences even as adults, and by their families. All of these costs are likely to be greater for

the long-term unemployed.

Government programs can alleviate part of the short-term earnings loss associated with job loss and unemployment. As a typical measure, extensions of unemployment insurance ease the burden of adjustment for laid off workers, are likely to prevent entry into more costly government programs such as disability insurance, provide a degree of demand stabilization, and – at least in recessions – are unlikely to be associated with significant reductions in employment in the short or the long run.

However, policy is unlikely to be able to prevent the large and lasting reductions in earnings that eventually follow a typical job loss. The majority of long-term losses are due to losses in the value of certain skills as industries decline; due to the loss of long-term career jobs; or due to slow wage-adjustment in the labor market. None of these factors are easily manipulated by government policy. Yet, some policies have been shown to be able to reduce unemployment, such as targeted efforts to help workers in their job search, or programs reducing the costs of long-term adjustment, such as the costs of retraining.

Given the difficulties of helping job losers and unemployed workers recover from long-term earnings losses after the fact, it may be worthwhile to explore available options to prevent large-scale layoffs in the future. Such options include programs of work sharing to subsidize employment before workers are laid off and become unemployed; to encourage the introduction of flexible work-time arrangements; or to encourage the provision of credit to economically viable firms affected by distress in financial markets. For example, the cost of unemployment insurance benefits for a typical worker is a small fraction of the total earnings lost due to a layoff over the remainder of the individual's working life. If the same benefits were paid during employment to avoid job loss, this would substantially reduce the cost of recessions. This would be beneficial even if the worker were to be let go eventually, since earnings losses tend to be significantly smaller for layoffs that do not occur in a large recession.

To conclude, job loss and unemployment during severe recessions can impose substantial and

¹ E.g., Congressional Budget Office (2010b).

lasting costs on affected workers in terms of earnings, health, and strain on their families. The short-term burden of these costs can in part be alleviated at comparatively small cost, for example by extensions in unemployment insurance. Less is known about how to help reduce the substantial long-term costs. While cost-effective policies may be available to help reemploy the long-term unemployed, the potential of policy interventions to significantly aid recovery of long-term earnings declines appears bleaker. Given these large and long-term costs, preventive measures to avoid massive layoffs are a policy option worth considering.

The Short- and Long-Term Consequences of Layoff and Unemployment

An increasing literature has documented that job losses during recessions have severe and lasting consequences for earnings. For example, workers displaced in the recession of the early 1980s – which until 2008 was the strongest U.S. recession since World War II – on average had earnings reductions of 30% or more in the first year after layoff. These losses declined somewhat over time, but even 15 to 20 years after job loss, the earnings reduction was still 20%.² Such lasting earnings reductions occurred for job losers in all age ranges, in all industries, for men and women, and throughout the earnings distribution. This phenomenon is not limited to the early 1980s recession, is not limited to particular regions of the country, and does not depend on the particular way of measuring the cost of displacement.³ Older workers suffer larger losses in earnings, but these losses extend over shorter periods of time, since remaining lives are shorter and job loss hastens retirement.⁴ Workers in the middle of the education-distribution, such as workers with some college or only a high-school degree, appear to lose more than very low or very high skilled individuals.⁵

These lasting reductions in earnings occur alongside, and may be partly augmented by, increases in job instability, recurring transitions to non-employment, and repeated switches of industry or

² Jacobson, Lalonde, and Sullivan (1993), von Wachter, Song, and Manchester (2009).

³ Farber (2005) provides estimates of the short-term costs of job loss for the U.S. over the past two decades. Schoeni and Dardia (2003), von Wachter, Handwerker, and Hildreth (2008), Couch and Placzek (2010), and Kodrzycki (2007) show medium run estimates for California, California, Connecticut and Massachusetts in the early 1990s.

⁴ Chan and Stevens (2001).

⁵ von Wachter and Handwerker (2009).

occupation.⁶ Some of this increased mobility between jobs may be a sign of beneficial adjustment, but on average those workers who immediately find a stable job in their pre-displacement industry do significantly better. The increase in job instability lasts up to ten years after layoff. During the same period, these workers experience lasting increases in earnings instability. Thus, there is no sign that laid-off workers trade off lower earnings for more stable employment. While heightened regional mobility appears beneficial in the short run as mobile workers may eschew a particularly depressed local labor market, movers do not have lower long-term earnings losses.

There is also increasing evidence that laid-off workers suffer short and long term declines in health. In the short term, layoffs and unemployment are associated with an increasing incidence of stress-related health problem, such as strokes or heart attacks.⁷ These problems can lead to a large spike in mortality right after job loss. For example, mature men who lost their stable job in Pennsylvania during the early 1980s experienced an increase in mortality right after job loss of up to 100%. This initial rise in mortality declines over time, but mortality remains significantly higher for job losers than for comparable workers who did not lose their jobs. If sustained until the end of their lives, such increases lead to reductions in life-expectancy of 1 to 1.5 years.⁸

Several studies also point to short and long term effects of layoffs on the children and families of job losers and unemployed workers. For example, in the short run parental job loss reduces schooling achievement of children.⁹ In the long run, it appears that a lasting reduction in the earnings of fathers also reduces the earnings prospects of their sons.¹⁰ There is also emerging evidence that layoff heightens the incidence of divorce, reduces home ownership, and increases the rate of application to and the receipt of disability insurance programs.¹¹

All of these costs are likely to be larger for workers unemployed for a longer period of time. It is well documented that earnings losses for unemployed workers increase significantly with time

⁶ Stevens (1997) and von Wachter, Song, and Manchester (2009).

⁷ Burgard, Brand, and House (2007).

⁸ Sullivan and von Wachter (2009).

⁹ Stevens and Schaller (2009).

¹⁰ Oreopoulos, Page, and Stevens (2008).

¹¹ Charles and Stephens (2004); von Wachter and Handwerker (2009); Rupp and Stapleton (1995) and Rege, Telle,

spent outside of employment.¹² It is difficult to establish whether this is because the duration itself worsens labor market prospects, or because those workers facing the strongest challenges in the labor market take longer to find a new job. Independently of the source, longer unemployment spells are likely to put significant additional strain on workers' financial situation and the overall well-being of them and their families. These workers are also particularly dependent on benefits from unemployment insurance. The poverty rate among long-term unemployed is high, especially for those exhausting unemployment benefits.¹³

Finally, even though they were not laid off or are not officially counted as unemployed, the long-term earnings and career prospects of young workers entering the labor market during a recession also suffer. For example, individuals graduating from college during a large recession are likely to see reduced earnings for 10 to 15 years compared to more lucky graduates.¹⁴ As is the case for job losers, those labor market entrants in the middle of the education distribution do worse, while those with lower or higher education tend to do better.¹⁵ The pattern of recovery of unlucky college graduates is telling; a recession reduces the quality of the first employer. After about five years workers find an employer of better quality, but their earnings still have to recover within the firm relative to more lucky graduates who obtained their job in better economic times. Thus, the initial set-back in the career can take 10 to 15 years to dissipate even for this very mobile demographic group.

The Reasons for Long-Term Earnings Losses after Layoff and Unemployment

There are several main sources of lasting reductions in earnings after a layoff. An often cited explanation attributes the losses in earnings to a loss in the use of certain skills, as some industries or occupations shift their operations elsewhere or permanently reduce their employment levels. If some of workers' earnings derived from payment for services and skills only needed in specific industries or occupations, upon job loss workers lose wages associated

and Votruba (2009).

¹² Congressional Budget Office (2007). Machin and Manning (1999).

¹³ Congressional Budget Office (2004), Tables 6 and 9.

¹⁴ Oyer (2008), Kahn (2010), Oreopoulos, von Wachter, and Heisz (2008).

¹⁵ Oreopoulos, von Wachter, and Heisz (2008), Kondo (2008).

with these skills.¹⁶ Such a loss can lead to long-term earnings declines if workers do not reinvest in a new equivalent set of skills. In particular for middle-aged or older workers, it might not be worth spending their time and money in costly retraining as they face uncertain reemployment over a shorter remaining working life.

Another explanation is that workers in stable jobs, especially workers aged 30 or above, are likely to have found an occupation and an employer suitable for their interests and qualifications. The process of searching for such a job can take time, involving both changes of occupations and employers at the beginning of their career, as well as job search and promotions within a firm.¹⁷ On average, this phase of workers' careers can last 10 years. Part of the gain from this prolonged search and matching process is lost at job loss. By its nature, finding such a suitable job again is likely to take a long time. If suitable job offers start arriving only as the economy picks up, the adjustment process can last well beyond recovery in the aggregate labor market.

Increasing evidence also suggests that the first wage on a worker's new job is likely to influence her pay for a long time.¹⁸ This persistence can arise from (explicit or implicit) wage contracts between workers and firms. Since many unemployed workers end up finding the first job when wages are still depressed due to the recession, persistence implies they may live with lower earnings for quite some time. As a result, workers laid off in recessions suffer substantially larger earnings losses than workers laid off in booms.¹⁹ While workers can improve their pay by obtaining outside job offers, changing jobs, or moving to different regions, many face obstacles to such adjustment, often due to family commitments. However, the rate of mobility is likely to be too low even given those factors, possibly because individuals do not realize the need to keep improving their economic situation over 5 to 10 years following a job loss or an unemployment spell.

Some workers may also experience reductions in earnings because they held jobs in industries or at firms that paid exceptionally high wages. Yet, it does not appear that workers in such jobs are

¹⁶ Neal (1995), Parent (2000), Poletaev and Robinson (2008)..

¹⁷ Topel and Ward (1992), Neal (1999), Baker, Gibbs, and Holmstrom (1994).

¹⁸ Beaudry and Dinardo (1991), Schmieder and von Wachter (2010).

¹⁹ von Wachter, Song, and Manchester (2009).

more likely to be laid off. In fact, during large recessions job losers are less likely to be selected from high-wage jobs, partly because economic difficulties are widespread and do not just affect single firms or sectors. Similarly, it is unlikely that job losses arise because firms systematically let go those workers who are overpaid or who are least productive.²⁰

Policy Options to Ease Burden of Adjustment of Laid Off and Unemployed Workers

Policies Aimed at Reducing the Burden of Short-Term Earnings Losses

Government programs can help to ease the burden of the short-term cost of job loss and unemployment. The most common approach to do so has been to increase the duration over which eligible workers can receive unemployment benefits. Currently, the maximum duration of unemployment insurance (UI) benefits is 99 weeks, about four times the regular duration of 26 weeks. Significant extensions in the duration of UI also took place in the 1982 and 1990 recessions.²¹

Extensions of UI benefits have several beneficial aspects for recipients and for the economy as a whole. Extended benefits allow workers to buffer the effect of the earnings loss on consumption, albeit consumption still falls for the average UI recipient.²² In addition, extended benefits allow workers to search longer for a suitable job, and provide insurance against the stress of not being able to find a job because of continued slack in the labor market. Extensions in UI benefits also prevent some workers from applying to other government programs not intended to smooth short-term economic shocks, such as Social Security Disability Insurance or Old Age and Survivors Insurance. In particular, benefits provided under disability insurance can be very costly, especially if provided to younger or middle aged workers with low-mortality impairment.²³ While increases in unemployment rates typically lead to a significant rise in application and award rates, extensions in UI have the potential to dampen this effect. Finally,

²⁰ Estimates of the cost of job loss are robust to extensive controls for worker and firm characteristics; the effect of layoffs is not larger when firms displace fewer workers, such as during plant closings or good economic times.

²¹ Congressional Budget Office (2004)

²² Gruber (1997), Browning and Crossley (2001), Congressional Budget Office (2007).

²³ Autor and Duggan (2006), von Wachter, Song, and Manchester (2010).

extended UI benefits provide a degree of demand stabilization through the multiplier effect.²⁴

On the downside, several studies have suggested that UI may impose a cost by reducing recipients' willingness to work.²⁵ In addition, prolonged spells of unemployment may lead workers' skills to atrophy or otherwise reduce their employability. Yet, it is likely that in severe recessions, the benefit of extended UI outweighs the costs. First, the value of income replacement to workers should be particularly high. Second, longer UI durations are unlikely to have a strong effect on employment, since strategic considerations are likely to be weaker when the number of jobs is scarce.²⁶ Moreover, recent research suggests that a sizeable part of the decline in employment may not be due to the distortion in work incentives, but due to the presence of individuals facing credit constraints. If this is the case, not all of the employment effects of UI represent a distortion, but may be a sign that UI helps to alleviate credit constraints that prevent individuals to self-insure against unemployment shocks.²⁷

In the only study of its kind, our work analyzing large extensions in the durations of UI in Germany has shown that these led to only moderate reduction in employment, without a noticeable difference in this effect in large recessions.²⁸ Based on a very large sample of unemployed workers spanning over 25 years and utilizing a very credible research design, these findings lie at the lower range of typical U.S. estimates.²⁹ For a large increase in UI duration from 26 to 99 weeks, the estimates from Germany suggest that extended UI would lead to a moderate increase in the rate of unemployment. Yet, the current effect in the U.S. would likely be smaller due to several factors. The increases in UI durations were stepwise and extension was not always certain. Only 50% of all eligible unemployed workers have taken up UI benefits in this recession, further reducing the potential impact of UI extensions on employment.³⁰ Finally, the effects on aggregate employment are based on the assumption of full employment; under a slack

²⁴ Congressional Budget Office (2008), Table 1.

²⁵ Congressional Budget Office (2008). For a more technical overview, see Meyer (2002).

²⁶ E.g., Congressional Budget Office (2008).

²⁷ This point is made by Chetty (2008), who estimates that over half of employment effects of unemployment insurance may be due to such an income effect.

²⁸ Schmieder, von Wachter, and Bender (2009).

²⁹ Meyer (2002), Table 5.

³⁰ The take up rate of UI fluctuates between 40-50% for all unemployed and between 70-80% among job losers (Congressional Budget Office 2004). A similar back of the envelope calculation and caveat is made by Elsby, Hobijn, and Sahin (2010), Section 3.2.

labor market, the effect of individual search decisions on aggregate employment is likely to be smaller.

This research also suggests that contrary to what is often believed, extensions in UI benefits appear to neither help nor hurt the longer term job prospects of recipients. Increases in UI durations have no effect on the wage at the first job after unemployment. Similarly, neither the wage nor the employment rate five years after entry into unemployment is affected by longer UI durations.³¹ Thus, it appears extended UI benefits have an effect on workers' disposable income, consumption, and on short-term employment choice, but may have neither adverse nor beneficial effects on long-term employment prospects.

Several other measures to ease the short-term burden of adjustment have been tried in the current and in past downturns and have been featured in policy proposals in this recession. These include wage subsidies paid to employers and tax breaks for firms to raise job creation; temporary assistance to obtain further training; and some form of public employment. The best available evidence suggests that these measures have some success in reducing unemployment and alleviating earnings losses of job losers.³² These measures do not share the advantage of extended UI that it builds on an existing infrastructure of a successfully functioning program and that its effect is felt immediately by UI recipients and the economy.³³ However, with the exception of training, they share with extensions in UI benefits the focus mainly on the short term, with less known long-term benefits for laid-off and unemployed workers.

Policies Aimed at Reducing Long-Term Unemployment and Lasting Earnings Losses

The reach of the large losses in earnings, increases in job instability and reductions in health lasts beyond the duration of extended UI benefits. In fact, since the losses last well beyond 5 or 10 years, the majority of the lifetime loss in earnings occurs after eligibility for UI benefits has expired. Yet, few policy options are available to alleviate the long-run costs of job loss and

³¹ Schmieder, von Wachter, and Bender (2009).

³² For example, for an assessment of the effect of wage subsidies see Perloff and Wachter (1979) and Congressional Budget Office (2010a). For an assessment of the effect of training programs for displaced workers see Department of Labor (1995), Section 5.

unemployment.

For example, at present there is no evidence that the longer duration of UI benefits significantly alters the long-term earnings or employment trajectory of the unemployed.³⁴ Similarly, the evidence of the success of efforts to train laid-off workers in new skills is mixed.³⁵ Little evidence on the long-term effects of other programs is available. By the nature of the mechanisms behind long-term earnings losses as explained above, it is in fact unlikely that any policy will completely close or significantly reduce the long-term earnings gap – short of altering the market's mechanisms of wage setting, the trade-offs governing workers' investment in their skills, or the multiple factors affecting the decision to relocate. Yet, there are some options available to help those with long unemployment spells to find jobs and to try to improve the long-term earnings prospects of job losers.

In particular, it is likely that a lack in mobility between jobs, occupations, or regions may contribute to the persistence of observed reductions in earnings at job loss. A reason may be that workers are not aware of the time it would take to dissipate their earnings losses. As explained above, the individual's recovery process is likely to last well beyond the recovery of the aggregate labor market. Job losers might not be aware of the long-term efforts required to rebuild a career, and active counseling may help in bringing expectations in line with the reality workers will be facing in the labor market. Evaluations of job search assistance have found it to reduce UI rolls and to be cost effective.³⁶

Another reason why workers do not move or change occupations might be because they are not aware that the job prospects in their line of work and in their local labor market may have declined permanently. This may lead individuals to wrongly assess the prospects of finding a job in their old industry or occupation in their local labor market, and wait too long to switch careers, change employers, or move to another region. Information on how job prospects in the workers' profession and related occupations are evolving both locally and nationally might be a useful tool

³³ Congressional Budget Office (2008), Table 1.

³⁴ Schmieder, von Wachter, and Bender (2009).

³⁵ While the average returns from training is positive, relatively few displaced workers take up training (Jacobson, Lalonde, and Sullivan 2005).

to help unemployed workers and their families make better choices. Such information is routinely available from the Census Bureau and the Bureau of Labor Statistics, and could for example be included with workers' UI benefit checks.

Part of the effort to rebuild a career might involve retraining or relocating. One way to raise mobility is to offer workers support in covering expenses related to retraining or moving. Evaluations of subsidies to attend community college have found that they on average raise earnings of displaced workers, in particular if covered subjects are of more technical nature. However, such programs seem to be beneficial and cost-effective for selected populations and may not be a solution for the broader population of participants.³⁷ Less is known about the potential benefits of relocating unemployed workers. On the one hand, reallocation of labor across regions plays an important role in equilibrating local labor markets.³⁸ On the other hand, regional mobility does not appear to significantly lower earnings losses of displaced workers, perhaps because most large recessions afflict most regions of the country.³⁹ Yet, over the longer run, government programs helping unemployed workers to relocate, for example by reducing their mortgage debt, are likely to help workers recover some of their lost earnings.

An alternative set of policies includes efforts to directly stimulate employment growth at the local level. These could be targeted at improving the economic situation in regions particularly hard-hit by the recent downturn. Yet, in general an upturn in the labor market improves the lot of some workers, but does not raise the earnings trajectory of job losers or those formerly unemployed.⁴⁰ There is no reason per se why localized policies should have a different effect on the employment of long-term unemployed or the earnings of reemployed laid-off workers than a regular upturn in the labor market.

One reason why workers experiencing long-term unemployment spells are not affected by an improvement in labor market conditions is that they have become detached from the labor market. In this case, low-cost policies such as informing workers about job opportunities or the

³⁶ Department of Labor (1995), Section 5. For a survey of recent evidence see Jacobson (2009).

³⁷ Jacobson, Lalonde, and Sullivan (2005).

³⁸ Blanchard and Katz (1992).

³⁹ von Wachter, Song, and Manchester (2009).

employment outlook in their occupation may not deliver the desired effect of increasing workers' mobility and raising their chances of finding a job. In this case, a more active approach may be needed to reintegrate long-term unemployed workers into the labor market. For example, it may be cost-efficient to temporarily subsidize workers' wages upon reemployment for a certain period if this leads to a permanent increase in labor force participation and reduces applications to programs geared for the disabled or the poor.⁴¹

Finally, given increasing evidence that children's long-term economic success might be affected by the lay off of a parent, it is worth considering ways of directly helping individuals coming from affected families. One possibility that builds on existing programs would be to provide additional financial aid to cover college tuition and living expenses. While work on the cross-generational effects of displacement is still developing, many families that experienced a lay off with children in college or nearing college age today are likely to feel the sting in their financial resources. Thus, it may be worth beginning to explore measures to help cover part of the costs of higher education or training for the children of job losers.

Policy Initiatives to Avoid Mass Layoffs in Future Recessions

It is likely that cost-effective government policies can help long-term unemployed find renewed employment. Yet, few measures promise to be able to substantially reduce the long-term earnings losses that can afflict laid-off or unemployed workers. While Congress considers financial reform to safeguard against another financial crisis, it may be worth considering reforms that help prevent costly earnings losses during a future recession.

For jobs lost in declining firms or industries, this may mean that inevitable job destruction would be spread over time. Thus, layoffs would likely occur in a better economic environment, and therefore lead to significantly smaller losses in earnings. For jobs lost at economically viable sectors or at viable firms, this could avoid costly breakup of productive employment

⁴⁰ Jacobson, Lalonde and Sullivan (1993), von Wachter, Song, and Manchester (2009).

⁴¹ This has been recently advocated under the name of 'wage insurance' for example by Jacobson, Lalonde, and Sullivan (1993), Litan and Kletzer (2001), and Kling (2006). Evidence on related 'reemployment bonus experiments' suggest that short-term subsidies raise employment, but may only be cost effective if targeted to

relationships that would have likely continued in the absence of an economic crisis.

Two mechanisms to achieve such a temporary buffering of employment at firms in economic difficulties could be so-called “work-sharing” arrangements supported by the government, or private arrangements such as “work-time” accounts. Work-sharing has effects that are similar to those of current measures to increase job creation through tax breaks or wage subsidies, except that incentives to generate employment are given prior to job displacement. In particular, instead of firing, say, 30% of its workers, an employer would reduce hours worked by all its workers by 30%. Subsidies by the government make up part of workers’ reduced earnings. Part of these subsidies could be financed by the UI system, in which case workers essentially draw part of the benefits they would have received if they had become unemployed.

Work-sharing policies have been currently adopted by 17 U.S. states. Yet, these have a limited public commitment to replace earnings, so the take up is relatively low. Even though a large amount of layoffs have already taken place, if expanded such programs could increase aggregate employment by reducing continuing layoffs at those firms that keep shedding workers.⁴² Work-sharing was also available to firms in Germany during the current recession, and has been credited to have helped to avert a significant number of layoffs, despite a drop in GDP growth that was larger than the decline in the U.S.⁴³ Clearly, it is important to pay attention to the details of such an arrangement. From the point of view of Unemployment Insurance, being unemployed is a clearly defined state. For administering work sharing, it may be difficult to screen eligible firms. Yet, the successful implementation by many U.S. states suggests that these difficulties can be surmounted on a practical level.

The evaluation of work-sharing is still at an early stage. Yet, it comes with lower financial involvement and less direct steering of economic activities than more targeted interventions, and is likely to extend the benefits of government support to a much broader group of workers. A related strategy to help avert layoffs of productive workers would be programs geared to maintain access to short-term credit to from viable firms in financial distress that are otherwise

workers most likely to exhaust their benefits (Department of Labor 1995, O’Leary, Decker, and Wandner 2005).

⁴² This argument is spelled out in Hassett’s (2010) testimony to the House Committee on Financial Services.

economically viable. Such an approach would be most sensible in times of a sudden reduction in private credit, such as occurred after the financial crisis in 2008.

A second approach would be to encourage workers and firms to find private solutions to the risk of layoffs. For example, work-time accounts would be based on an agreement between workers and firms to smooth hours over the business cycle. Thus effectively the firm saves part of the overtime pay on behalf of workers during good economic times, and draws down balances when economic conditions worsen instead of firing the worker. In addition to work-sharing, such work-time accounts were a major factor in keeping layoffs to a minimum in Germany during the current recession. The use of these accounts was particularly prevalent in sectors that exhibited stable growth prior to the crisis and were experiencing shortages in skilled labor.⁴⁴ Such an arrangement is based on long-term relationships between workers and firms that involve some degree of firm- or sector-specific skills. While the paradigm in the U.S. is one of high labor turnover, many employment relationships are long-lasting, and employers invest in searching for and training workers. Thus, in light of the large costs of job displacement, such arrangements may be beneficial to both workers and firms.⁴⁵

Clearly, layoffs cannot be prevented altogether and are to some extent a natural feature of a market economy. However, in special circumstances such as the financial crisis of 2008 or high interest rates in 1982, some layoffs might occur at otherwise healthy firms, leading to costly layoffs as productive employment relationships are severed. Similarly, layoffs in declining industries might be accelerated, leading to large-scale layoffs exceeding the capacity of the labor market to reallocate these workers. For such cases, mechanisms that allow firms to avoid large-scale layoffs could prevent large and lasting consequences affecting a high number of workers. The potential benefit of such safe guards is underscored by the difficulty of alleviating the long-term consequences of workers affected by layoffs and unemployment.

⁴³ Moeller (2010) assesses the role of work-sharing and work-time accounts in averting layoffs in Germany.

⁴⁴ Moeller (2010).

⁴⁵ A small theoretical literature discusses why such contracts are not prevalent in the U.S. (Grossman and Hart 1983, Ramey and Watson 1997).

To conclude, job loss and unemployment during large recessions can impose large and lasting costs on affected workers. The short-term burden of these costs can be alleviated relatively cost-effectively, for example by extending unemployment insurance. Less is known about how to help adjustment to the significant long-term costs. While cost-effective policies exist to reintegrate long-term unemployed into the labor market, the potential for policy interventions to reduce long-term earnings losses appears bleaker. Given the large long-term costs of layoffs and unemployment, preventive measures to avoid large-scale layoffs in future recessions should be a high priority.

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