EconoFact Chats: The Long Shadow of Labor Market Scarring

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Michael Klein:

I'm Michael Klein, Executive Editor of Econofact, a non-partisan web-based publication of the Fletcher School at Tufts University. At Econofact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

Almost 10 million fewer people were employed in November, 2020 as compared to November, 2019, and almost 4 million of these people have been unemployed for more than half a year. There are concerns that the recovery in employment is slowing, and with the resurgent pandemic, that we're in for a very long dark winter. A vaccine seems to be on its way, but even when the economy recovers, will these very hard times cast a long shadow, especially on younger workers? What do we know about what's called scarring in the labor market, the persistent effects of being out of work on the unemployed?

Michael Klein:

To address these issues, I'm pleased to welcome Jesse Rothstein of the University of California, Berkeley, to Econofact Chat. Jesse and Lisa Kahn, of the University of Rochester, have a very recent Econofact memo on this topic. Along with his role as a professor, Jesse is also the Faculty Director of the California Policy Lab that brings insights from academic research to inform policy on important social problems. His experience includes service as chief economist at the US Department of Labor, and as a senior staff economist at the Council of Economic Advisors. Jesse, welcome to Econofact Chats.

Jesse Rothstein:

Thank you, Michael.

Michael Klein:

Jesse, let's first put the employment situation over the past 9 months in some context. How many people have lost their jobs since the outbreak of the pandemic, and what is the recovery looked like?

Jesse Rothstein:

At it's height in April, more than 25 million people had less jobs. That's the most precipitous collapse we've ever seen. We went from about 152 million jobs in February to about 130 million in April, so that's a loss of almost 15%. The unemployment rate went from 3.5% in February to 14.7% in April, and even that's probably undercounting things by quite a bit, because some people who lost their jobs were misclassified and not counted as out-of-work.

Michael Klein:

To put this into some context, what do comparable statistics look like for the Great Recession period that began in the fall of 2008?

Jesse Rothstein:

Between November, 2007 and December, 2009, about 8 million people lost their jobs, so that's about 5%. About a third of the size of what we've seen this time, and of course that was over 2 years, not the 2 months that we saw this year.

Michael Klein:

Jesse, you mentioned the possible misclassification of workers when calculating the unemployment rate. This is similar to the fact that the unemployment rate might not accurately reflect the state of the labor market for another reason as well. When people stop looking for work, the unemployment rate actually goes down, which makes it look like the labor market is doing better, but really it's not.

Jesse Rothstein:

Yes. The unemployment rate is the number of unemployed people relative to the labor force, but to be either unemployed or in the labor force, you need to be either working or actively looking for a job. So if unemployed people stop actively looking for a job, then they're put out of the labor force and that makes the unemployment rate go down. That doesn't mean the number of people wanting jobs has gone down, but just our count of the people who are actively looking has. We've been seeing lower rates of participation over the last 10 years.

Michael Klein:

Does this unprecedented precipitous collapse of the labor market hit some groups harder than others?

Jesse Rothstein:

Yes. In this crisis, we've seen that workers in industries like retail and hospitality were the hardest hits, maybe not surprising given shelter-in-place orders, and the workers in those industries are disproportionately younger, from minority groups, and women.

Michael Klein:

As I mentioned in the introduction, you and Lisa Kahn have just contributed an Econofact memo on labor market scarring. The memo draws on your research and hers on the aftermath of the Great Recession in the labor market in the 2000 teens. We're hearing the term scarring more frequently in the news today. Can you explain what is meant by labor market scarring?

Jesse Rothstein:

Sure. Scarring is a term that economists use to describe persistent effects of past conditions on workers current outcomes, irrespective of current economic conditions. The idea is that no matter how good the labor market is now, the fact that it was weak earlier in your career has scarred you because you went through that, and that reduces your current employment prospects or wages.

Jesse Rothstein:

When we study scarring, we usually focus on conditions when people first entered the labor market. Not because that's the only source of scarring, but because we know that your first job is a really important one for determining your later prospects. If you have to start out at a bad time, you might have trouble getting your foot securely on the job ladder, and that means that it has implications for your ability to climb that ladder later in your career.

Michael Klein:

Your analysis looked at labor market scarring for college graduates in the wake of the Great Recession that began in September of 2008. What did you find in that research?

Jesse Rothstein:

Compared to what we've seen at other times and taking into account people's lives level of education, their age, and the state of the economy, the employment rate was about 2 percentage points lower for these college graduates who entered the labor market in 2010, as compared to people who entered a couple of years earlier. This lower level of implanted persistent as we followed them through the time we have data on them, up to this year, there was also a reduction in wages by about 2%, but that wasn't as persistent.

Michael Klein:

So this cast a long shadow on these peoples' careers, but there's a distinction between scarring and the fact that there's a greater sensitivity of younger workers to the ups and downs of the business cycle, right?

Jesse Rothstein:

Yes. We've always known that young people's outcomes are more sensitive to the current economic conditions than those of older workers. If you already have a job, you can wait out a recession, but if you're just starting your career, you're stuck trying to find a job when there might not be any defined. Scarring effects that we're talking about here are above and beyond that. Not only do young people do worse during the recession itself, but they carry around the damage from that recession, even once the economy starts to recover.

Michael Klein:

So it's not just proportional to the business cycle itself?

Jesse Rothstein:

Right, it seems to then extend beyond the immediate downturn.

Michael Klein:

One of the results in your paper that I found really interesting, is that even as the labor market improved through the 2000 teens, the employment rate of new graduates stayed below what we would have expected based on past experience.

Jesse Rothstein:

Yeah, that's right. In past recessions, we've seen that people who started their careers after the recession was over, aren't damaged by it. They seem to be back to normal. But in this time, we saw that the rate of employment, even for people who started their careers in 2015, several years after the Great Recession ended, the unemployment rate was a lot lower, but they were still had lower employment rates than you would have expected.

Michael Klein:

That's worrisome for today, because, as we mentioned at the outset, the fall in employment has been even larger and even more precipitous than what we saw in 2008 to 2009.

Jesse Rothstein:

Right. The labor market wasn't doing well even before this crisis. That makes the current problems even more worrisome in terms of their long-term implications. Maybe it wouldn't be so bad as the labor market recovered really quickly and got back to even better than it was before the crisis, but the job market recovery rate was very slow in the wake of 2008 Great Recession and in the previous one as well, and it doesn't look right now as if we're having, what's called, a V-shaped recovery where we're bouncing right back.

Michael Klein:

So which letter of the alphabet are we going for here, W, U, L? L is really-

Jesse Rothstein:

People seemed to have settled on K. That the wealthy are doing pretty well and lower income workers are really doing much worse.

Michael Klein:

Another thing that I found very interesting in your research is that the trend of labor market engagement of younger workers was actually falling before 2008, and the Great Recession might've just accelerated that trend. The slow recovery of employment in the wake of the 2008 crisis was characterized by a relatively jobless recovery. Do labor economists understand why this occurred?

Jesse Rothstein:

There are a number of potential explanations for that jobless recovery. My view is that, basically, we declared victory too soon. We passed the Recovery Act in 2009, and then Congress decided the problem had been taken care of, and we turned pretty soon to austerity policies. But we were still in a really deep hole and with government withdrawing and support for the economy, it took us a really long time to climb out of that hole. I think the weak labor market engagement of younger people is another indication of just how long we were in the hole. It's suggested for most of what we thought was a recovery, the labor market was even weaker than we thought, based on just the unemployment rate.

Michael Klein:

So there's a bit of an echo of that today, right? Because in 2009, there were concerns that the Congress wouldn't be behind a stronger response, and today, of course, we're seeing a similar thing with the discussion about a successor to the CARES Act. So we're facing sort of a very similar political situation today as well, right?

Jesse Rothstein:

I think that's right. This time, the Congress moved quickly. The CARES Act was passed remarkably fast after the collapse started, but then as the summer dragged on and it became clear that this was going to last longer than they contemplated when they wrote the CARES Act, political considerations seemed to have taken over and the Senate has decided it is not eager to pass something, even though the economy clearly needs. This recovery is going to be much slower than it could be.

Michael Klein:

And that's a little bit like the echo of what happened back in 2009, where, when things moved away from the most acute phase of the crisis, then some of the support was removed.

Jesse Rothstein:

That's right. That's right, and that, I think, is one of the leading explanations for why we were so slow to recover last time.

Michael Klein:

What's the saying? Those who do not learn from the past are doomed to repeat it.

Jesse Rothstein:

Exactly. I think there's definitely a faction that's trying to repeat it.

Michael Klein:

One of the things that is different now, maybe it's different, is that we have a much stronger, what's called, gig economy now. Do you think the gig economy was more of a cause or a symptom of what we saw as this labor market disengagement in the 2000 teens?

Jesse Rothstein:

I think it's more of a symptom. I'm actually studying this right now. The first thing to understand is that the rise of gig jobs is not really big enough to account for the trends we've seen. Even a very generous accounting would indicate that just a few percent of workers are doing gig work. I tend to think that the growth of that sector mostly reflects a lack of conventional job opportunities. If people can get real jobs with benefits, they wouldn't feel the need to take poorly-paid gigs.

Michael Klein:

Could it be that part of the issue with the gig economy is there is a poorer matching of skills that people had with the skills that jobs demanded? Do you hear people talking about a skills mismatch and that as a possible source of some of these issues?

Jesse Rothstein:

That's possible, but it doesn't seem so likely. There isn't really a lot of evidence of skill mismatches getting worse through this period. And remember, the kind of work that we're talking about is work that's focused on new college graduates, who are probably the least likely to have outdated skills that don't meet the demands of the labor market.

Jesse Rothstein:

It's possible that somehow during the last few years it became harder for workers and firms to find each other, the matching up of workers to the right jobs got worse, but if you look at what's happened over the last few years that could plausibly cause a change in the matching process, you'd tend to focus on things like the rise of internet job search and AI algorithms that help employers sort through resumes. Those sorts of advances should improved, not worsen, the ability for the economy to match workers and firms together. To explain the outcomes we'd seen, you'd somehow need things to have gotten worse, and it's hard to see what could have caused that.

Michael Klein:

Jesse, are there lessons from that time and from research like the type that you've done and others have done that we can apply today?

Jesse Rothstein:

I think these results point to the idea that a downturn is just much more costly than it appears in the immediate term. That not only are you doing damage to people who can't get jobs today, you're also scarring their long-term prospects. That implies that there's a really high value to policies that keep employment high and the labor market tight and that promote fast recoveries when we do have a recession. There's also some evidence that a strong labor market can undo some of the damage caused by earlier scarring, which is another reason to really want to run the economy tight.

Michael Klein:

Yeah, that's a really interesting point, and it's related to something that came up when I had Jeff Fuhrer on the show a few weeks ago. As you probably know, Jeff spent nearly four decades working in the Federal Reserve system and we discussed the Fed's new framework review that they conducted over the past year and a half.

Michael Klein:

In the Fed's listening tour, people from low-income and minority communities pointed out that running a hot economy gave many people in those communities the chance to get a job when they might not otherwise have had a chance in the decades before. So the Fed is now concerned more about running an economy below full employment, than running it too hot. And so this actually points to the flip side of scarring. If people have a chance in a good economy to get a job, then this can have a persistent long-term benefit. Would you agree with that?

Jesse Rothstein:

I do. I think that's absolutely right. Jeff's point is more about those without a college degree who are very much affected by weak economies. The research I've done shows that that argument can extend to people with a college degree as well. That running the economy hot, really has big benefits for many, many workers.

Michael Klein:

At the beginning of the interview, the challenge of accurately understanding what's happening in the labor market came up, especially in a very timely fashion and when we have these huge changes as precipitous fall in the labor market. I know you've been involved in a project to use some new data to get a very up-to-the-minute read on labor market conditions. Could you talk a little bit about that?

Jesse Rothstein:

Sure. Our standard indicators of labor market conditions are based on monthly surveys, and they're reported with a lag. In situation like what we saw this spring, it took a while, a month or more, to gauge just how bad things were. With some colleagues, I've been developing a new measure that uses data from a firm called Homebase to measure daily fluctuations in employment for small employers in the retail and food services industries. This was really useful earlier this year when we were able to see just how big the collapse in March was, much faster than the official statistics, and we can see that basically the entire collapse happened in 2 weeks between the middle and end of March. Being able to see this in real time was important, given the scale and the speed of the collapse. The CARES Act passed on March 27th, and even that was already later than what would have been good for the economy. But the official measure of the March collapse didn't come out until early May, much too late for the needed response.

Michael Klein:

There are some other problems with the way in which the unemployment statistics were gathered as well. For example, wasn't there an issue that people were asked if you're employed, but absent or something like that, and then those people were not being counted as laid off?

Jesse Rothstein:

Right. Nobody designed our labor force information systems for a shelter-in-place period, and so we didn't have good ways of capturing the circumstances of people who were home temporarily, but not laid off, or working from home or other things. And overall, we think that that led us to understate the true unemployment rate by several percentage points.

Michael Klein:

The data that you and others are developing could get around some of these problems, and also, as mentioned, because they're very recent, very high frequency, you could really identify a point like what we saw this year much better than the traditional surveys are able to do.

Jesse Rothstein:

I see them as complimentary. I think we need both, but you're right. This ables us to zero-in much more tightly on short time periods, and also it allows us to focus in on a really important sector, the small business retail and food sector, which we think was a key to the collapse that we saw this spring, and will be a key barometer of the recovery as we finally come out this.

Michael Klein:

Were there other episodes in the past, Jesse, where you think, "Had we these data, it might've been especially useful," For example, in 2008, 2009? For example, access to finance was much harder for small businesses than for big companies that might've had access to the bond market or the stock market, as opposed to just bank loans.

Jesse Rothstein:

I think that's right. Our official statistics have pretty limited views into hiring and into firm creation and disappearing, and these kinds of data are, I think, a really useful way of trying to understand that kind of a sector, which again, as you say, could be moving differently than large firms are, especially at times when the finance sector is having trouble.

Michael Klein:

To people listening to this podcast, it might seem like we're getting into the nerdy weeds here quite a bit about different things, but there is some really important real-world implications for how nimble policy could be to respond to these things, just based on what data are available.

Jesse Rothstein:

That's right. You can't respond to problems that you don't know are they are, and we only were limited by what we can measure and quickly. And so I think understanding, when people start to get vaccinated, if restaurant employment to rebound, that'll give us a very different view of what's going on, than if we discover the restaurant employment has been very slow to recover.

Michael Klein:

So that's a really good example. Yet another way in which these very timely data can be incredibly useful. From one nerd to another, I thank you very much, but also has from one citizen to another, this is a really important contribution and I think it illustrates how careful data analysis can really contribute to the public good.

Jesse Rothstein:

Thank you. Yeah, I think it's important and I think we're all learning how to incorporate non-traditional data sources into our understanding, and I think that's going to be a big growth area for the next few years.

Michael Klein:

It's a sort of clever use by economist of data that is not necessarily just government data, but looking at other sources where, for other reasons, people have put together these data and now economists are saying, "Well, this can be really useful for a lot of things as well."

Jesse Rothstein:

Exactly, exactly. Our data happened coming from a firm that collects them because they provide time clock services to small businesses, and so they know, for every worker, when they clock in and when they clock out every day. That's not the sort of thing the government has traditionally looked at.

Michael Klein:

Yeah. That's a very clever use of that and it's really a wonderful thing that you're doing that. So, Jesse, thank you very much for speaking with me today about this really important issue, and also about the innovative ways that you and others have taken to try to approach that and make economic policy better for the nation as a whole.

Jesse Rothstein:

Thank you.

Michael Klein:

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