Point/Counterpoint

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THE POST-RECESSION EMPLOYMENT SITUATION: A COMPARATIVE PERSPECTIVE

Slow economic growth since the end of the U.S. recession in June of 2009 has not yet translated into increases in employment large enough to meaningfully reduce the rate of unemployment. Because expansionary macroeconomic policy has been pursued on both the fiscal and monetary fronts, it appears at first glance that the hands of government at this point may be largely tied until growth arrives. Nonetheless, the current rate of unemployment (9.1 percent) is well above what the country has typically experienced in the last couple of decades. Worse, when discouraged workers who have left the labor force and other participants impacted by the recession (such as part-time workers who would like to be full-time) are added to the count, the combined unemployment (or underemployment) rate stands at a troubling 16.1 percent (Bureau of Labor Statistics, 2011, Table A-15, Definition U-6). It is difficult to see unemployment rates at these levels and not wonder if something more should be done to help those being impacted.

The experience of the U.S. has not been unique. The recession has been global. Some countries have clearly performed better than the U.S., while others have suffered more. These differences may arise from policy approaches to dealing with widespread unemployment, structural differences in national economies, and whether specific countries are in a position to stimulate demand with expansionary monetary and fiscal policy. Moreover, the extent of unemployment may be influenced by coordinated national responses across countries.

In this Point/Counterpoint, I have invited four groups to discuss the employment situation in the wake of the Great Recession, focusing on the following questions:

1. What national initiatives have worked and which were less effective in helping stimulate employment? Might more be done?
2. Should other services or additional support be provided to unemployed workers, their households, and others impacted by the recession?
3. How do government financial and structural deficits interact with employment policy?
4. To what extent did countries coordinate policy responses and learn from best practices? Are there still lessons that might be drawn from different experiences across countries?

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The four groups of participants in this exchange include (1) Barbara Moench, Sigried Caspar, and Ines Hartwig (European Commission, DG Employment); (2) David Neumark (University of California at Irvine) and Ken Troske (University of Kentucky); (3) Dongchul Cho and Sukha Shin (Korea Development Institute School of Public Policy and Management); and (4) Robert Haveman (University of Wisconsin at Madison), Carolyn Heinrich (University of Texas), and Tim Smeeding (University of Wisconsin at Madison).

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EUROPEAN LABOR MARKET IN CRITICAL TIMES: THE IMPORTANCE OF FLEXICURITY CONFIRMED

Sigried Caspar, Ines Hartwig, and Barbara Moench[1]

WITH THE SLOW AND UNEVEN PACE OF RECOVERY FOLLOWING THE RECESSION, WHAT NATIONAL INITIATIVES HAVE WORKED AND WHICH WERE LESS EFFECTIVE IN HELPING STIMULATE EMPLOYMENT? MIGHT MORE BE DONE?

The midterm impact of the economic crisis on the employment situation in the EU member states varied largely (European Commission, 2010a, Chapter 1). Whereas the Baltic States, Ireland, and above all Spain registered job losses of more than 10 percent from immediately before to after the crisis, that is, between the second quarter of 2008 and the second quarter of 2010, in other countries such as Poland, Germany, Austria, and Belgium the employment rate in 2010 was similar to its level in 2008. In Germany, for example, a fall in output of around 6.6 percent during the crisis was met by a decrease of the employment rate of only 0.3 percent. The weaker-performing member states were thus faced with a much more pronounced reduction of employment in reaction to the declining economic activity.

There are several reasons for the comparatively stronger effect on employment in certain member states (Eurostat, 2011a). One key factor is the structure of the economy and the productivity levels of the sectors most affected by the crisis. For example, the construction sector—one of the hardest hit by the crisis—accounts for an especially large share of national employment in countries such as Ireland and Spain, while the production of machinery and equipment—which was hit badly in Germany—is characterized by high productivity levels; that is, a strong cut in GDP coincides with a much smaller reduction in employment. Furthermore, in sectors with high productivity, the qualification of employees tends to be higher, which makes internal flexibility, including labor hoarding, a quite attractive strategy for an employer.

Another factor that is likely to amplify the volatility of employment shocks is the relative proportion of workers under temporary contracts, who can be relatively easily dismissed, with those with highly regulated permanent contracts. In coun-

[1] The views expressed in this paper are the authors' alone and do not necessarily correspond to those of the European Commission.

tries with high shares of temporary contract workers, it is easier for reductions in GDP to be quickly and directly translated into employment reductions. This was the case for Spain.

Three-quarters of the 5.1 million jobs lost in Europe during the crisis period were jobs held by men. Low-skilled workers, whose situation on the European labor market has been critical for a long time, also suffered disproportionately during the crisis, with 3.3 million jobs lost. Also, young people could not enter the labor market during the early, critical phase of their careers due to the crisis. Young people thereby suffered from not being able to enter and having often been temporary contract employees before the crisis. On the other side, the crisis did not create as many problems for women, highly-qualified, and older workers.

In spite of their diversity, member states sought to respond to the crisis in a coordinated and mutually reinforcing way by launching the European Economic Recovery Plan (EERP) in December 2008 (European Commission, 2008). Labor market policies form an important part of the EERP and, in line with the EU's long-term strategy of labor market reforms, the overall key priorities can be grouped in the following way:

1. Maintain employment, create jobs, and promote mobility. Measures included temporary short-time working arrangements, wage subsidies, non-wage cost reductions, expanding public sector employment, and self-employment.
2. Upgrade skills and match labor market needs. Measures included targeted training activities, reinforcing apprenticeship schemes, intensified job-seekers assistance programs, and extending the capacity of the public employment services and private employment agencies.
3. Increase access to employment and support households. Measures included reinforcing temporary income transfers for the newly unemployed and modification of the unemployment benefit scheme.

Across the EU, a total of €200,560 million, or 1.6 percent of EU-27 GDP, was spent on labor market polices (LMP) in 2008 (Eurostat, 2010). There was, however, considerable variation among member states, with expenditures ranging from 3.3 percent of GDP in Belgium—some way above the level observed in all other countries—to the next five highest spending countries (Spain, Denmark, Finland, the Netherlands, and Ireland), consuming between 2 and 2.5 percent of GDP. However, the majority of EU countries spent far less—just over a quarter of 1 percent in Romania and Estonia. Active labor market measures included training, employment incentives, supported employment and rehabilitation, direct job creation, and start-up incentives. Passive labor market measures included out-of-work income support, short-term work, and early retirement.

Measures taken by the member states not only limited the overall decline in employment but also contributed to a fairer distribution of the adjustment burden. Although it is too early to determine whether the employment saved will endure after the crisis, a tentative model-based assessment indicates positive outcomes overall.[2] More specifically, model simulations show that temporary public financial support in the form of in-work subsidies increases employment and that such support can be particularly effective in terms of employment gains if targeted specifically at the young (European Commission, 2010a, p. 100).

Also, due to their specific nature, some measures such as short-time work arrangements tend to be more effective in the initial phase of the downturn, while,

[2] The European Commission's Labour Market Model (LMM) is a dynamic computable general equilibrium model containing an in-depth description of the labor market. The current version of the model covers six member states, namely Denmark, Germany, Italy, Austria, Poland, and the United Kingdom. For a detailed description, see Berger et al. (2009).

for example, the use of temporary subsidies, especially those targeted at new hires, are more effective in the recovery phase as they help to speed up job creation when production rebounds. Nevertheless, maintaining the arrangement for too long poses the risk that necessary restructuring may be delayed, that enterprises become overstaffed, that workers lose the incentive to upgrade their skills, that deadweight losses accumulate, and that funds get diverted from other useful purposes such as training. Additionally, wage subsidies are a costly labor market policy instrument in budgetary terms, and are more useful if they aim to include groups which otherwise would not find jobs. And with wage subsidy policies, the risk of a "revolving door" effect is particularly high. From a budgetary perspective, over a three-year period, if support were granted on an unrestricted basis to every worker, the annual costs of the measure could amount to 0.5 to 0.6 percent of GDP per year for the countries considered in the European Commission's Labour Market Model (European Commission, 2010a, p. 100).

In spite of the positive effects of recently implemented recovery measures, their achievements could soon be lost if efforts do not continue to redress the persistent structural obstacles in many member states' labor markets, which constitute the main threat for the future. Labor market segmentation has a prominent place among these structural obstacles, if only because it weighs most heavily on young people and their employment prospects, directly endangering the future competitiveness of the EU economy.

Altogether it can be summarized that so far recovery from the crisis is smoother where the government had already started to implement a balanced flexicurity approach before the crisis and structural modernization of the labor market institutions was already advanced.

SHOULD OTHER SERVICES OR ADDITIONAL SUPPORT BE PROVIDED TO UNEMPLOYED WORKERS, THEIR HOUSEHOLDS, AND OTHERS IMPACTED BY THE RECESSION?

When looking at post-crisis policies, the overall objective of EU labor market policies is to go beyond the employment levels of the pre-crisis period, when the overall average employment rate peaked at a moderate 66 percent, with 59 percent of women of working age and 46 percent of older workers (55 to 64) in the workforce. It is appropriate to gradually phase out most of the crisis-related employment measures. However, measures such as hiring subsidies, job-search assistance, and training are expected to continue during the early phase of the recovery. In addition, it is important to progressively strengthen labor market policies that reduce structural unemployment rates, increase labor market participation, strengthen the reallocation of labor toward a smart, sustainable, and inclusive economy, and promote social cohesion by targeting specific groups of workers.

Young people are particularly vulnerable at the moment of moving from school to work, especially the least qualified, who have the greatest difficulties in getting a foothold in the labor market. Econometric estimates show that tertiary educated individuals are at least twice as likely to experience good transitions (e.g., from joblessness to employment or from temporary to permanent employment) as individuals with only primary education. The share of NEET (not in education, employment, or training) youth provides a good measure of employment integration of young labor market entrants and varies significantly within the EU, from as low as about 4 percent in Denmark and the Netherlands to as high as 16 to 20 percent in Italy, Cyprus, and Bulgaria. Not least, due to their particularly vulnerable situation on the labor market, young people constitute a major target group for the European Social Fund (ESF).[3]

[3] Information on the ESF is available at http://ec.europa.eu/esf/home.jsp?langId=en and http://ec.europa.eu/esf/BlobServlet?docId=159&langId=en.[0]

Joblessness and in-work poverty are some of the key drivers of social exclusion and poverty. Despite the tight fiscal constraints in some member states, it should also be recognized that the expenditure on active labor market policy could be increased as its potential return is still high, with the possibility of expanding tax bases that can generate additional tax revenues that outweigh increases in fiscal outlays.

Labor market segmentation remains a structural challenge in several member states. Such segmentation is harmful and inefficient, as it carries the risk of making jobs more precarious, damaging sustainable integration into the labor market, and limiting the accumulation of skills. Policies aiming to align working conditions for workers on temporary and permanent contracts by simultaneously enhancing the flexibility of standard contracts and the security of nonstandard contracts are an important area of reform for better integration of the labor market as a whole.

One lesson learned during the crisis is that modernization of labor market institutions in the upswing pays off in times of crisis. This includes well-functioning passive labor market policy schemes, such as unemployment benefits, that play an important role in stabilizing internal demand and allowing people to sustain a period out of work. On the other hand, highly protected and inflexible employment contracts that push ever larger numbers into short-term contracts need to be modernized so as to fight segmentation in the labor market. Furthermore, the importance of a broad and up-to-date skill base is proven once more. All of the Mediterranean countries that are suffering particularly badly from the late consequences of the crisis show significant gaps in this respect.

HOW DO GOVERNMENT FINANCIAL AND STRUCTURAL DEFICITS INTERACT WITH EMPLOYMENT POLICY?

The economic crisis has resulted in an increase in government debt (Maastricht definition) in all EU countries between 2008 and 2009 (Eurostat, 2011b). For both EU and the Euro Zone, the Maastricht debt in terms of GDP was over 60 percent in 2009. Social security funds were responsible only in a minor way for the general government debt: Contributions of less than 5.0 percent were observed in 21 countries. The exception was Lithuania, with a ratio of 10.0 percent.

The apparent cost of debt (interest over total nominal debt) shows the differences between countries in terms of their conditions for accessing financial markets. The level of apparent cost of debt varied between 2.7 percent in Sweden and 8.6 percent in Romania. Comparing 2008 and 2009 data, the apparent cost of debt decreased in 12 countries. This was the case for Sweden, Finland, Bulgaria, Italy, Portugal, Malta, Belgium, Germany, Spain, Latvia, the Netherlands, and Slovakia. The highest increases were experienced by Romania at 1.8 percent and by Estonia at 1.6 percent. In those member states where the financial situation has become very difficult this also has repercussions on the labor market, as in all member states the government (local and or central government) is an important employer and client for goods and services.

So if the government is no longer able to ask for services or to recruit new staff and prolong contracts with temporary staff, this sends contractive impulses to the whole economy. As can be seen from the examples of Greek, Spain, Ireland, and also Portugal and the Baltic states, this makes recovery more difficult.

Nevertheless, more important than the financial deficits in the long run for most countries will probably be the question of structural deficits, which are annually addressed by country-specific recommendations that the European Council adopts, following a thorough analytical discussion between member state experts and the European Commission (the Commission). Here the Commission points to structural weaknesses that need to be addressed to allow for a smooth recovery and to be better prepared for the next cyclical downturn.

TO WHAT EXTENT DID COUNTRIES COORDINATE POLICY RESPONSES AND LEARN FROM BEST PRACTICES? ARE THERE STILL LESSONS THAT MIGHT BE DRAWN FROM DIFFERENT EXPERIENCES ACROSS COUNTRIES?

The crisis has made member states acutely aware of the fact that the EU is a shared economic space, not 27 independent economies. What affects one country affects all. This is particularly the case for the 17 member states sharing a single currency as part of the euro area. This increased awareness, nevertheless, has not been followed to the same extent by action. On the contrary, quite a number of member states seemed to be more concerned about their own economic development than about the community, an understandable approach but a mistake. To regain the capacity to grow and ensure that member states' performances reinforce rather than hinder each other, member states will need to strengthen the EU dimension. The need for stronger policy coordination at the EU level is not only linked to the crisis. Stronger policy coordination is also the best response the EU can make to the challenges of globalization and to achieve smart, sustainable, and inclusive growth as set out in the Europe 2020 strategy.

Based on a communication from the European Commission (European Commission, 2010b), the heads of state and government in the European Council have set up a new working method—the European semester. It is geared to ensure that collective discussion on key priorities takes place at EU level, before and not after national decisions are taken. The results of this discussion must then be effectively reflected in national decision making, in particular in national budgets and structural reforms, so that national and EU efforts are brought together in the right sequence to deliver and monitor progress over time.

Based on its assessment of the national reform programs presented by the member states in April 2011, the Commission has put forward country-specific recommendations as well as recommendations for the Euro area.[4] As for member states labor market policies, the following set of issues has been raised:

- Reform of pensions systems. Most member states are engaged in reforming their pensions systems, both as a way to curb future aging-related expenditure as their populations grow older and to create additional incentives for longer working lives. Increasing the statutory retirement age and linking it to life expectancy remain priorities, and the creation of automatic or formula-based links between retirement age and life expectancy can be an effective tool. Phasing out early retirement schemes and boosting employability of workers over 50 are a necessary part of the policy response. The Commission recommends that member states relying on a two- or three-pillar system should ensure the standalone viability of each of the pillars. In a number of member states, the adequacy of pensions' level to ensure a decent standard of living in old age is or may become an issue.
- Unemployment. In several member states, the crisis has led to drastic increases in unemployment, and the most vulnerable have often been the most affected. The risks for certain people to fall into inactivity or exclusion may materialize if not prevented and tackled. Member states are called on to put in place effective support measures and employment services. The situation of people experiencing poverty and other particularly vulnerable groups also calls for particular attention.
- Attention to education and training. Several member states should be more proactive in improving education performances and access to lifelong learning. Particular efforts are needed in some member states to tackle the issue of early school leaving and to provide apprenticeship programs and vocational

[4] European Commission (2011b), in connection with European Commission (2011a).

training. Targeted action is also recommended to tackle the high unemployment levels of young people. Many member states are experiencing rapid aging of their workforces, and the return to growth raises the prospect of increasing skills bottlenecks: Matching educational and training outcomes with labor market needs is thus a priority.

- Fighting segmentation. A number of member states still suffer from the segmentation of their labor market with different types of contracts. They need to move resolutely toward a more effective—and fair—combination of flexibility and security in working arrangements ("flexicurity"), including the rebalancing of employment protection legislation, so as to stimulate job creation, labor market participation, mobility across sectors, and human capital accumulation.
- Taxation system and indirect labor costs. Insufficient attention has so far been given to reducing the tax wedge on labor, in particular for low-wage and low-skilled workers. To achieve fiscal consolidation, many member states will need to revisit both the tax and expenditure sides of the national budgets. It is recommended to shift taxation away from labor and onto consumption or to support environmental objectives. The Commission emphasizes that further action is needed to remove social and tax obstacles for second earners to join or remain in the labor force. Reviewing the tax and benefit systems, improving the availability of child care, and allowing for more flexible forms of employment are recommended as priorities in this context.

This "European semester" is followed by a "national semester": In the second semester of this year (2011), member Sstates will discuss and incorporate European guidance into their 2012 budgets and national decision making, keeping in mind the preparation of the next national programs for spring 2012. These national discussions will be complemented by discussions in the Council that will examine member states' national policies and performances in their areas, monitor implementation, and carry out peer reviews on specific themes to encourage mutual learning of interesting practices. The next European semester starts again in January 2012, when the Commission will take stock of progress in implementing the country-specific recommendations, first at the EU level in its next Annual Growth Survey, and then in the recommendations given to each member state for the following year. This policy cycle is geared to fostering mutual learning between member states and encouraging member states to further pursue structural labor market reforms in addition to transitional crises measures.

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ADDRESSING THE EMPLOYMENT SITUATION IN THE AFTERMATH OF THE GREAT RECESSION

David Neumark and Kenneth Troske

HAS NATIONAL POLICY HELPED COUNTER THE GREAT RECESSION AND WHAT ELSE MIGHT HELP?

Since U.S. economic growth began to slow in 2006, both the Bush and Obama Administrations have enacted a number of fairly costly programs designed to stimulate the economy and employment growth. Under President Bush, Congress passed the Economic Stimulus Act of 2008, which provided approximately $100 billion in tax rebates to qualified households and other tax incentives for businesses. This was followed by the Emergency Economic Stabilization Act (EESA) in 2008, which authorized the U.S. Treasury to invest up to $700 billion as part of the Troubled Asset Relief Program (TARP). Although not explicitly a stimulus program, among the goals of TARP were to ". . . preserve homeownership and promote job and economic growth" (Emergency Economic Stabilization Act, 2008). In particular, TARP's auto industry financing program—which provided approximately $80 billion to the auto industry—was explicitly designed to protect jobs in the auto industry (Congressional Oversight Panel [COP], 2011). TARP was followed in early 2009 by the $800 billion American Recovery and Reinvestment Act (ARRA). Finally, in December 2010 Congress enacted a tax cut package that temporarily reduced Social Security taxes for individuals, extended the 2001 and 2003 tax cuts, and continued extended unemployment insurance benefits, at an estimated cost of $700 billion.

Because many of these programs are fairly new, there has been little comprehensive examination of their impacts, but initial analysis suggests that these stimulus efforts have had a fairly limited impact on job creation and unemployment, and any impact they had has come at a significant per-job cost. For example, there is some research showing that the 2008 tax rebate had a small but significant temporary impact on personal consumption expenditures and GDP (Parker et al., 2011), which, via Okun's law, suggests that the program's effect on the unemployment rate was a short-term, fairly modest decline (around 0.5 percentage point).

In addition, while there is consensus that TARP and the other financial rescue efforts helped end the 2008 financial crisis and prevented an even more severe recession, most economists remain skeptical that TARP has succeeded in its other goals of increasing business lending, stemming the rising tide of foreclosures, and promoting job growth (COP, 2010c). For example, despite the significant support from TARP for the auto industry, between 2006 and 2009 employment in the auto industry fell by 394,000 workers or 37 percent (http://www.bea.gov/industry/gdpbyind_data.htm). Of course, we do not know how much auto industry employment would have fallen absent the support from TARP—the usual problem of the unobserved counterfactual—but given the size of the fall in employment, it is hard to deem the auto industry program an unqualified success. Finally, the Congressional Budget Office (CBO) estimated that through the second quarter of fiscal year 2010, total ARRA stimulus expenditures were $570 billion and that the effect on employment ranged from 1.4 to 3.6 million jobs (CBO, 2010).[5] These figures imply costs per job created of $158,000 to $407,000.

We do not view this evidence as suggesting that we should make no additional efforts to increase job creation. But we think they imply that additional efforts to decrease unemployment will have, at best, limited impacts. Moreover, given the current focus on the budget deficit, if there is any appetite for increased federal spending to spur job growth, it is going to be for something of *much* lower cost than ARRA and other components of past federal efforts. And coupling these fiscal realities with the relatively weak evidence on job creation resulting from past large efforts, any additional federal effort should more narrowly target job creation.

A recent review (Neumark, 2011) suggests that the costs of creating jobs through direct hiring credits are likely much lower than through general stimulus. ARRA included many policies that could induce job growth, including home buyer credits, a more generous Earned Income Tax Credit, and tax credits (or higher tax credits) for car purchases, green energy investments, and health insurance premiums. In addition, ARRA provided stimulus in the form of substantial infrastructure spending. Most of these can be characterized as "indirect" job creation policies—policies that change the economic incentives facing businesses or workers, and which may, in so doing, lead to higher employment. But they do not directly create incentives along the employment margin by reducing the cost of labor, and in some cases they may not increase employment at all.

In contrast, "direct" job creation policies seek to create jobs by lowering the cost of labor, which economic theory predicts will increase employment. Moreover, such policies can be effective even in the current environment of weak aggregate

[5] The $570 billion figure comes from the report's estimate that 70 percent of the total $814 billion impact would be spent by the end of fiscal year 2010, which ended in September 2010. The employment figures come from the report's Table 1, which shows that 1.4 to 3.6 million jobs were created through the third quarter of 2010 (that is, September 2010). There is some ambiguity regarding how to count jobs created by the stimulus, since jobs are not permanent (see Council of Economic Advisers, 2009), and the CBO estimates the amount by which employment is *currently* higher because of ARRA. The CBO parallels more closely the calculations for costs per job created by direct hiring credits, discussed later in this article, by estimating the number of jobs created during the period in which the policy should have an effect (i.e., during a recession and its aftermath). As a consequence, the numbers cited here cover a period when the ARRA was likely having a very large effect, rather than more recent quarters when spending (and the effects) of ARRA have waned (CBO, 2011).

demand. This environment can be viewed as one in which firms can hire most of the labor they want at the existing wage, so that labor supply is highly elastic. In such a case, a hiring credit pushes out the labor demand curve against a relatively flat labor supply curve, generating a large employment increase but not much wage increase.

The usual view of hiring credits in the economics literature is that they are ineffective at creating jobs (Dickert-Conlin & Holtz-Eakin, 2000). However, this negative view is based on hiring credits targeting the disadvantaged, which by and large have dominated the U.S. experience with federal hiring credits. The literature establishes that these types of categorical hiring credits fail for two reasons: stigma effects that offset the direct cost reduction for targeted workers and high administrative costs generated by efforts to ensure that the credits are paid for hiring that would not have occurred absent the credit—costs that deter firms from using these credits.

Hiring credits to counter the business cycle have been rarer, but the evidence on their effectiveness is more positive. The federal New Jobs Tax Credit (NJTC) enacted in the mid-1970s was unique among federal efforts in that it did not target particular groups, although it did create stronger incentives to hire low-wage workers by applying only to the first $4,200 of wages per employee (in 1977 and 1978). And the recently enacted Hiring Incentives to Restore Employment (HIRE) Act includes an exemption from the employer's share of Social Security taxes for March to December 2010, plus an additional $1,000 credit per worker. The HIRE Act targets those entering employment from unemployment or from out of the labor force, but does not explicitly incentivize job creation by rewarding hiring only in growing firms (in contrast to the NJTC, which required 2 percent employment growth to receive the credit).

There is no solid evidence at this point on the HIRE Act.[6] In contrast, there are some studies of the NJTC (Perloff & Wachter, 1979; Bishop, 1981) that support a cautious conclusion that the NJTC was effective at creating jobs. Katz (1998), for example, argues that although it is difficult to sort out the effects of the NJTC from other factors, the evidence supports the conclusion that this kind of "temporary, noncategorical, incremental employment subsidy has some potential for stimulating employment growth" (p. 31).

The greater effectiveness of the NJTC is likely attributable to two factors. First, with a high unemployment rate and a hiring credit that focused on all of the unemployed, stigma was likely minimal because being unemployed in a recession does not reflect badly on a worker. Second, the NJTC explicitly incentivized job creation by requiring that firms' employment increase by at least 2 percent, a simple rule that entailed low administrative costs but that, in a period of anemic job growth, may have kept windfalls for firms that would have been hiring anyway to an acceptable level. The low administrative burden implied by this fairly simple rule may explain why the NJTC was claimed by 50 percent of eligible hires, compared with much lower claiming rates for credits focused on the disadvantaged (Bartik, 2001; Hamersma, 2005).

It is difficult to estimate the costs of creating jobs using hiring credits. It is hard to determine how many jobs were created by a credit, compared to the much larger number of hires that would have occurred regardless of the incentive and for which credits are also paid. Moreover, there is uncertainty about macroeconomic multiplier effects and longer-term benefits to workers from keeping them employed and in the labor market. As summarized in Neumark (2011), the literature suggests a plausible range of costs per job created using hiring credits focused on the unemployed

[6] The U.S. Treasury Department (2010) estimates the number of hires *eligible* for the credit in the millions of workers. However, even optimistic assessments of likely windfall rates (the percentage of hires for which credits are claimed that would have occurred anyway) are near 90 percent (Bartik, 2001; Bartik & Erickcek, 2010), and could be considerably higher for the HIRE Act because it does not require that employment be increasing.

of \$9,100 to \$75,000, with costs at the lower end if we take account of multiplier effects (which the CBO estimate does in computing the employment effects of ARRA). These ranges suggest that it is likely that the costs of creating jobs via hiring credits are *much* lower than the costs of job creation via the federal stimulus. Specifically, using the midpoints of this cost range and the CBO's cost range, hiring credit costs per job created are only about one-seventh as high as under ARRA.

One implication of these calculations is that there may be scope for a significant federal job creation hiring credit that could have effects on the scale of ARRA, at much lower cost. Taking the estimated costs seriously, the midpoint of the range implies that a \$50 billion hiring credit program would create almost 1.2 million jobs—nearly the lower range of the CBO estimate of the effect of the ARRA as of late 2010, with expenditures less than one-tenth of what ARRA spent to create these jobs. It is difficult to know what is politically feasible at the federal level. But this calculation suggests that if the goal is direct job creation, the federal government can get a great deal more bang for its buck by focusing on hiring credits, and, moreover, that such a policy might deliver a great deal of bang without spending a prohibitive amount of bucks. Moreover, it might be easier to obtain political agreement on an aggressive hiring credit, as this policy response acts by lowering costs for businesses and relying on the private sector to generate job growth.

Nonetheless, even taking this number literally, \$50 billion targeted toward hiring credits would only lower the unemployment rate by about 1.1 percentage points—a sizable reduction, to be sure, but one that would still leave the unemployment rate at 8.3 percent (based on May 2011 numbers; http://www.bls.gov/news.release/pdf/empsit.pdf). Moreover, even the best job creation hiring credit would be expected mainly to shift job growth to the period targeted by the credit. While this may have some longer-run benefits in terms of maintaining and increasing workers' skills and employability, there is no reason to think that a credit by itself leads to a long-lasting increase in the rate of job growth, which is ultimately what is needed.

Perhaps the more fundamental question, then, is what federal policy can do to improve the long-run health of the labor market by spurring a persistent increase in the rate of job growth. This is of course a major challenge, and the hardest one to solve. However, there are some areas where policy, and policy changes, can likely play a role, although here our remarks are more speculative.

On the supply side, we should focus on programs that enable workers to enhance their human capital and ensure that they can be employed when the economy starts to recover. Viewed this way, relatively high unemployment among youth who have recently left school, while a symptom of the sluggish economy, can also be viewed as an opportunity to increase the human capital of this young cohort by encouraging and enabling them to acquire additional, job-specific skills. As part of this, we may want to focus on enhanced job training and streamlining our job training system in the United States, ensuring that we focus training dollars on effective programs and on workers for whom programs produce the largest benefits (both higher wages and higher probability of employment), such as economically disadvantaged workers (Heinrich et al., 2011). As a way to strengthen employment we should also consider programs that help workers who currently are working in low-wage jobs with very little prospect of wage growth, since research shows that higher wages lead to increased employment (Juhn, 1992). To the extent that workers are in dead-end jobs because they possess low skills, and also are credit constrained and unable to invest in additional human capital, we may want to provide direct tuition subsidies and additional support for other expenses such as books, fees, or child care so that workers in these jobs who have demonstrated a strong attachment to the labor market and strong noncognitive skills can attend community college and improve their long-run prospects (Swagel & Troske, 2011).

On the demand side, we think recent research suggests that a "redirection" of programs and incentives that target small businesses might be appropriate. These incentives may be temporary, including the HIRE Act's implicit favorable treatment of small businesses in the form of write-offs of up to $250,000 in investment in equipment; state hiring credits that are only available to small businesses, such as California's New Jobs Credit's limitation to firms with fewer than 20 employees (and similar credits for small business in Idaho, Illinois, South Carolina, and other states); and the ARRA's net operating loss carrybacks for small businesses (http://www.irs.gov/newsroom/article/0,id=204335,00.html). Others are more permanent, such as the many incentives for small businesses administered by the Small Business Administration (see the summary in Neumark, Wall, & Zhang, 2011).

The role of small businesses in job creation has long been debated, beginning with Birch's (1987) assertions about the vastly disproportionate role of small businesses in job creation. However, perhaps the most important contribution to this debate is a recent study by Haltiwanger, Jarmin, and Miranda (2010) showing that the job growth stemming from small businesses stems exclusively from *new* small businesses. This makes intuitive sense: The small barbershop on the corner is unlikely to grow much, whereas the high-tech start-up just might. Moreover, this finding accords with the evidence that a large share of employment growth comes from new business establishments (e.g., Neumark, Zhang, & Wall, 2007).

What this research suggests is that both temporary and permanent government assistance to small businesses—to the extent that it helps small businesses—should be focused on *new* small businesses, not small businesses *per se*, with the goal of spurring entrepreneurial development of new businesses. Specific policies could include a reduction in the regulatory burden for new businesses or legislation designed to lower the costs of starting a new business, although it is possible that in many dimensions we already do enough for small businesses in terms of lower regulatory (or tax) burden.

Finally, a policy that would not only lower the costs of starting a new business in some industries, but help more generally, would be to reduce the minimum wage for new businesses, as well as for groups hardest hit by the recession and workers who have been unemployed for an extended period of time. Such a policy is likely to spur job creation at essentially no direct cost to the government, operating essentially as a hiring credit that does not have to be financed by taxpayers (although it will lower wages for some). It seems to us that these kinds of changes may be some of the more effective demand-side policies to help increase the rate of job growth.

ARE THERE WAYS TO CUSHION THE BLOW OF THE GREAT RECESSION WITHOUT MAKING IT WORSE OR PROLONGING IT?

We believe that the persistently high unemployment rate and the slow rate of job growth are the results of continuing problems in the housing market. In response to the decline in housing prices by as much of 30 percent, as many as 25 percent of mortgage holders underwater, and a record percentage of mortgage holders in foreclosure, households have significantly increased their savings rate, leading to lower consumption spending. In addition, the decline in home prices has limited borrowing by small businesses, because small business owners typically use home equity to help finance their borrowing, which in turn has limited the ability of small businesses to expand and hire new workers (Schweitzer & Shane, 2010).

These considerations suggest that until the housing market stabilizes, or homeowners' mortgage obligations decline, the recovery will be slow and unemployment will remain high. The implication is that federal efforts to stabilize the housing market and reduce the burden of the housing market decline on households can—if chosen wisely—both reduce the adverse impact of the Great Recession on households and help with economic recovery. Unfortunately, many of the federal government foreclosure mitigation efforts appear to be increasing the amount of uncertainty in the housing market, and are directed at homeowners who are least likely to benefit from the assistance. The government's constantly changing programs have caused lenders to be reluctant to offer help to borrowers, and caused homeowners to put off moving and recognizing their losses, in the hope that the government will come out with yet another new program that will bail them out, prolonging the problems in this market (COP, 2010a).

However, there are some programs that could probably help stabilize the housing market and provide effective help to borrowers. Foote et al. (2009) present evidence suggesting that providing temporary assistance in paying mortgages for people who have recently lost a job is a more effective way to reduce foreclosures than modifying the payments of individuals who are in default despite being employed. Although government foreclosure mitigation programs focus on helping homeowners who are in foreclosure and who still have a job (Special Inspector General for the Troubled Asset Relief Program [SIGTARP], 2011), this has begun to change recently. Treasury has developed new programs designed to help unemployed homeowners, but these programs are still small and offer only limited help to unemployed homeowners (SIGTARP, 2011). Given the flood of foreclosed homes that are clogging the system, the high unemployment rate, and the evidence that unemployed homeowners, if helped, often pay off their mortgage, it appears that foreclosure relief efforts better targeted toward unemployed homeowners would help stabilize the housing market *and* help unemployed workers. Indeed, there may be some gains to tying this type of mortgage relief to receipt of unemployment insurance (UI) benefits, both to more easily identify the unemployed and to increase the likelihood that recipients of mortgage relief for the unemployed are looking for work. Mortgage relief will not directly impact employment, but it will provide some additional support to unemployed workers until they can find new employment.

More generally, we believe that the government should alter its mortgage modification programs so that, instead of focusing on keeping people in homes they cannot afford, they focus on getting people into economically appropriate housing. As Swagel (2009) notes, "Too many borrowers were in the wrong house, not the wrong mortgage" (p. 10). One program that accomplishes this goal is the Home Affordable Foreclosure Alternative (HAFA) program, which provides financial incentives to lenders to accept short sales or a deed-in-lieu of foreclosure as well as offering borrowers financial assistance for relocating. This program allows borrowers to move into an affordable residence without damaging their credit, while getting both borrowers and lenders to explicitly recognize the loss in the value of the house. Both of these actions will help speed the transition of the housing market back to equilibrium, and help speed the economic recovery and lower the unemployment rate.

The other natural way to help cushion the blow of the Great Recession is through extended UI benefits. The motivation to do this is clear, but so is the potential downside—continued UI benefits can lead to longer spells of unemployment and a higher unemployment rate. Recent evidence suggests that extended UI benefits have led to an increase in the unemployment rate of about 1 percentage point or less (Daly, Hobjin, & Valletta, 2011). We are in no particular position to judge whether the benefits are worth the cost, but we regard this evidence as suggesting that the extension of UI benefits is not a principal factor slowing down the economic recovery; and clearly the extended UI benefits provide resources to a large number of families. At the same time, to the extent practicable, we would prefer that resources be devoted to direct job creation efforts and programs that provide assistance to individuals without creating incentives to remain unemployed.

DO CONCERNS OVER THE DEFICIT PRECLUDE ANY MEANINGFUL RESPONSE?

In the current environment, the biggest impact the deficit has is that it significantly limits our policy responses. Rightly or wrongly, the perception is that additional deficit-financed programs will be significantly more costly because of the impact that the growing deficit will have on the interest rate that we will have to pay on borrowed funds. This in turn raises the benefits that any proposed program will have to generate to overcome the additional expected cost. If the deficit were substantially smaller, the government would have more policy levers at its disposal, so the deficit is limiting policy responses to the problems in the labor market.

We are somewhat sympathetic to this view. Although it is hard, as yet, to see evidence that the U.S. debt is eroding confidence in the dollar and raising interest rates, this is a risk that cannot be ignored. Moreover, political realities—including the Republican control of the House and considerable influence in the Senate through the filibuster, as well as legal constraints on deficits in many states—may preclude anything but reductions in spending in the near future. At the same time, it appears to us that one of the biggest lessons from the last financial crisis is that governments need to be willing to expend significant resources to stabilize the economy and avoid an even more significant recession. Therefore, we hope that, even with the current deficit and debt concerns, politicians recognize the importance of this policy tool and do not create artificial limits on their ability to deal with future financial crises. Along these same lines, if we could identify a program that we were fairly certain would lead to a several-fold increase in job creation, we believe we should not let current concerns about the deficit dissuade us from adopting such a program.

Moreover, we would make two related points about current budget-cutting efforts. First, when deciding which programs to cut, lawmakers should rely on empirical evidence about the effectiveness of the programs. For example, Congress has recently focused on cutting spending on job training programs. Recent evidence shows that the average participant in the Adult Worker part of the Workforce Investment Act (WIA) program receives much larger benefits from the program than the average participant in the Dislocated Worker part of WIA (Heinrich et al., 2011). So if funding for the WIA program is going to be cut, we would argue that cuts should focus on the Dislocated Worker portion of WIA.

Second, we believe that budgetary difficulties should not stand in the way of government expenditures that are truly *investments* that will increase the capacity of the economy for future growth, and investments that deliver economic returns in this particular dimension should be exempted from budget agreements reached between the two parties at the federal and state level. (We say this while being cognizant that an oft-used rhetorical gimmick is for advocates to label their preferred spending programs as “investments” rather than as “spending.”) In line with our earlier comments, we would put human capital investment in the category of an investment as well as an example of a program with substantial empirical evidence showing that the benefits exceed the costs.

In this context, it is particularly discouraging to see funding for human capital investments decreasing to such an extent that, at least in some states, student enrollments are declining or constrained. For example, because of budget cuts, California community colleges—which provide one of the forms of education most likely to increase labor market skills (Jepsen, Troske, & Coomes, 2011)—have been forced to turn away over 100,000 students due to course reductions and enrollments are likely to fall further if the state’s budget picture does not improve (California Community Colleges Chancellor’s Office, 2011a). In addition, fees have increased, and first-time college student enrollments have declined sharply (California Community Colleges Chancellor’s Office, 2011b). Many other states have imposed similar cuts (Center on Budget and Policy Priorities, 2011).

We understand the difficulty of restricting expenditures to growth-enhancing investments, as the allocation of spending inevitably gets influenced by other factors, including pork-barrel projects guided mainly by the goals of delivering federal funds to particular districts and states (e.g., Alvarez & Saving, 1997). This is one reason why we urge lawmakers to focus on the available empirical evidence when deciding which programs to cut and which to keep. A mechanism like the approach of the Base Realignment and Closure Commission might be considered as a way of making decisions on government investments more technocratic and aimed more directly at enhancing economic efficiency.

ACKNOWLEDGMENTS

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CRISIS AND EMPLOYMENT: THE CASE OF KOREA

Dongchul Cho and Sukha Shin

Abstract

This paper examines Korea's employment dynamics and analyzes how adverse impacts could be mitigated during the recent economic crisis in comparison with the 1997 to 1998 Asian crisis. A clear lesson is that policies to mitigate adverse impacts of financial crisis on the macroeconomic level should be given priority for preserving employment. In this regard, expansionary monetary and fiscal policies to keep aggregate demand from collapsing need to be emphasized once a crisis breaks out. However, equally crucial is the maintenance of sound pre-crisis fundamentals to help keep negative impacts from proliferating, even when a crisis is triggered. In addition, flexible labor market structures and temporary employment-boosting policies appear to be necessary to reduce the negative impacts of a crisis on workers.

INTRODUCTION

As an open economy on both the financial and export fronts, Korea was one of the countries hit most directly by the global economic crisis in the fourth quarter of 2008. Immediately after the Lehman Brothers' bankruptcy filing in September 2008, both currency and stock values collapsed by more than 30 percent and foreign reserves declined by approximately 20 percent during the three months until the end of the year. Korea's export growth rate (year-on-year) also collapsed at a drastic pace, from 27.6 percent in September to −19.5 percent in November 2008.

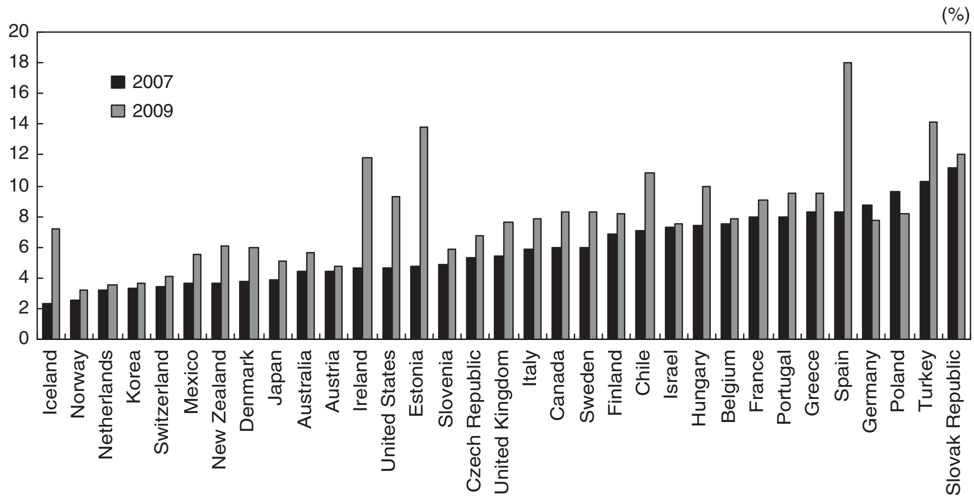
However, Korea managed to recover at a relatively strong pace in the second quarter of 2009, and its labor market was spared from the recent turmoil. Figure 1 shows that Korea, along with Norway, the Netherlands, and Switzerland, maintained one of the lowest unemployment rates among OECD countries in both 2007 and 2009.

Yet the recent solid labor market performance of Korea stands in stark contrast to its own experience during the 1997–1998 Asian economic crisis. As Figure 2 vividly shows, Korea lost more than 6 percent of the total number of jobs, and its unemployment rate soared to almost 9 percent in 1998. How did Korea survive during the recent global economic crisis while it suffered miserably during the Asian crisis? By identifying the main factors that answer this question, this paper draws policy lessons regarding employment protection during an economic crisis.

THE RECENT CRISIS IN COMPARISON WITH THE ASIAN CRISIS

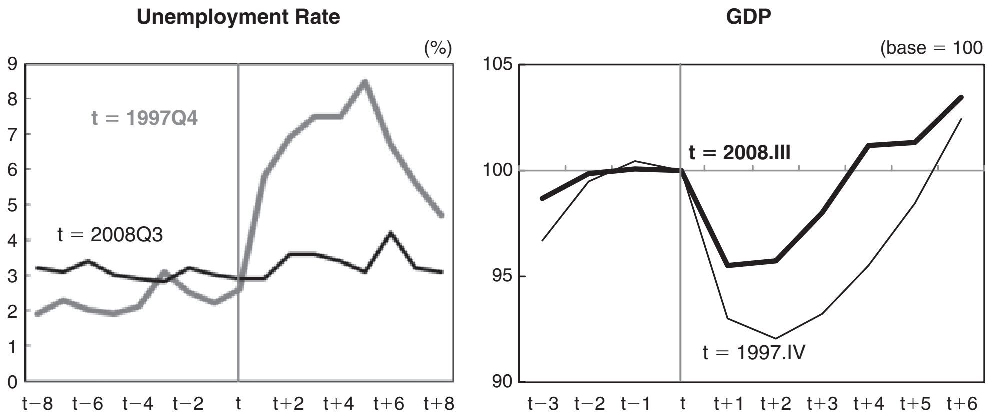
There must be various factors that can explain the difference in Korea's performance during the two crises. Cho (in press) classifies them into two categories: pre-crisis fundamentals and post-crisis macroeconomic policies.[7]

[7] See Cho (in press) for detailed discussions.



Source: OECD (n.d.).

Figure 1. Unemployment Rates of OECD Countries.



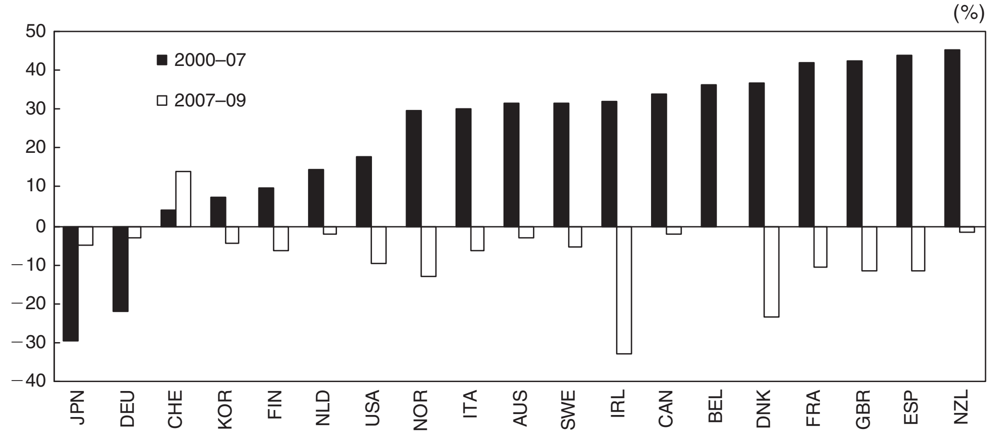
Source: Korean Statistical Information Service (n.d.).

Figure 2. Comparison to the Asian Crisis.

First, the pre-crisis fundamentals of the Korean economy had been significantly improved as a result of restructuring efforts since the Asian crisis. For example, the ample amount of foreign reserves that had been accumulated since the Asian crisis[8] played a critical role in dampening the adverse impacts of a sudden reversal in capital flows on the domestic banking system.[9] The improved financial positions of firms, particularly large corporations (or *chaebols*), were also crucial in absorbing the impacts that could have been transmitted from the banking system to the real

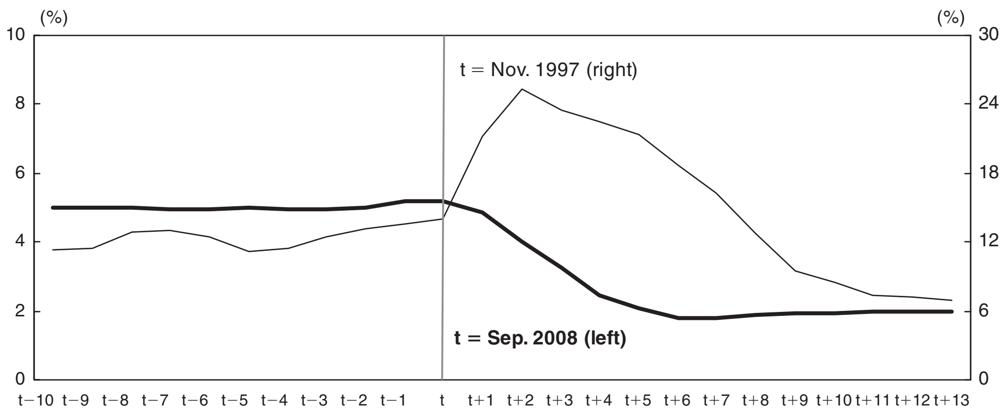
[8] For example, the ratio of reserve to short-term foreign debt increased from less than 0.5 in 1997 to almost 2 in 2008.

[9] As an emerging economy with no hard currency, Korea experienced an abrupt and massive capital outflow. The size of financial capital withdrawn on net for just the month of October 2008 was $25.5 billion (more than 3 percent of annual GDP), which was far larger than the $6.4 billion (1.2 percent of GDP) in December 1997, the worst month during the 1997–1998 crisis.



Source: OECD (n.d.).

Figure 3. Changes in House Price to Income Ratio.



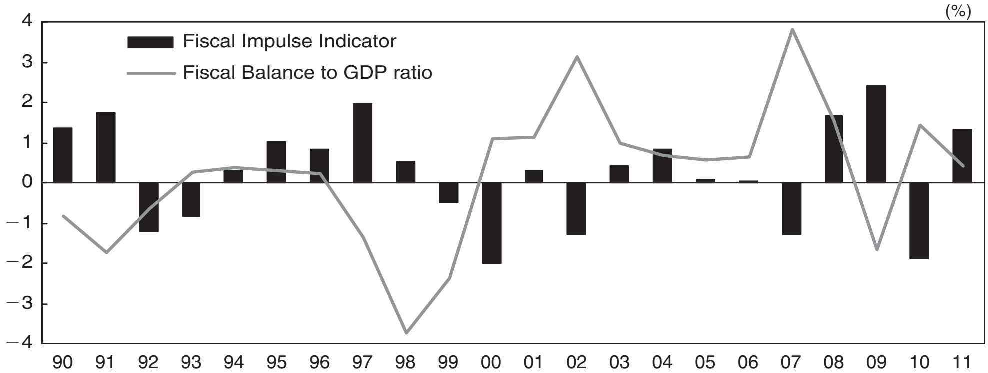
Source: Cho (in press).

Figure 4. Interbank Overnight Call Rate.

economy.[10] In addition, the milder house price hikes in Korea than those in advanced countries during the run-up to the crisis, as shown in Figure 3, must have helped keep them from collapsing, minimizing adverse transmissions of the global crisis to domestic financial markets.

Second, the post-crisis macroeconomic policy reactions were also different from those during the Asian crisis. Monetary policy was particularly different: The interest rate target was raised in December 1997 to almost 30 percent, twice the pre-crisis rate (approximately 12 percent), but it was lowered to 2.00 percent, less than half the pre-crisis rate (5.25 percent) in response to the recent crisis (see Figure 4).[11] No doubt

[10] As an example, the average debt-to-equity ratio of the corporate sector fell from over 400 percent in 1997 to around 100 percent in 2008, and the interest coverage ratio rose from barely over 100 percent in 1997 to over 500 percent in 2008.
[11] Given that foreign reserves were almost depleted in December 1997, the high interest rate policy may have been inevitable, but Korea in 2008 reserved room to maneuver on this front.



Note: Fiscal impulse is the increase in the structural budget deficit to GDP ratio from the previous year.
Source: Statistics Korea (n.d.).

Figure 5. Fiscal Impulse.

the monetary easing in 2008 was crucial in guarding the domestic economy from the external storm, whereas the monetary tightening in 1997 aggravated the domestic banking crisis.

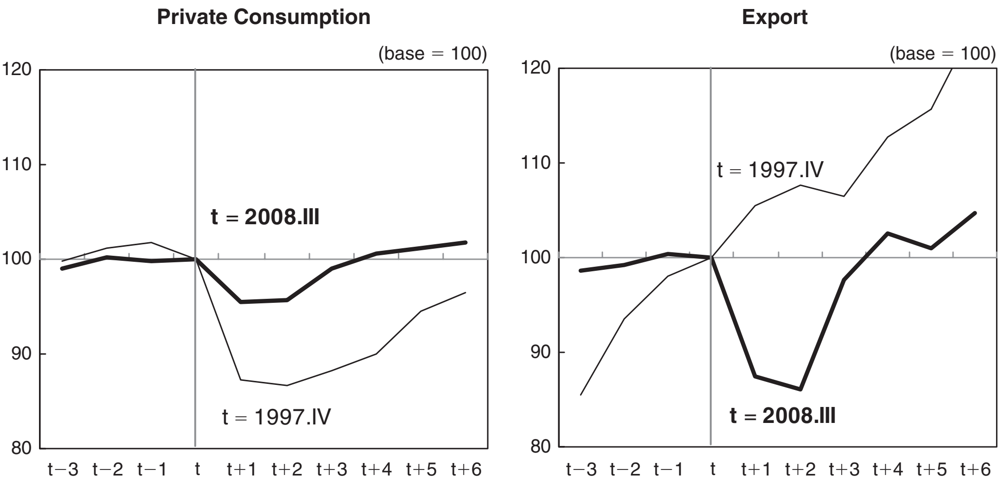
Fiscal policy was also more expansionary during the most recent crisis. Although the size of the budget deficit relative to GDP was far larger during the Asian crisis (see Figure 5), a substantial portion of the deficit was a result of the severe recession rather than discretionary fiscal expansion.[12] In addition, the budget deficit had already increased before the crisis in 1997; the fiscal impulse indicator (essentially measured by the *increase* in the budget deficit net of the portion attributable to cyclical fluctuations) turned out to be near neutral in 1998. This time, however, relatively conservative fiscal policy until 2007 provided room for fiscal stimulus in 2008 and 2009 without incurring huge deficits in absolute sizes. Based on this sound fiscal position, a supplementary budget of 10 trillion won (approximately 1 percent of GDP) was implemented in November 2008, and an additional supplementary budget of 28.4 trillion won (approximately 2.8 percent of GDP) was drawn up by March 2009. Considering time lags common to fiscal policy effects, the prompt execution of fiscal spending must have contributed to stabilizing the economy this time.

With better pre-crisis fundamentals supported by more appropriate post-crisis policy reactions, Korea was able to guard its domestic financial system (and hence domestic demand) from the external shocks and maintain relatively stable macroeconomic conditions this time. As a matter of fact, Korea was one of the few countries in which a nonperforming loan ratio was maintained at low levels.[13] This was a remarkable achievement, considering the magnitude of external shocks: Not only was the size of capital outflow far larger,[14] but export demand also collapsed this time (it kept expanding during the Asian crisis). Figure 6 contrasts the responses of domestic demand and export for the two crisis periods, based on which Cho (in press) refers to the 1997 to 1998 crisis as the *implosion* triggered by weak internal

[12] In December 1997 the IMF initially recommended that the Korean government maintain a budget balance when fiscal stimulus was most needed. Only after the severe recession was recognized in 1998 was a budget deficit allowed, and it gradually expanded as the recession deepened. See Chopra et al. (2002) for details.

[13] According to IMF's Financial Soundness Indicators (http://fsi.imf.org/), Korea maintained the second lowest nonperforming loan ratio in 2009 (next to Switzerland) among the 32 countries for which the data were available. As a reference, the ratios were 0.5 percent in Switzerland, 0.6 percent in Korea, 3.3 percent in Germany, 4.0 percent in France, 5.0 percent in the United States, and 9.4 percent in Italy.

[14] See footnote 3.



Source: Cho (in press).

Figure 6. Differences of the Recent Crisis from the Asian Crisis.

fundamentals in comparison with the *explosion* of the external financial markets during the recent global crisis.

FACTORS THAT MITIGATED ADVERSE IMPACTS ON EMPLOYMENT

Macroeconomic and Financial Conditions

Korea: Time-Series Analysis

As in other countries, employment in Korea is a function of aggregate demand. Therefore, the lower unemployment rate in 2009 (3.4 percent) compared to that in 1998 (7.0 percent) should be explained by the higher growth rate in 2009 (0.2 percent) compared to that in 1998 (−5.9 percent), or, equivalently, the smaller GDP gap in 2009 (−2.3 percent) compared to that in 1998 (−7.0 percent).[15] To investigate this point, we ran various specifications of regressions of the unemployment rate on the GDP gap for quarterly data from 1990 to 2010 and found that the coefficient was robustly estimated to be around −0.31.[16] Applying this coefficient estimate, the difference in GDP gaps between 1998 and 2009, 4.7 percent, can account for a 1.5 percent differential in the unemployment rate between the two years, which is less than a half the actual differential, 3.6 percent.[17] This result implies that the growth rate alone is not sufficient to explain employment fluctuations during crisis periods.

The discussion of the previous section suggests an additional factor that affects employment adjustments—aggregate demand composition. It has been found that most of the short-term employment fluctuations in Korea are driven by domestic demand (particularly private consumption) rather than exports, which makes sense in that export (mostly manufacturing) industries are relatively capital intensive, while domestic demand (mostly service) industries are labor intensive.[18] We explored

[15] The GDP gap was measured by a Hodrick–Prescott filtered series.
[16] See Shin and Cho (in press) for the detailed regression results.
[17] Betcherman and Islam (2001) and Fallon and Lucas (2002) studied employment adjustments of several countries during the Asian crisis and pointed out that the loss of employment of Korea was the largest among the crisis-hit countries, considering the decline in GDP.
[18] Shin and Kim (2008), for example, found that domestic demand is significantly correlated with employment, whereas export demand is not. In addition, employment elasticity with respect to production is estimated to be twice as large in the manufacturing sector as in the service sector.

this relationship by using the ratio of private consumption to GDP as a proxy for the relative importance of domestic demand in short-run fluctuations and found that the coefficient of this variable was significantly estimated to be around −0.35, while not particularly affecting the GDP gap coefficient. The result implies that the same GDP gap can have a larger impact on employment when the recession is driven by private consumption, as in 1998, than when driven by export, as in 2009. More specifically, the consumption to GDP ratio was 1.5 percent *below* its trend in 1998, but 0.8 percent *above* the trend in 2009, which can account for an additional 0.8 percent differential in the unemployment rate between the two years.

Another factor to be considered, particularly in relation to crises, is the degree of financial distress. During the Asian crisis, many overleveraged conglomerates went bankrupt under the tight financial environment and made immediate and large-scale layoffs, whereas most of the major conglomerates and banks remained financially stable during the recent crisis. As an example, the dishonored bill ratio, an indicator of financial distress, soared to a record high (0.38 percent) in 1998, while it stayed at a level likely to be seen during a tranquil time (around 0.03 percent) in 2009. We again explored the importance of this factor in a regression framework and found that financial distress (as measured by the dishonored bill ratio) can generate a significantly higher unemployment rate, after controlling for the effects of the GDP gap and demand composition.[19] With a coefficient estimate of around 2.2, an additional 0.8 percent differential in the unemployment rate between 1998 and 2009 can be attributed to the difference in the degree of financial distress.[20]

In short, the contrasting employment performances between the two crisis periods cannot be fully explained by the difference in the growth rate alone. Korea's relatively stable employment rate during the most recent crisis can be attributed to the protection of domestic demand and financial market stability, in addition to a relatively mild decline in growth.

OECD Countries: Cross-Country Analysis

We have also explored the importance of these factors—growth, demand composition, and financial distress—using cross-sectional data of 31 OECD countries. In order to control for country-specific effects, we took the differences of all the relevant variables between 2007, a pre-crisis year, and 2009, a post-crisis year. Therefore, the dependent variable of regressions measured an increase in the unemployment rate during the economic crisis in each country. As for explanatory variables, the growth rate during the same period (decreased by each country's "potential growth rate") and the increase in the consumption to GDP ratio were used.[21] Since dishonored bill ratio data do not exist for OECD countries, we used the rate of change in the house price to income ratio as a proxy for the degree of financial distress for the 19 countries (shown in Figure 3) where data were available.

In all of the regression estimates, coefficients for the growth rate and the consumption ratio appeared to be statistically significant with correct signs: The more the growth rate collapsed, the more the unemployment rate soared, and the more consumption driven the crisis was, the larger the impact on employment was observed. The regression results for the 19 countries in which the house price to income ratio data were available did not appear as reliable as those for 31 countries. Due to the smaller sample size, standard errors became larger and estimates were not robust

[19] Shin and Cho (in press) find that the dishonored bill ratio has a particularly large effect on employment during recession periods by estimating an error correction model in which an intersection term of the growth rate and the dishonored bill ratio is included.

[20] Again, the inclusion of this variable in the regressions did not greatly alter the coefficient estimates for GDP gap and the consumption ratio, −0.31 and −0.35.

[21] The average growth rate during 2000–2007 was used as the proxy for each country's potential growth rate.

to specification variations. Yet the results did suggest that the unemployment rate soared more in countries where the house price to income ratio collapsed more drastically, though the coefficient estimate was not statistically significant.

All in all, this section's framework is helpful for understanding cross-country variations of the changes in the unemployment rate during the crisis. For example, approximately 7 percent of GDP was lost (relative to their respective potential) in both Germany and the U.S. for the two years 2008 and 2009. However, the unemployment rate rather declined in Germany while it soared in the U.S. The model suggests that a consumption-driven recession accompanied by the house price collapse (or severe financial crunch) in the U.S. amplified the impacts on employment.

Labor Market Structure

The main determinants of aggregate employment during crisis periods seem to be the macroeconomic and financial environment rather than micro labor market structures. Yet some structural issues deserve to be mentioned. Shin and Cho (in press) argue that there was approximately 2 percent "over-employment" in the aggregate before the Asian crisis, while no such evidence was found before the recent crisis.[22] We interpret this result as evidence of labor market rigidity before the Asian crisis, and contend that even more drastic employment restructuring was triggered upon the introduction of emergency layoff measures in 1998 than would otherwise have taken place.[23]

Changes in employment structures also support this view. In 1998 employment restructuring was concentrated mainly on core workers, namely, permanent wage-income workers: More than 85 percent of job losses fell on wage-income workers, out of which two-thirds fell on permanent workers. Even in 1999, when the economy strongly rebounded with 10.7 percent economic growth, firms continued to lay off permanent wage-income workers and responded to the rapid recovery by hiring temporary workers only.[24] In 2009, however, the number of permanent wage-income workers increased, while non–wage-income and temporary workers lost jobs. This contrasting performance in 2009, which has benefited from the increased flexibility in the labor market structures since the Asian crisis, contributed to mitigating the impacts of the global crisis by protecting core workers such as household heads.

Policies Directly Aiming at Employment Boosting

In addition to macroeconomic and financial policies, the Korean government implemented various policies to support employment during the crisis. The major areas of emphasis were (1) increasing short-term public work programs, (2) expanding social services, and (3) subsidizing internship programs for young workers. According to the *2010 White-Book on Jobs* (Ministry of Employment, 2011), the government supported 1.2 percent of total employment by these policies. A somewhat smaller yet comparable magnitude of increase in employment can also be detected from employment statistics by sectors: The number of workers employed by the public sector increased by approximately 0.8 percent of the total employment in 2009.

[22] They measure overemployment as the deviation from the co-integrating relationship between employment and GDP.

[23] Permanent employment was the norm in Korea for a long time, which was regarded as a serious obstacle to prompt restructuring. In order to cope with the crisis, however, the Korean government implemented emergency layoff measures in 1998.

[24] In 1999 the number of temporary wage-income workers increased by 13.3 percent, but the number of permanent wage-income workers declined by 6.1 percent.

Compared with the Asian crisis, however, the recent policy menu produced similar magnitudes of effects: Approximately 1 percent of total employment was supported by government policies in 1999, as well. In this regard, it may be difficult to argue that these policies were great contributors to the solid employment performance this time *relative* to that during the Asian crisis. Nevertheless, it was of a sufficient size to relieve the burden of workers at the margin, though the jobs created or maintained by government support were generally low-wage work.

Also interesting was its timing: In both periods, employment in the public sector began to rise immediately following the second and third quarters after the crisis broke, and became normalized as the economy recovered in two years. Considering the notorious time lags in implementing fiscal policies in general, the two- to three-quarter lag in the case of Korea does not seem inadequate until the actual employment statistics began to change. It is also appreciable that such policies faded out in one to two years as the economy recovered, not imposing persistent burdens on the fiscal side.[25]

SUMMARY AND CONCLUDING REMARKS

This paper examined Korea's employment dynamics and compared how adverse impacts were mitigated during the 1997–1998 Asian crisis and the most recent crisis. A clear lesson from the Korean experience is that unemployment problems during crisis periods cannot be solved by looking at the labor market alone. They are functions of macroeconomic fluctuations, particularly financial market situations that affect firm bankruptcies and large-scale layoffs. Policies to mitigate adverse impacts on financial markets should, therefore, be given priority over preserving employment. In this regard, expansionary monetary and fiscal policies to keep aggregate demand from collapsing need to be emphasized once a crisis breaks out. However, equally crucial is the maintenance of sound fundamentals during tranquil periods to not only lower the probability of crisis, but also help keep negative impacts from proliferating when a crisis happens to be triggered. In addition, sound internal fundamentals can help stabilize domestic demand, which appears to be more important for employment than export demand.

Labor market structures also appear to affect the sensitivity of employment adjustment in response to a crisis. As we witnessed in Korea during the Asian crisis, for example, rigidly accumulated workers may become vulnerably exposed to drastic restructuring during an economic crisis. Finally, temporary policies directly aimed at boosting employment appear to have been effective in relieving the burden of workers at the margin.

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POLICY RESPONSES TO THE RECENT POOR PERFORMANCE OF THE U.S. LABOR MARKET

Robert Haveman, Carolyn Heinrich, and Timothy Smeeding

THE U.S. LABOR MARKET CRISIS

Since the onset of the Great Recession, the U.S. labor market has been reeling. Public concern has largely focused on the unemployment rate, which rose to double digits and has since been stalled at just over 9 percent. This rate is unacceptably high, and macroeconomic policy efforts have been unsuccessful in bringing it down.

The overall unemployment rate, however, masks more fundamental and troublesome developments. Perhaps the most serious is the precarious situation of working-age men with modest education and few job skills, who increasingly find themselves unemployed, underemployed, or out of the labor force. These workers are some of the nation's most vulnerable. Some are older, some younger, but they have in common limited schooling and deficient basic skills. They are also disproportionately racial minorities or foreign-born.

Indeed, 20 percent of American men in the prime working age (25–54) group are not working (compared to less than 5 percent in the 1950s), and 35 percent of those without a high school diploma are out of the labor force. Among low-income young men, particularly minorities, the jobless rate is shockingly high: Over 40 percent of black teens and over 30 percent of young black men ages 16–24 are unemployed, and this doesn't count those who have given up on finding work (Leonhardt, 2011; McLaughlin, Trubskyy, & Sum, 2011).

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Some of the unemployed, mainly those who are older and who had long work histories before extended unemployment, have become recipients of Social Security Disability Insurance (SSDI) benefits. While 5 million Americans collected federal disability benefits a decade ago, there are now over 8.2 million recipients. The record extension of unemployment insurance (UI) benefits has also protected most of the experienced unemployed from severe hardship. For those who do not qualify for UI or SSDI, lives have been disrupted, with serious implications for physical and mental health and family well-being. Even for those who qualify, future benefits are uncertain.

Underlying these developments is the direction of technological change and workplace organization, with less-skilled workers being replaced by machines and more-skilled workers to run and repair the machines. More open international borders have led to the substitution of lower-paid foreign workers for U.S. workers with modest education but few skills[26] (Autor, Dorn, & Hanson, 2011). The outcome of these trends will determine job and career prospects, especially for men with little formal education (Goldin & Katz, 2008).

Many in lower-paying jobs have taken pay cuts and see few career possibilities and stingy nonwage benefits. Indeed, the fast-growing personal service sector (e.g., retail sales, cashier, and customer service) now accounts for more than 20 percent of jobs, with a large majority paying wages under $15 per hour (Damme, 2011). The traditional manufacturing/construction path from high school to the middle class has now largely dried up for younger workers[27] (Autor, 2010; Glaeser, 2010).

Wage gaps between higher- and lower-skilled workers have increased, due to falling demand for modest-skill workers and the failure of the nation's higher education system to generate the more highly educated and skilled workers needed for the growing high-skill sector. Many young men (under age 30 with a high school diploma or less), 70 percent of whom are fathers and most not living with their children, are in this situation. Others have abandoned the formal workforce and cope with declining economic fortunes in ad hoc and often unproductive ways (Smeeding, Garfinkel, & Mincy, 2011). And the social support system is designed primarily to help those working in low-paying jobs and living with children—not absent fathers (Berlin, 2011). Long-term unemployment for young workers has also created permanent labor market scars that will negatively affect their future earnings growth (von Wachter, 2010; Bell & Blanchflower, 2011).

This deep labor market polarization problem reflects two developments. The first is an increase in high-skill, high-wage jobs (and, to a smaller extent, low-wage, low-skill jobs), which has reduced relative opportunities for workers with some schooling but few technical skills who in prior years held routine-task production and clerical middle-wage jobs (Autor, 2010). The second is a flat high school graduation rate and poor college graduation rates—particularly among men.

WHAT CAN POLICY DO?

Macroeconomic Policy Measures[28]

Some combination of fiscal stimulation and monetary easing are two main tools in the kit that both economists and policymakers bring to the table in circumstances

[26] Autor, Dorn, and Hanson (2011) find that China accounts for 40 percent of the loss in manufacturing employment, with spillover effects on labor force participation rates. According to the U.S. Department of Commerce, since 2000, multinational companies added 2.4 million jobs in foreign countries and cut 2.9 million jobs in the United States (Wiseman, 2011). While corporate profits are high, firms are reluctant to hire or invest so long as consumer sentiment is low and public sector demand uncertain.

[27] A variety of constraints on labor market flexibility also contributes to this situation. Such constraints involve prevailing wage standards (including minimum wages), union wage contracts, and the fringe benefits and payroll taxes that businesses are required to pay for every standard worker. Because of these arrangements, employers tend to find hiring low-skilled workers an unprofitable proposition.

[28] Our discussion draws from Romer (2011) and Appelbaum (2011).

like these. Unfortunately, neither of these options currently offers much potential. The U.S. Federal Reserve has unleashed much of its stimulus arsenal, including U.S. Treasury bond buybacks, and has driven interest rates to unprecedentedly low levels. There is little interest in fiscal stimulation, given the current budget situation. Neither cuts in public spending nor increases in taxes will offer the sort of stimulation necessary to improve the U.S. labor market. Both approaches reduce demand for goods, services, and workers.

Assuming that the ultimate outcome will be some combination of spending cuts and tax increases, while still disputed, most economists support the view that tax increases do less damage to employment demand than do spending cuts.[29] The basic reason for this result is that a tax increase is likely to lead to some reduction in savings, especially increases imposed on higher-income households. However, when government cuts spending, overall demand also falls by about the same amount. And when government transfer payments are cut, the reduction tends to fall on lower-income families, who don't save much to begin with—the bulk of the income reduction shows up as a cut in spending.

Work and investment incentives also play a role in this debate. While some point to the reduction in the rewards for working and saving that accompany higher marginal income tax rates for the rich, the most recent evidence suggests that these effects are small. For example, raising current tax rates by 10 percent is estimated to reduce reported income due to reduced work and entrepreneurship by about 2 percent (Saez, Slemrod, & Giertz, 2011). Similarly, spending cuts might also have a longer-run effect as cuts in public spending for infrastructure investment, education, or science could negatively impact employment and economic growth.

None of these considerations blunt the fact that no matter how fiscal tightening is pursued, it is difficult to see any boost in jobs coming from this source, and it certainly does not provide a major contribution to solving the underlying problem confronting the large pool of low-skilled, low-educated unemployed workers, particularly men. Addressing this problem will require more creative, targeted measures.

European and U.S. Responses to Economic Downturns and Joblessness

Clearly, the menu of possible policies designed to improve imbalances and address the labor market polarization problem is much larger than that which the United States is currently pursuing. Here we mention the most prominent of these, drawing from both past U.S. experience and measures undertaken in other countries.

Western European countries have been the most creative and persistent in implementing active labor market policies designed to stimulate new jobs and maintain current ones. In attempting to learn from their efforts, we begin by asking what these countries have done in the past, have since abandoned, and are doing now that we might emulate.

It is now generally agreed that the 1980s policies designed to move older workers into retirement at earlier ages and to open up jobs for younger workers were not successful. While expanded early retirement options were successful in encouraging older workers to leave the workforce, they did not translate into more jobs for youth. Large unfunded public pension and disability programs emerged due to earlier retirement. Indeed, rapidly growing disability rolls have led several countries to tighten eligibility and to stabilize the rolls (Banks et al., 2009). Early retirement programs have been curtailed and social retirement pension generosity has

[29] This debate is complex, as some studies have shown that observed tax increases are often correlated with other changes that are occurring in the economy. For example, the tax increase may occur while the economy is overheating, making it seem like the increase had little effect on the observed GDP growth rate. To reason from these linked situations can give a misleading impression of both spending and tax changes.

decreased. Because U.S. benefit levels are already modest by European standards, the main lesson is the need to reign in growth in the SSDI program (Milligan & Wise, 2011).

While European Union (EU) states have tended to share the pain of recessions more equitably than the United States, today the management of monetary policy by the European Central Bank—along with the poor enforcement of deficit limits—has made it difficult for these nations to bring the standard monetary/fiscal tools to bear on labor market problems. Instead, these nations have adopted other approaches to address these issues.

Indeed, while many EU nations have suffered the same as or greater decline than than has the U.S. in GDP during the Great Recession, some of them—especially Germany and Belgium—have been much more successful in maintaining employment (OECD, 2010, Figure 1.2, p. 23). Many others have suffered the same younger under-skilled worker job loss as the United States. (Bell & Blanchflower, 2011).

The most successful EU states have employed an armada of programs during the recession, including government supported programs involving job sharing and short-time work (*Kurzarbeit*) to encourage employers to reduce hours rather than lay off workers.[30] Evidence suggests that encouraging reduced hours could have a significant effect on employment in the United States as well (Boushey, 2011).[31] Additionally, "working time accounts" have been used in Germany to avoid overtime payments to workers whose total working hours were at or below average for the firm, again protecting older and more advantaged workers (Burda & Hunt, 2011). Almost none of these strategies have been tried in the United States.

Training, Retraining, and Job Search

Europeans also have strong programs for worker (re)training, coupled with job search assistance, more commonly known as Active Labor Market Policies (ALMPs). The most well-known of these are the Danish "flex-security" labor market policies that combine flexible employment standards designed to make hiring and firing easier, depending on production, with effective retraining institutions and generous (but time-limited) income support programs. Other EU countries have maintained or even expanded core job search assistance and have also sought to provide more targeted reemployment services, including training opportunities, for the most hard-to-place unemployed (Banks et al., 2005).

In the United States, employers rather than the public sector account for the lion's share of spending on formal workplace training—including activities such as on-the-job training (OJT), customized training, work-based learning, and tuition assistance. Expenditures on these private-sector programs exceeded $109 billion in 2005 (at a time when the federal government was spending about $5 billion on public workforce development programs). A drawback is that employer-based training efforts disproportionately go to better-educated and skilled workers and exclude the unemployed and low-skilled. The U.S. also spends far less on workforce development

[30] Job sharing refers to public subsidies to private employers to maintain employment or to designate some working time be devoted to the public sector, even when the employment contract was with a private employer. These schemes, agreed upon by the industrial and trade unions, employers, and the public sector, were born in the 1970s and 1980s when the steel industry in Alsace-Lorraine was shedding jobs. The public sector avoided payment of unemployment compensation and other benefits, workers kept their jobs (albeit at reduced pay), and employers maintained stocks of skilled employees when demand turned up again. These schemes are most effective for traditional employees with strong union and collective bargaining contacts.

[31] About 20 states have adopted a U.S. version of a "short-time compensation" or "work-sharing" program within their UI system by allowing workers to receive partial benefits from UI if their hours have been reduced.

compared to many of its international counterparts: In 2005, U.S. labor market policy expenditures were approximately 0.4 percent of GDP, with countries such as Germany, the Netherlands, and Denmark outspending the United States by as much as ten times this level (OECD, 2011).

The American Recovery and Reinvestment Act (ARRA) of 2009 allocated approximately $2 billion to expand the federal Workforce Investment Act (WIA) adult training activities, with the objective of raising individual skill levels and improving job seekers' employment prospects. Research suggests that the timing of extra public dollars for training could not be better, as the opportunity costs—or "lock-in" effects—of training are likely to be lower at a time when unemployment rates are high and employment opportunities are poorer. The latest evaluation evidence also indicates that these extra dollars would best be directed toward programs serving disadvantaged adults, which are considerably more effective than the WIA and Trade Adjustment Assistance programs serving dislocated workers. A recent nonexperimental evaluation of WIA programs found the average increment in earnings for adult women (associated with receipt of training) to be 26 percent of their average earnings, with the impact for adult men around 15 percent of average earnings (Heinrich, Mueser, & Troske, 2008). This same study found no evidence that WIA dislocated worker training programs produce benefits.

U.S. research that examines training outcomes over a longer follow-up period supports strategies that combine skills acquisition (particularly through customized community and technical college training programs) with job search efforts that encourage participants to be selective in job entry, with average increases in participant earnings on the order of 20 to 25 percent over five years (King & Heinrich, 2010). While youth training programs have been much maligned as generating low returns, a recent review of the evidence base points to some promising strategies that combine academic and work-oriented activities and promote more intensive youth engagement in these programs (Heinrich & Holzer, 2011). The Career Academies program, for example, organizes youth into small, intensive learning communities that blend academic, career, and technical curricula and establishes partnerships with local employers to provide career awareness and work-based learning opportunities for at-risk students. An eight-year experimental evaluation of Career Academies showed significant reductions in high school dropouts and higher monthly earnings, months worked, hours worked per week, and hourly wages than control youth.

Currently, the reauthorization of WIA is long overdue, and the program faces long odds of avoiding deep, proposed funding reductions. In the past, programs serving disadvantaged adults have typically received about half of the funding allocated for dislocated worker programs. These services benefit persons who, as measured by their unemployment rates, are in most dire need of them—primarily the young, low-skilled men and women who are very loosely attached if not already disconnected from the labor force—and who have been most dramatically affected by the recent deep recession as well. For these low-skilled older youth and adults, federal training programs should be maintained, as they will play a key role in linking them with opportunities to increase their education and skills, and, ultimately, their employment and earnings as the U.S. economy recovers.

Unemployment Insurance

Unemployment Insurance (UI) and serial extensions of support have been used in many nations as the bellwether tool to support incomes when experienced workers are unemployed. However, economists have also long recognized the importance of work disincentives and benefit dependence that inhere in these programs. EU nations often require job search, mandatory ALMPs, or income-tested benefits after unemployment benefits have exceeded a certain period, for example, one year

(OECD, 2007). In the U.S., serial extensions of UI in response to the Great Recession have reached up to and beyond two years, though at relatively low benefit rates. These benefits have mainly gone to older, more established workers, while younger workers, with limited work histories, often don't qualify for unemployment insurance at all. While workers ages 16 to 29 accounted for almost 40 percent of the unemployed in 2009, they constituted only 20 percent of all unemployment insurance recipients. Of all the unemployed in this age group, only a third received UI benefits (Smeeding, Garfinkel, & Mincy, 2011).

"In-Work Benefits"

A more targeted set of programs aimed at low-income working families who do find some work but not enough to ensure self-sufficiency are called "in-work benefit schemes." Such programs are employed in many nations to increase effective pay when wages are low (Immervol & Pearson, 2009). These schemes have been shown to bolster earned income and increase work time in many nations (e.g., Canada, the Netherlands, United Kingdom, Ireland, and France, among others). The U.S. in-work benefit scheme—the Earned Income Tax Credit (EITC)—currently is budgeted at $76 billion (CBO, 2011) and is effective in raising earnings. While the EITC has been shown to be a highly effective antipoverty device (Sherman, 2011), support is not available to single men who are fathers and pay child support, because the children typically reside with the mother.

Employment Subsidies

Using the tax transfer policy to stimulate jobs for lower-skilled workers is not a new idea in Europe or in the United States (Bishop & Haveman, 1979; Haveman, 1996). Most advanced countries have attempted a variety of such measures, with varying degrees of success. For instance, reductions in social security contributions and scaling-up of hiring subsidies are two such tools (OECD, 2010). Most of the successful measures are targeted at workers characterized by low levels of skill and education and who face relatively bleak labor market opportunities, including minorities, youth, older workers, disabled workers, and single mothers. So far, targeted and marginal employment subsidies seem to have worked better than general payroll tax cuts and employment subsides for workers who lost jobs in the Great Recession (OECD, 2010).

The U.S. policy to reduce employee payroll taxes by 2 percentage points in 2011 is not particularly well targeted in terms of raising consumption, and it is ineffective in raising employment because employers do not get the same 2 percentage point reduction in their payroll taxes. Based on European experiences, an employment subsidy policy targeted at the first $25,000 in wages only for employers, or a policy offering a larger subsidy for added (marginal) employment only, seem to be better policy choices for expanding employment. These measures effectively alter the terms on which lower-skilled workers are hired; they make hiring low-skilled workers a more profitable and attractive proposition than it is now. They are designed to offset constraints on labor demand from market rigidities and to counter those trade and technological forces working against the employment of less-skilled workers. They intend to increase the returns to employers from the work that they do, and in the process lower business costs while increasing output.[32]

[32] An employer-based marginal employment subsidy would provide financial incentives to employers who hire low-skilled workers over and above the numbers they would otherwise hire. Such a subsidy would affect the decisions of firms regarding both the number of workers to hire and the composition of those new hires. The New Jobs Tax Credit that was in place in the United States during the late 1970s is an example of such a program. Evaluations of this program concluded that it was a potent and cost-effective measure to increase employment of low-skilled workers.

SUMMARY

The U.S. response to the Great Recession has been tepid, modest, and untargeted compared to EU nations (Aizenman & Pasricha, 2011). Macroeconomic policy is currently at an impasse as fears of greater deficit spending collide with proposed efforts to increase spending on job creation programs. Many of the programs and policies being effectively implemented in Europe are not being pursued in the United States.

On the microeconomic frontier, the response has been very uneven. Most older, middle-aged, and more established unemployed workers have been supported through extended unemployment, and many will end up on the Disability Insurance rolls, where new policies and procedures to encourage work have yet to be instituted (Autor & Duggan, 2006, 2010). All those with jobs benefited from gross payroll tax reductions; those without jobs have been largely neglected. Younger workers who are not eligible for UI and cannot find jobs are at greatest risk. They are falling further behind as we hopefully turn the corner of the recession.

Income support programs like SNAP, UI, and EITC have helped to mitigate the effect of the recession on those who qualify, but they have not generated jobs, especially not for those most affected by the recession (Sherman, 2011). As income support efforts from the 2009 ARRA and the 2010 Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act are bound to be curtailed by deficit reduction efforts, income support programs will be less able to forestall low income and poverty. More jobs that pay a decent wage are needed and in short order (Smeeding et al., in press; Burkhauser & Larrimore, 2011).

Additional education and training of the more general kind—for example, increasing four-year college graduation rates—will take a long time to bear fruit. There is more hope for shorter-term vocational training programs, especially in growing personal service sector jobs, but again the effort is relatively feeble (Carnevale, Smith, & Strohl, 2010).

What can be done now? Some marginally employed and nonemployed workers are now actively involved in formal and informal training programs that will impart some job-relevant skills, and more could be encouraged to do the same. An important difference between the publicly supported programs that we know work (e.g., Career Academies) and current efforts is a lack of involvement by employers. Almost all European short-time work plans involve employer–government interactions to preserve jobs, but such cooperation is difficult to achieve in the United States, where the labor movement and "organized" labor are increasingly weak institutions. Still, it is crucially important that employers play a role in offering training opportunities to ensure they lead to decent jobs with chances for advancement, especially for young, low-skill men and women. It appears that there is room for employers to invest more in these workers, too. Since the trough of the recession, more than 85 percent of the growth in national income through the first quarter of 2011 has gone to profits and capital incomes (Sum et al., 2011).

Supply-side and demand-side approaches are designed to improve the employment prospects of disadvantaged workers by generating ongoing job creation pressures at reasonable cost. By targeting the additional employment on segments of the labor market with the most severe unemployment problems, they promise to increase employment and output without significant inflationary pressure. Measures such as these directly alter the wage structure in private labor markets, raising the take-home pay of low-skilled workers relative to those with more secure positions in the labor market. Their potential is to reduce inequality in employment and earnings in a way that encourages independence, work, and initiative. Clearly, they would do more to ameliorate employment and earnings disparities than recent stimulus-oriented proposals for job creation, such as revenue sharing with state governments or additional infrastructure spending, which might help some stay employed or increase employment among select groups (e.g., seasoned construction workers), but would do little for the many who are currently not working.

An important factor inhibiting policies that share the pain of the Great Recession is the weakness of labor as a political and economic force in the United States. While labor parties and wage-setting institutions play a prominent role in Europe, organized labor is a weak political and economic force in the United States. Unionization is at an all-time low and even long-tenured, mainly unionized, public sector employees have lost more than 600,000 jobs since the beginning of the recession. The reasons for this decline in labor power are long and complex, but any reckoning of the U.S. labor market must grapple with this reality (Levy & Temin, 2010; Levy & Kochan, 2011).

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A STRATEGIC AND INTEGRATED LABOR MARKET APPROACH: ESSENTIAL TO OVERCOME THE CRISIS AND TO ASSIST STRUCTURAL ADJUSTMENT

Sigried Caspar, Ines Hartwig, and Barbara Moench

Comparing the papers on the Korean and the U.S. situations leads to interesting conclusions. Cho and Shin argue that the recent crisis did not create huge problems in the labor market because Korea was firstly in a fundamentally sound economic situation and secondly took adequate anti-crisis measures, in particular by stabilizing internal demand. This allowed Korea to "get through" the crisis without major cuts in employment or GDP. This was not the case in the U.S., as the Neumark and Troske paper points out. Taking into account that the American housing market was at the heart of the crisis, it is obvious that the U.S. could not deal with the crisis as an external phenomenon. In that sense, the papers point to the conclusion that it might be more adequate to compare the impact of the Asian crisis in 1997 to 1998 on Korea with the impact of the recent crisis on the U.S. In both cases, the countries faced significant national structural problems when they were hit by the crises. This corresponds to the experience in the EU during the recent crises.

Those countries that overall were rather competitive and where the burst of the internet bubble in the early 2000s had lead to a consolidation and structural reforms performed rather well. In contrast, the global crisis hit the national economy much more severely in those countries where the economy had grown very fast for several years or where significant structural imbalance persisted.

The structural importance of investment in human capital is highlighted in the papers from Haveman, Heinrich, and Smeeding and from Neumark and Troske. The relevance of investments in training, in particular for groups disadvantaged in the labor market, goes beyond an immediate response to the crises. In fact, Korea, as Cho and Shin point out, has been able to cushion the most severe effects of the crises because of its prior long-term investment in human capital in response to the first crises in 1997 to 1998.

The EU's main financial instrument for investing in human capital is the European Social Fund (ESF) put in place with the treaties establishing the European Economic Community back in 1957.[33] The ESF is devoted to promoting sustainable employment in the EU. It helps Member States make Europe's workforce and companies better equipped to face new, global challenges. Over the period from 2007 to 2013, some 75 billion Euro—which corresponds to about 10% of the EU budget—will be distributed to the EU Member States and regions, in particular to those where economic development is less advanced. The ESF aims at giving EU citizens better skills and better job prospects. Annually about 10 million people are involved in ESF activities. Although the ESF does not limit its activities to the unemployed, contrasting the number of individuals it assists with the 22 million unemployed in Europe reveals its relative importance as a means to support active labor market policy. It is estimated that on average roughly half of those people who were unemployed when signing up for ESF support find work within 12 months of participating in the program.

Looking at individual groups within the workforce, all papers point to the difficult situation of young people during and after the crises. Youth unemployment is also a major cause for concern across EU Member States. The rate has increased from 14.7 percent in 2008 to 20.4 percent in early 2011. At the same time, many young people are failing to fulfill their educational potential or obtain the skills employers need. One in seven young people drops out of secondary education, and one in four has poor reading ability. Less than one in three young Europeans has a university degree, compared with, for example, 50% of Japanese. Therefore, young people constitute a major target group of ESF support. Almost one-third of people benefiting from ESF support are younger than 25.

In practice the ESF works alongside national and regional active labor market and training instruments. Given its high flexibility in implementation and its integration into national or regional strategies, awareness of European citizens about this instrument is widespread, and when people know about the ESF they support its policy goals. Many Europeans would even like the European level to take a stronger stance in labor market and social policy issues.[34]

Another obvious important conclusion from reading the Neumark & Troske article in particular is that each instrument comes along with pros and cons. Their suggestion to support the creation of employment directly instead of through expenditure programs with only moderate employment effects is intriguing. EU experience suggests that the choice between the two requires two aspects to be taken into account: On the one hand supporting the recruitment of workers irrespective of whether they

[33] Information on the ESF is available at http://ec.europa.eu/esf/home.jsp?langId=en.

[34] A recent survey found that 63 percent of the survey participants want the EU to address unemployment as a priority, and 42 percent consider poverty as the second EU priority. As for concentrating the EU funds, 56 percent see job creation as the priority area for the investment of EU resources (European Commission, 2010).

are disadvantaged in the labor market makes the job search for the disadvantaged groups even more difficult. If done for a longer period of time, hiring credits often come along with a revolving door effect and high windfall profits to enterprises. Thus, they are seen as an instrument whose use is warranted only in well-specified situations. On the other hand, expenditure programs have other benefits in addition to creating jobs. When organized carefully they can—in addition to boosting immediate demand—also help to improve an economy's overall competitiveness and sustainability. So, in the EU these programs are largely considered investment programs contributing to modern public infrastructure. Thereby they also target rather labor-intensive sectors, like the construction sector, and they strengthen sectors that are considered of strategic importance. Therefore in addition to the immediate effects on the demand side, expenditure programs also have a longer-term structural effect on the economy and society as a whole. With such complex and interlinked benefits, it is obvious that an evaluation of the wide-ranging impacts of expenditure programs would be very difficult if not simply impossible.

In summary, the reaction to the crises and its immediate aftermath clearly calls for a mix of methods and tools, and for integrated programs with a reasonable mid- to long-term perspective. This is not always easy to ask for given the rather short timespan during which political initiatives are expected to deliver results.

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LESSONS FROM OTHER COUNTRIES, AND RETHINKING (SLIGHTLY) UNEMPLOYMENT INSURANCE AS SOCIAL INSURANCE AGAINST THE GREAT RECESSION

David Neumark and Kenneth Troske

LESSONS FROM OTHER COUNTRIES

Caspar, Hartwig, and Moench do little to convince us that they have identified policy prescriptions that might usefully be applied to the United States. They suggest that in countries with high shares of temporary contract workers, employment reductions were sharper (because they could be). But do we really think that an inability to lay off workers is a good labor market policy? Clearly there are costs to such rigidities, and elsewhere in their essay Caspar, Hartwig, and Moench argue for more mobility!

Caspar, Hartwig, and Moench also suggest that early in a downturn, short-time work arrangements can mitigate employment reductions, but they also suggest that in the longer run these arrangements can slow down necessary adjustments, so it is unclear whether these programs are beneficial. Brusentsev and Vroman (2011) study U.S. states that allow for short-time compensation under their unemployment insurance (UI) systems. They find that the usage of short-time UI goes up quickly when the unemployment rate rises, but then subsequently declines, consistent with short-term adjustments taking the form of hours reductions when workers can collect benefits in the face of hours reductions. Nonetheless, a number of issues remain unanswered. We would like to see evidence on whether these programs reduced the disemployment effects of the Great Recession in the short run, and even if they did, what their longer-run effects were. Short-time UI could make things *worse* in the longer run, increasing the time it takes workers to find new, more productive matches after a recession. Moreover, at this point we do not see scope for short-time UI benefits to help with recovery from the Great Recession; rather, at best, it is potentially a proactive policy to consider with respect to limiting the impact of future recessions. (These criticisms of the evidence apply also to the discussion of short-time UI benefits in the Haveman, Heinrich, and Smeeding essay.)

Perhaps slightly more promising, Caspar, Hartwig, and Moench's CGE model results—although it is hard to say what underlies them—suggest that job subsidies can more effectively create employment gains if targeted on the young. Given the limited information provided, we can only speculate as to why, but this may be in part because the subsidies offset minimum wages, in which case we might ask whether it makes more sense, especially for governments in a fiscal bind, to simply reduce minimum wages. On the other hand, there may be more uncertainty with hiring young workers, so firms may be particularly reluctant to hire without the subsidy. Another reason to target hiring credits at the young is if we think that there are particularly high costs to their leaving school and being unable to find jobs (or, conversely, high benefits to rapid integration into the workforce after leaving school). Of course, it is important to assess whether, in fact, disemployment costs are higher for youths.

One general concern we have about many of the conclusions drawn in both essays is the lack of discussion of the costs and benefits of the proposed programs. As we pointed out in our essay, many of the U.S. efforts to create jobs were very costly and appear to have had only a limited impact on job creation. Even in situations where an economy is on good financial footing, it is still important to identify programs that have lower costs relative to the expected number of jobs created (or saved).

One implication of both essays on the experiences of other countries, but particularly from Cho and Shin's, is that countries in good fiscal shape prior to the Great Recession fared best. This is consistent with the point we made. Countries with relatively low baseline debt-to-income ratios had greater flexibility to spend more to alleviate some of the labor market effects of the recession. In the United States, the increase in the federal deficit *prior to* 2007 is forcing politicians to focus on the growing deficit and debt rather than additional economic stimulus. While we recognize the incentives that lead politicians to have high rates of discount, we believe a central lesson from our recent economic history is that an additional cost of deficit spending during periods of economic expansion is the limits it places on efforts to address problems during subsequent economic crises.

OTHER IDEAS FOR A U.S. RESPONSE

Turning to the essay by Haveman, Heinrich, and Smeeding, we are sympathetic to the view that school-to-work programs like Career Academies have the potential to increase labor market attachment of the relatively less advantaged. We refer the reader to Neumark (2007) and the August 2006 special issue of the *Economics of Education Review* for a more comprehensive assessment of school-to-work programs and other types of career-focused education, including at the community college level. But we think the authors overstate the evidence on Career Academies. As shown in Kemple (2005), the group randomized *out* of assignment to the Academies did far better than reasonable comparison samples, and only a little worse than the treatment group, raising serious questions about the external validity of these results.

The authors are not very explicit regarding proposed policies, so we will take mention of them as at least tacit support. One idea is to expand the Earned Income Tax

Credit (EITC) for single men without children (or with whom children do not reside). We are wary of this proposal for two reasons. First, in the short run it seems unlikely that labor supply subsidies could have much impact on aggregate employment, because the problem we now face is almost surely deficient aggregate demand; increasing incentives for labor supply may be "pushing on a string" (Neumark, 2011). Second, as Rothstein (2008), Leigh (2010), and Neumark and Wascher (2011) show, the employment-enhancing effects of the EITC increase competition with those already in the labor market. Thus, if more single men enter the labor market because of an expanded EITC for them, we should expect some wage and employment declines for the current "target" population of single mothers with children.

The authors also suggest that a stronger union sector would enable the enactment of policies that "share the pain of the Great Recession," but they offer no evidence. While this may be justifiable speculation based on cross-country comparisons, many factors vary across countries. We would not rule out the possibility that a strong union sector would have resulted in shifting more of the pain of the Great Recession to the nonunion sector, rather than greater "sharing." Perhaps in European countries with large and highly centralized unions this perspective is less plausible.

On the other hand, we find intriguing the authors' point that UI extensions do next to nothing for new labor market entrants who have experienced difficulty finding jobs for what is now a very extended period. If UI is viewed as social insurance against economic downturns, then in normal recessions the key group that needs help smoothing consumption may be those already employed. In the current prolonged and deep recession, however, the same insurance motivations may well extend to the young as insurance against prolonged periods of difficult labor market entry (although if unemployed youth can live with their parents, the consumption-smoothing imperative may be weaker).

If we were to use UI in this way, it might be useful to focus spending more on human capital accumulation (with a stipend) than on UI *per se*. Since it can be hard to distinguish between youth genuinely having difficulty finding jobs and those who would take advantage of UI benefits offered to those who had not met the usual prior work requirements for eligibility, requiring participation in schooling or training instead might generate less moral hazard and thus better targeted assistance. (In contrast, there is little question about at least the initial *entry* of a previously employed worker into unemployment.) Moreover, to the extent that such human capital investment increases future wages, it could have longer-run dividends. That said, there is little evidence that youth training programs provide either short-term or long-term benefits for participants (Schochet, Burghardt, & McConnell, 2008), so focusing such modified UI benefits on schooling, which has unambiguous benefits, likely makes more sense.

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TIME TO SHIFT FROM MACRO- TO MICRO-POLICIES

Dongchul Cho and Sukha Shin

MACROECONOMIC POLICIES: CONTRIBUTIONS AND LIMITATIONS

All of the authors seem to share the perception that one can no longer expect much from macroeconomic policies. We share this opinion, but this should not be interpreted as the skeptical view that macroeconomic policies are ineffective on employment. We saw from the Korea's two crises how contrasting outcomes could result from different macroeconomic policy responses. The recent Great Recession might have become another Great Depression had the bold boosting policies not been provided.

By nature, however, boosting policies cannot continue forever. Monetary policy is constrained by inflation, and fiscal policy is constrained by public debt sustainability. In particular, budget deficits in 2009–2010 were expanded to obviously unsustainable levels in many countries, resulting in explosive increases of public debts. In fact, the "unprecedented" impact of the recent global crisis was on public debts rather than GDP or employment.[35] Fiscal sustainability risks are being elevated, not only with respect to the global financial market stability, but also with respect to long-term growth of the global economy.[36] In this environment, it seems clear that fiscal consolidation is inevitable for the years to come, although it may be possible to prolong low interest rate policy until inflation becomes an imminent risk.

It is also notable that macroeconomic policies are supposed to be used to correct the cyclical part, as opposed to the "natural" part, of the unemployment rate fluctuation. Although no one knows the exact level of the natural rate in each country, policymakers need to bear in mind that unemployment rates in many crisis-hit countries became permanently higher.[37] For example, the unemployment rate in Sweden jumped from 2–3 percent to 6–8 percent after the abrupt financial crisis in the early 1990s. In Japan, where a prolonged rather than a drastic crisis prevailed in the 1990s, the unemployment rate was increased from 2–3 percent in the 1980s to 4–5 percent in the 2000s. Therefore, if the unemployment rate does not significantly fall despite the two years of recovery in production, it is reasonable to begin

[35] Based on their study on crisis experiences since 1880, Bordo and Landon-Lane (in press) concluded that "the economic impact of the Great Depression dwarfed that of the recent crisis."
[36] For the adverse effects of high public debts on growth, see Reinhart and Rogoff (2010) and Kumar and Woo (2010), among others.
[37] Many research results (Cerra & Saxna, 2008, among others) show that crisis-hit countries could not completely restore their pre-crisis GDP paths after ten years.

to suspect that a substantial portion may be attributable to a rise in the natural rate, which is not to be dealt with by macroeconomic policies.

It is true that "if the deficit were substantially smaller the government would have more policy levers at its disposal" (Neumark & Troske). But it also seems true that even if the government had more policy levers, it might be a time to shift the focus from general stimulus to more targeted responses to the problems in the labor market.

MICROECONOMIC POLICIES: STREAMLINING

Some countries, in which the unemployment rate is "unacceptably high" (Haveman, Heinrich, & Smeedling), may need to continue temporary policies that help boost employment. For this purpose, we find the argument that direct hiring credits are more cost-effective in job creation than general stimulus convincing because they directly alter the incentives of firms to hire. While Neumark and Troske reckon "$50 billion targeted toward hiring credits would only lower the unemployment rate by about 1.1 percentage points," this magnitude sounds huge to us as an effect of policy spending of approximately 0.4 percent of GDP. It also seems intuitively correct that "the use of temporary subsidies, especially those targeted at new hires, is more effective in the recovery phase" (Caspar, Hartwig, & Moench). Similar policies were experimented with in Korea during the crisis periods in the form of employment subsidies for incumbent workers and young interns trying to enter the labor market. It is a bit premature to solidly assess these policies, but many labor economists agree that they were effective in increasing employment (or mitigating the decrease in employment).

Our concern about these sorts of policies is not their effectiveness on employment, but their long-term implications. As Neumark and Troske explicitly acknowledge, "there is no reason to think that a credit by itself leads to a long-lasting increase in the rate of job growth, which is ultimately what is needed." Another issue is whether an artificial price distortion in favor of employment is justifiable for the long-term welfare of the general public. Only when market demand for labor is believed to be lower than optimal can this policy be regarded as appropriate.

For this reason, policymakers should also make efforts to streamline structural labor market policies, which include enhancing workers' human capital and increasing incentives for new small businesses creating most jobs (Neumark & Troske); redirecting government support toward programs serving the young, low-skilled, or disadvantaged people who are very loosely attached to the labor market (Haveman, Heinrich, & Smeedling); and modernizing labor market institutions toward flexicurity (Caspar, Hartwig, & Moench). Among these, we would like to emphasize the importance of structural reforms to lower the barrier between permanent and temporary workers, based on Korea's experiences. Incumbent permanent workers are still overprotected, and thus firms prefer temporary workers at entry levels. A decade of these hiring practices, beginning with the Asian crisis, seriously segmented the labor market of young and low-skilled workers from that of old and high-skilled. This labor market segmentation generates a substantial degree of social tension as well as economic inefficiency, which were aggravated during the recent crisis period by making young and low-skilled workers suffer disproportionately more. Although it is difficult to agree on an optimal level of protection for workers in general, it seems easy conceptually, though not politically, to agree that the discrimination against new workers should be reduced.

Structural policies will not be able to generate visible effects on employment in the near future. Nevertheless, they deserve to be pursued to enhance labor market efficiency and (possibly) to reduce the natural rate of unemployment, especially when the necessary room for enacting discretionary macroeconomic policies has been eroded.

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CLIMBING OUT OF A DEEP HOLE: WHICH PATH UP?

Robert Haveman, Carolyn Heinrich, and Timothy Smeeding

In our response, we first discuss the Neumark and Troske piece, and then compare the U.S. context to that in Europe and Korea, as described by the Caspar, Hartwig, and Moench and the Cho and Shin contributions.

Although we are in basic agreement with Neumark and Troske on the extent and depth of the current employment situation, we differ to some extent in terms of remedies. Their emphasis on the negative effect of housing market difficulties on employment expansion (through reductions in worker mobility, consumption, and employment) is well placed. These effects are, in our view, closely tied to the plight of many minority and other low-skill workers in the current (now faltering) recovery. While Neumark and Troske argue that the stimulus packages had a very small impact on the economy, we feel that this may be too negative an assessment, especially given the larger global financial forces that seem to overwhelm domestic job creation efforts.

Neumark and Troske examine the employment effect of a hiring tax credit, and find that the short-run cost per job is less than that of other employment promotion strategies. However, the evidence on the relative effectiveness of direct job creation policies is limited. Nevertheless, it is clear that the more successful of such efforts have been targeted on the most vulnerable younger, under-skilled adults who are in greatest need (Bishop & Haveman, 1979, 1981). While the current 2 percentage point payroll tax (FICA) rebate helps maintain incomes for everyone and perhaps stimulates some consumer demand, the job creation impact would be larger if the rebate were applied to employers as well as employees, and only to the first $25,000 of earnings for new hires and especially to those who are long-term unemployed or have yet to make a stable connection to the job market.

We applaud Neumark and Troske's longer-run emphasis on enhanced job training and a more streamlined job training system, direct tuition, and child care subsidies so that workers with a strong attachment to the labor market and strong noncognitive skills can attend community college to gain skills. As we noted in our first essay, the United States can learn from European and Canadian efforts in active labor market policy and program design, such as the German *Kurzarbeit* policy of work sharing (Boushey, 2011), which has moderated the implications of the recession for unemployment rates there.

On the demand side, Neumark and Troske argue for "redirection" of programs and incentives that target new small businesses, and they make a case for lowering the regulatory burden on starting a business. With respect to their proposal for lowering the minimum wage for new small business, we need a stronger empirical and conceptual justification for the cost per job figures they cite in order to be convinced of the benefits of reducing an already modest minimum wage. In fact, we know very little about which of these initiatives are likely to be most effective in creating jobs and securing employment growth at a reasonable cost. Any new policies that are developed should include a rigorous evaluation component.

The European and Korean papers contribute an important comparative perspective on the recession. As Cho and Shin argue, Korea fared very well due to rising demand for domestic consumption and a very small welfare state. Indeed, the Korean unemployment rate ticked up by only 0.2 percentage points to about 4 percent at the height of the recession; the U.S. rate rose by 4.9 points to almost 10 percent at the trough. By comparison, the German unemployment rate fell by 1.6 percentage points to 7.8 percent (OECD, 2011). However, Korean institutions—with security on the family front (if not via public income support), an open and flexible economy, and a successful education system producing the highest scores among OECD countries on many PISA tests—are hard to convert or directly compare to those in the United States.

It is hard to tell a "European story" because of the large difference in institutions and the differing impacts of the recession. Germany and Scandinavia have clearly done much better than Spain, Greece, or Ireland. Caspar, Hartwig, and Moench therefore have the tough job of picking and choosing which policies to emphasize. "Flexicurity" (labor market flexibility and fluidity), upgrading of skills, and work supports all fit well with our views. But the United States has it only half right—we have the "flex" but not the "security," especially for younger would-be or disconnected workers. Caspar, Hartwig, and Moench emphasize that if the gains are to be longer term, there needs to be "structural reform" of the labor market—to "strengthen labor market policies that reduce structural unemployment rates, increase labor market participation, strengthen the reallocation of labor toward a smart, sustainable, and inclusive economy, and promote social cohesion by targeting specific groups of workers." All of this sounds great, but how does the United States move toward these goals?

It is harder than one might expect to extract some clear lessons about how deeper economic pain could have been avoided or how we might be able to make more

Table 1. Difficulty in maintaining living standards during the recession.

	Percent Finding It Difficult or Very Difficult to Live on Current Income	
Country	2010	Change from 2007 to 2010
A. Focal Countries		
All OECD	24%	+3%
Germany	16%	+2%
Korea	19%	−5%
USA	21%	+7%
B. Other European Nations		
Netherlands	9%	+1%
Sweden	7%	+1%
Ireland	15%	+10%
France	17%	−2%
Spain	23%	+11%

Source: OECD (2011, p. 71).

significant or rapid progress in pulling the U.S. labor market out of its malaise. If anything, we find that, of the nations examined in this set of articles, each has a different story to tell about the great recession, and the reality is that in every case, the stories are not yet fully told. Indeed, the patterns shown in the OECD's *Society at a Glance* (2011) volume make just this point. The following table (Table 1, taken from p. 71 in the OECD volume) indicates that the United States had great difficulty in maintaining living standards during the last recession, relative to other nations, and suffered above-average losses compared to the average OECD nation. The most secure nations with the largest welfare states (France, Sweden, and the Netherlands) felt very little pain. Korea, which had a below-average base, saw the fraction of citizens who found it difficult to get along during the recession actually *fall* by 5 percentage points. The German economy experienced some small increase in the difficulty of maintaining living standards, but from a very low base. Ireland and Spain felt considerable pain, but still fell below the OECD average pain index even with these increases. This table shows how hard it is to generalize the European situation from the experience of one or two countries.

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