Strength of Economy, Limited Benefit Eligibility in Texas Curb Long-Term Unemployment Rate

By Anil Kumar

An unemployment rate with a persistent long-term component can be more detrimental to the economy than the same jobless rate with a smaller share of long-term unemployed.

A sharp rise in the U.S. unemployment rate was a defining feature of the Great Recession. The rate more than doubled, from 4.5 percent in prerecession 2006–07 to a postrecession peak of 10 percent in 2009.

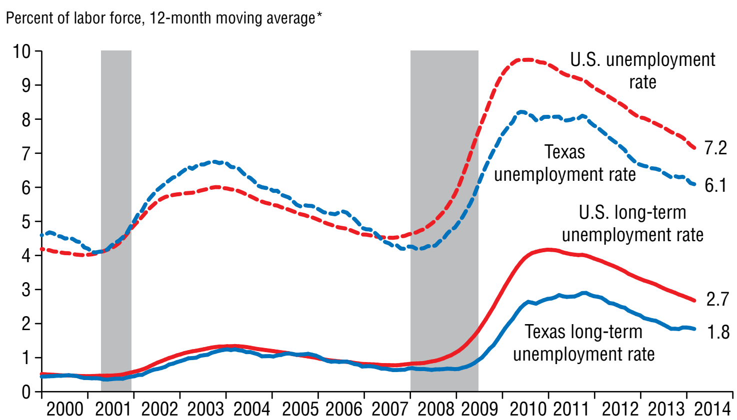
The increase in the percent of long-term unemployed—those jobless for more than six months—was even more compelling. The 12-month moving average of the long-term unemployment rate rose more than fourfold, from 1 percent before the recession to a postrecession peak of 4.1 percent, a level unprecedented in the postwar United States.

While the overall unemployment rate is of central concern for policymakers, its composition has important policy implications. An unemployment rate with a persistent long-term component can be more detrimental to the economy than the same jobless rate with a smaller share of long-term unemployed. Very long durations off the job can lead to considerable skill depreciation, permanently limiting productivity. Moreover, the relative effectiveness of Federal Reserve monetary policies and federal government fiscal policies differs when the long-term component of unemployment is high.

Increases in the Texas unemployment rate, reflecting a shorter recession and stronger job growth during the recovery, were somewhat subdued relative to those of the nation. Similarly, the spike in long-term unemployment was comparatively limited in Texas, although the state still experienced a surge.

From prerecession long-term rates similar to the nation's 1 percent of the labor force, the Texas rate almost tripled to a high of 2.9 percent in 2011 (*Chart 1*). The average period that a Texas worker was unemployed doubled from 15 weeks before the recession to a high of 30 weeks

Chart 1 Texas Long-Term Unemployment Rate Remains Below U.S. Rate



*Seasonally adjusted.

NOTE: The long-term unemployment rate depicts the percent of the labor force that has been unemployed 27 weeks or more. Shaded areas indicate U.S. recessions.

SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

in 2011; nationally, it increased from 16 to 37 weeks.

Long-term unemployment in Texas—along with headline unemployment—continues to be below national levels across almost all major demographic and industry groups, though it remains higher than prerecession averages, the Bureau of Labor Statistics' monthly Current Population Survey data show. Differences in demographic and industrial composition account for only a small portion of Texas' lower incidence and duration of unemployment vis-à-vis the nation.

Those out of work in Texas continue to enjoy a higher job-finding rate than their counterparts nationally, whether they are unemployed short term or long term. The state's higher job-finding rate has resulted from a combination of factors that include greater job growth, a strong energy sector and a milder housing market downturn. During much of the recession and recovery, a somewhat greater percentage of unemployed Texans left the labor force—where they were no longer counted among the jobless—relative to their counterparts across the nation. Both the greater ability to find work and higher incidence of dropping out of the labor force helped keep long-term unemployment lower in Texas than in the U.S.

Long- and Short-Term Unemployment

During the recovery, the headline unemployment rate and the ranks of the long-term unemployed have decreased slowly but steadily in the state and nation. The Texas unemployment rate has declined 3.1 percentage points from its peak of 8.3 percent in 2011 and stood at 5.2 percent in April 2014, approaching its prerecession average of about 5 percent.

Meanwhile, long-term unemployment is less improved. The 12-month moving average of the long-term rate in Texas has declined a percentage point since 2011 to 1.9 percent of the labor force in February 2014. The share of the long-term unemployed among all jobless workers is 30 percent—14 percentage points higher than the prerecession share, suggesting that improvement within this group hasn't kept pace with advances for the short-term unemployed.

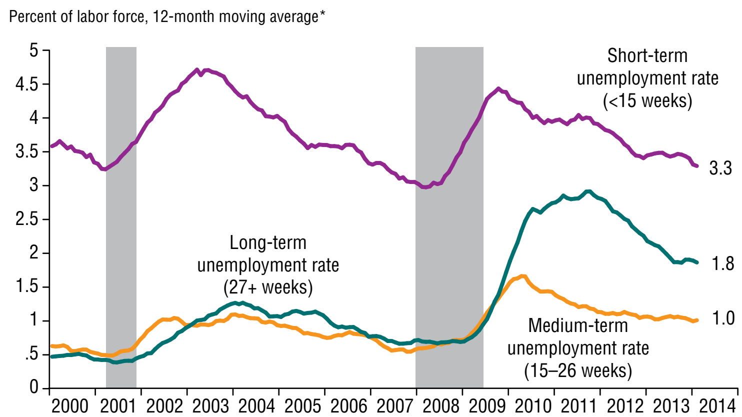
Tepid gains among the long-term unemployed are a key reason the headline rate remains high relative to prerecession levels four years after the Great Recession ended. The overall unemployment rate in Texas is broken down into short term (less than 15 weeks), medium term (15 to 26 weeks) and long term (27 weeks or more) in Chart 2. The short-term rate is already back to prerecession levels, and the medium-term rate is not far behind. But the long-term unemployment rate remains well above prerecession levels.

However, Texas' long-term unemployment rate remains lower than the nation's across virtually all demographic groups (*Chart 3*). The rate for most demographic groups in Texas was about the same as the national average before the recession. Thus, almost the entire difference among groups between Texas and the nation emerged after the recession.

Prerecession differences in long-term unemployment between Texas and the U.S. were significant only in the construction and manufacturing industries (*Table 1*), and the gap widened after the recession. The construction sector was the hardest hit of all sectors in the Great Recession's sharp housing downturn.

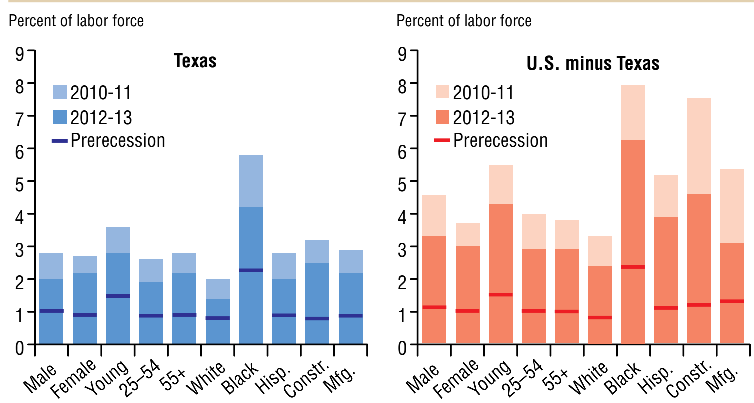
At the national level, long-term un-

Chart 2 Short-Term Unemployment Rate in Texas at Prerecession Levels as Long-Term Rate Lags



*Seasonally adjusted.
NOTE: Shaded areas indicate U.S. recessions.
SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

Chart 3 Texas Long-Term Unemployment Rate Declines, Remains Below U.S. Rate for All Major Groups



NOTE: The long-term unemployment rate depicts the percent of the labor force that has been unemployed 27 weeks or more.
SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

Table 1 Long-Term Unemployment Rate Varies Across Industries, Lower in Texas

	Texas	U.S. minus Texas	Texas	U.S. minus Texas	Texas	U.S. minus Texas	Texas	U.S. minus Texas
	2004–07	2004–07	2008–09	2008–09	2010–11	2010–11	2012–13	2012–13
Mining	0.6	0.5	1.6	1.7	3.8	3.5	1.3	1.6
Construction	0.7	1.1	1.5	3.5	3.2	7.6	2.5	4.6
Manufacturing	0.8	1.2	1.5	2.8	2.9	5.4	2.2	3.1
Wholesale/retail	0.9	1.0	1.2	2.1	2.6	4.2	2.1	3.3
Transportation	0.6	0.7	1.1	1.7	2.1	3.7	1.5	2.6
Information	0.8	1.1	1.7	2.2	4.3	4.1	2.3	3.1
Financial activities	0.6	0.6	1.1	1.7	1.9	3.5	1.8	2.2
Professional and business services	1.2	1.1	1.4	2.3	2.9	4.4	2.1	3.4
Educational and health	0.4	0.5	0.6	1.0	1.4	2.1	1.4	1.9
Leisure and hospitality	1.2	1.2	1.3	2.4	3.7	4.4	2.3	3.5

SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

employment in construction increased from about 1 percent before the recession to 7.6 percent in 2010–11, before declining to an average of 4.6 percent over 2012–13. Texas, benefiting from a milder housing downturn and stronger recovery, experienced much smaller swings, with long-term unemployment in the sector standing at 2.5 percent in 2012–13.

Persistently High Rate

Economists and policymakers have been puzzled about the headline unemployment rate's slow decline following the Great Recession. Recent research shows that structural factors involving age, education, industry or occupation are relatively less important than other supply- and demand-side explanations.[1]

The extension of unemployment benefits may have boosted the supply of individuals looking for work, reducing their job search costs and possibly contributing to the higher unemployment rate. On the demand side, recruiting intensity declined as employers less aggressively filled vacancies after the Great Recession, a recent paper found.[2]

Supply and demand factors affect the transition of workers in and out of unemployment. Joblessness rises if the "inflow" rate—employed workers leaving jobs, or people out of the labor force seeking to reenter it—exceeds the "outflow" rate—individuals finding employment or dropping out of the labor force.

The outflow rate is a key determinant of the extent of long-term unemployment. The part of the outflow rate measuring the proportion of individuals moving from unemployment to employment—known as the job-finding rate—plunged nationally from 28 percent in prerecession 2006 to an average of 17 percent during the downturn. It remained sluggish during the recovery from the 2007–09 slump (*Chart 4A*).[3]

The rate at which unemployed individuals dropped out of the workforce also declined dramatically during the recession and, along with the lower job-finding rate, contributed to the rising unemployment rate (*Chart 4B*). The number of unemployed people quitting the labor force has slowly increased during the recovery.

The Texas job-finding rate has exceeded that of the nation since the recession—helping tamp the state's unemployment rate increase. Additionally, because relatively more people in Texas dropped out of the workforce, the state's unemployment rate increase wasn't as great as in most of the U.S. The higher rate of labor force exits in Texas could be in part because the duration of unemployment benefits was, on average, lower and eligibility for benefits more limited than elsewhere in the country.

Nationally, the entry of those who had been outside the labor force also helps explain the rising unemployment rate during the Great Recession.[4] Moreover, the rate at which people returned to the workforce and managed to find a job declined significantly across the U.S. The figure in Texas was smaller—indicative of people finding jobs in a relatively healthier economy.

Duration Dependence

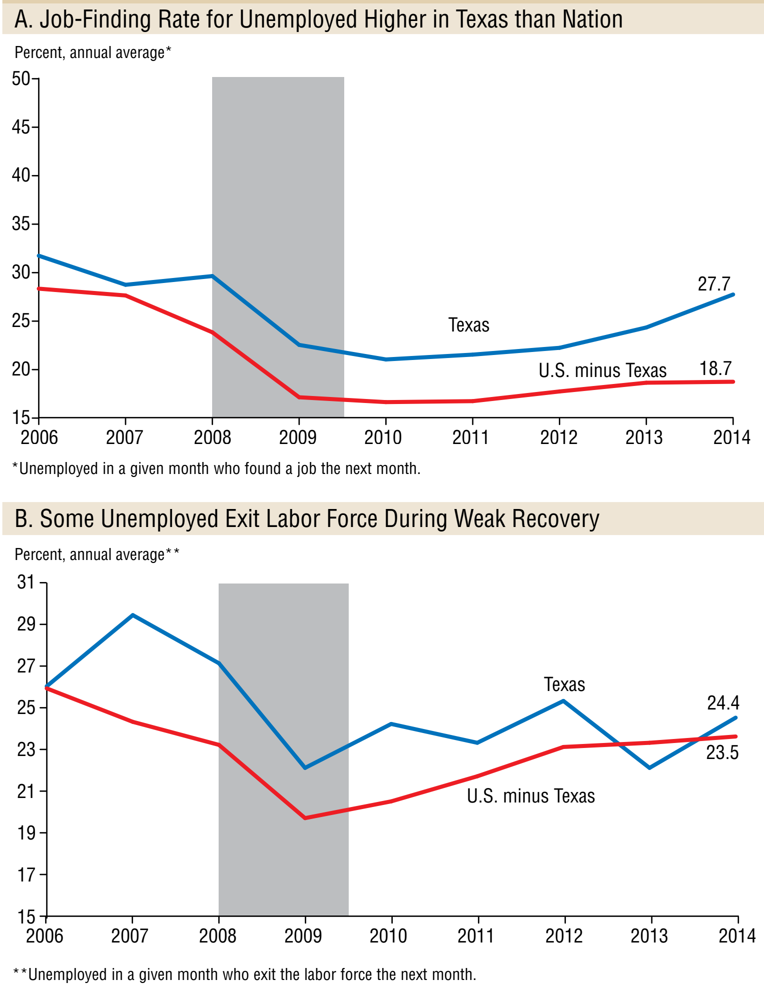
Economic job search models during times of unemployment show that the length of joblessness is negatively correlated with the likelihood of landing work—a phenomenon also known as duration dependence. In other words, the longer someone is away from the workplace, the less likely he or she is to find a job (*Chart 5A*).

There are several potential explanations for this. First, skills and productivity are lost over time. Employers subsequently question why no one else has hired the long-term unemployed, inferring that the candidate has negative qualities. Recent research shows that exiting unemployment becomes particularly difficult if joblessness lasts longer than nine months; there is no significant duration dependence for lesser periods.[5]

Nationally, someone just out of work has a 30 percent chance of finding another job, on average, in the next month, while a person whose joblessness has lasted more than 26 weeks has about a 14 percent probability of finding a job in the next month, as seen in Chart 5A. Due to stronger job growth and shorter unemployment-insurance benefit duration, an average worker in Texas is more likely than someone in the rest of the nation to exit joblessness and find a job at all durations of unemployment.

There doesn't appear to be a similar relationship involving time without work among the unemployed who subsequently drop out of the labor force (*Chart 5B*). Additionally, the likelihood that an unemployed individual will

Chart 4 Fewer People Find Jobs, Drop Out of Workforce During Recession



NOTE: Shaded area indicates U.S. recession.
SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

leave the labor force is somewhat higher in Texas than in the rest of the nation, regardless of unemployment length.

A slightly higher transition rate from unemployment to nonparticipation, particularly among Texans off the job for longer periods, could be partly due to a two-week shorter average potential duration of unemployment insurance benefits in the state. A longer period of benefits in the rest of the U.S. likely prompted the unemployed to keep looking for jobs and remain in the labor force.

Extended Unemployment Benefits

Generous unemployment benefits subsidize the cost of a lengthy job search and have long been linked to longer joblessness periods. Although enhanced benefits can lengthen duration by lowering job search intensity, they also provide fiscal stimulus by increasing consumption among the unemployed who are otherwise credit constrained. Recent studies regarding the impact of benefit generosity on unemployment duration and the jobless rate find only modest positive effects.

The average period of unemployment nearly doubled, from 18 weeks to 35 weeks, during the Great Recession. The increase was larger for those eligible for unemployment benefits, whose duration rose by more than 20 weeks.[6] This longer length of joblessness is equivalent to a 0.8 percentage point increase in unemployment that can be attributed to unemployment benefit extensions.

Estimates in the literature indicate that the impact of extended benefits on the unemployment rate in the postrecession period was likely less than 1 percentage point. To be sure, part of the increase in the unemployment rate was due to the unemployed either reducing job search efforts or declining some job offers in order to prolong benefit receipt—economically, not a desirable outcome.

But some of that increase was also due to individuals prolonging their job searches—to qualify for unemployment insurance—rather than dropping out of the labor market. As much as half the impact of extended benefits on the unemployment rate can be traced to increases in the labor force participation rate, according to a recent study. The remaining half was attributable to the benefits' disincentive effects on reemployment.[7]

Texas historically has had fewer unemployment benefit recipients as a percent of the total unemployed than the nation (*Chart 6*).

This is partly due to the shorter duration of unemployment benefits in Texas. Data from the U.S. Department of Labor's Employment and Training Administration indicates that the average potential duration of unemployment benefits—the maximum entitled benefit divided by the weekly benefit amount—reached a high of 22.2 weeks in 2009 in Texas, about two weeks less than the national average.

Regular unemployment compensation is a state-funded, federally administered program that provides a maximum of 26 weeks of benefits and is designed to replace, on average, 50 percent of wages for individuals who are involuntarily dismissed from jobs without cause. Once regular unemployment is exhausted, and if a state's unemployment rate is high, benefits can be extended 13 to 20 weeks under the permanent Extended Benefits program, which the federal and state governments fund equally.

Additionally, Congress can authorize 100 percent federally funded temporary unemployment insurance during national recessions. Congress last created such a temporary Emergency Unemployment Compensation program in July 2008; it expired last Dec. 31 after several extensions. The program provided 47 to 63 weeks of additional benefits in 2012 and 2013, the exact length of payments dependent on the jobless rate in individual states. In states with persistently high rates of unemployment, the maximum potential duration of benefits under the three programs reached 99 weeks.[8]

The duration of extended benefits under the Emergency Unemployment Compensation program was relatively short in Texas, whose unemployment rate was lower than most other states'.[9] Benefits were further limited by the state's milder downturn, as well as by layoffs and permanent job losses that were significantly lower than in the nation.

Policy Implications

The extent of long-term unemployment has important implications for Federal Reserve monetary policy, whose goals are price stability and low unemployment. A higher unemployment rate typically depresses wages and prices. A relatively higher proportion of long-term unemployed among the jobless can dilute this influence on wages and prices, and implies a diminished impact of monetary policy on the unemployment rate.

While chronic long-term unemployment potentially weakens the case for monetary policy intervention, it raises the stakes for fiscal policy. If workers are potentially exposed to long periods off the job, they may start saving more money when they do work, simply to get by when they are unemployed. Such savings most immediately slows consumer spending and impedes short-term economic growth.

Moreover, the long-term unemployed may have considerable difficulty finding jobs. If employers have inadequate information about worker quality, they may use length of unemployment as an indicator. Workers also are wary of investing in their own skill improvement if they think they will be unemployed for a long time and, thus, become even more unmarketable to employers.

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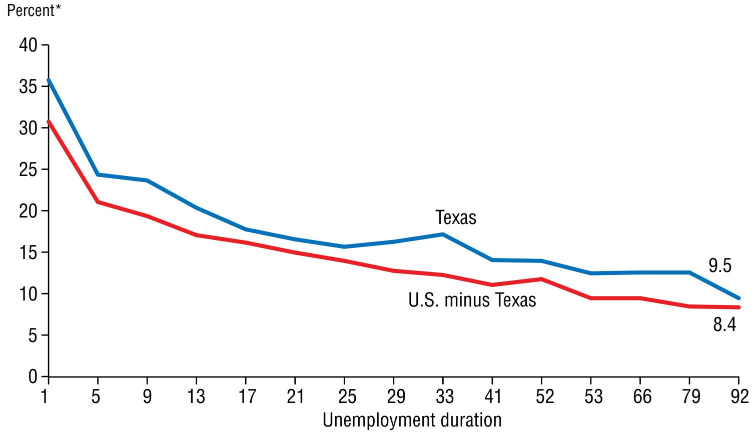
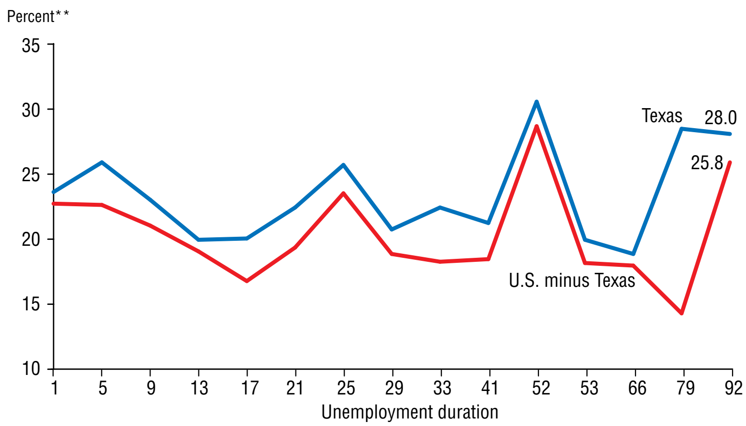
Chart 5 Length of Unemployment Affects Job Finding, Influences Labor Force Departures

A. Job-Finding Rate Declines with Length of Joblessness



*Percent of unemployed in a given month who found work the next month, by weeks of joblessness between 2008 and 2013 (1 = 1-4 weeks, 5 = 5-8 weeks, etc).

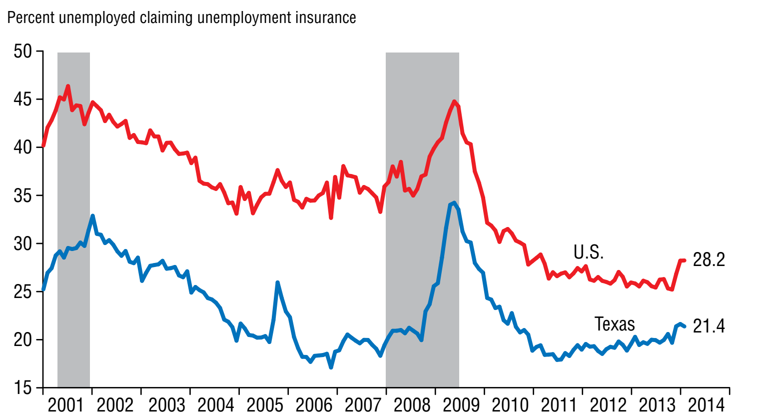
B. The Unemployed Exit the Labor Force at All Lengths of Joblessness



**Percent of unemployed in a given month who left the workforce the next month, by weeks of joblessness between 2008 and 2013 (1 = 1-4 weeks, 5 = 5-8 weeks, etc).

SOURCES: Bureau of Labor Statistics' Current Population Survey; author's calculations.

Chart 6 Texas Has Fewer Unemployment Insurance Claimants than Nation



NOTE: Shaded areas indicate U.S. recessions.

SOURCES: Bureau of Labor Statistics; Department of Labor Employment and Training Administration; Haver Analytics.

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Texas Economic Influences

Demographic influences explain neither the postrecession rise in unemployment duration in Texas nor the lower long-term unemployment rate in the state vis-à-vis the nation.

Lower long-term unemployment in Texas likely results from two factors. First, unemployed Texans experienced a higher job-finding rate because of the state's stronger job growth, booming energy sector and milder housing market downturn. And second, a somewhat higher percentage of the unemployed in Texas exited the labor force relative to the nation, in part due to their shorter average duration of unemployment benefits and lower eligibility relative to their counterparts nationally.

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Notes

[1] For this line of research, see "Long-Term Unemployment and the Great Recession: The Role of Composition, Duration Dependence, and Non-Participation," by Kory Kroft, Fabian Lange, Matthew J. Notowidigdo and Lawrence F. Katz, working paper, Harvard Web Publishing, September 2013. http://scholar.harvard.edu/files/lkatz/files/klnk_ltu_and_great_recession_sep16_2013.pdf.

[2] See "The Establishment-Level Behavior of Vacancies and Hiring," by Steven J. Davis, R. Jason Faberman and John C. Haltiwanger, *Quarterly Journal of Economics*, vol. 128, no. 2, 2013, pp. 581–622.

[3] The job-finding rate and all other transition probabilities are month-to-month and were calculated using matched monthly Current Population Survey data.

[4] See "The Labor Market in the Great Recession: An Update to September 2011," by Michael W.L. Elsby, Bart Hobijn, Aysegul Sahin and Robert G. Valletta, *Brookings Papers on Economic Activity*, vol. 43, no. 2, 2011, pp. 353–84.

[5] See "Do Employers Use Unemployment as a Sorting Criterion When Hiring? Evidence from a Field Experiment," by Stefan Eriksson and Dan-Olof Rooth, *American Economic Review*, vol. 104, no. 3, 2013, pp. 1,014–39.

[6] See "Extended Unemployment and UI Benefits," by Rob Valletta and Katherine Kuang, Federal Reserve Bank of San Francisco *Economic Letter*, no. 12, April 2010.

[7] See "Unemployment Insurance and Job Search in the Great Recession," by Jesse Rothstein, *Brookings Papers on Economic Activity*, vol. 43, no. 2, 2011, pp. 143–213.

[8] See "Extending Unemployment Compensation Benefits During Recessions," by Julie M. Whittaker and Katelin P. Isaacs, Washington, D.C.: Congressional Research Service, Library of Congress, May 2013.

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