The Decline of Job Loss and Why It Matters

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The Decline of Job Loss and Why It Matters

by Steven J. Davis*

There is considerable evidence that American workers face lower risks of job loss in recent years than ten, twenty or thirty years earlier. I summarize some of the evidence for this claim and explain why the decline of job loss matters. My attention centers on "unwelcome" job loss: employer-initiated separations that lead to unemployment, temporary or persistent drops in earnings, and other significant costs for job losers. Since there is no fully satisfactory statistic for the incidence of job loss, I consider several measures and data sources.

I. The Decline of Job Loss

The Federal-State Unemployment Insurance Program provides cash benefits to experienced workers who become unemployed "through no fault of their own" and who meet other requirements that vary somewhat by state. Administrative data on new claims for unemployment benefits under this program provide a useful indicator for cyclical and longer term movements in job loss rates. Drawing on these data, Figure 1 shows a dramatic decline in new claims for unemployment benefits since the 1970s and early 1980s. New claims average 0.24 percent of employment per week from January 2004 to November 2007, slightly below the 0.26 percent average from January 1996 to December 1999 and well below any earlier period covered by the data.

The new claims rate responds to changes over time in eligibility requirements and take-up rates as well as the incidence of job loss. Thus, it is important to ask how other job loss indicators compare to Figure 1. Steven J. Davis et al. (2007) consider the longer term evolution

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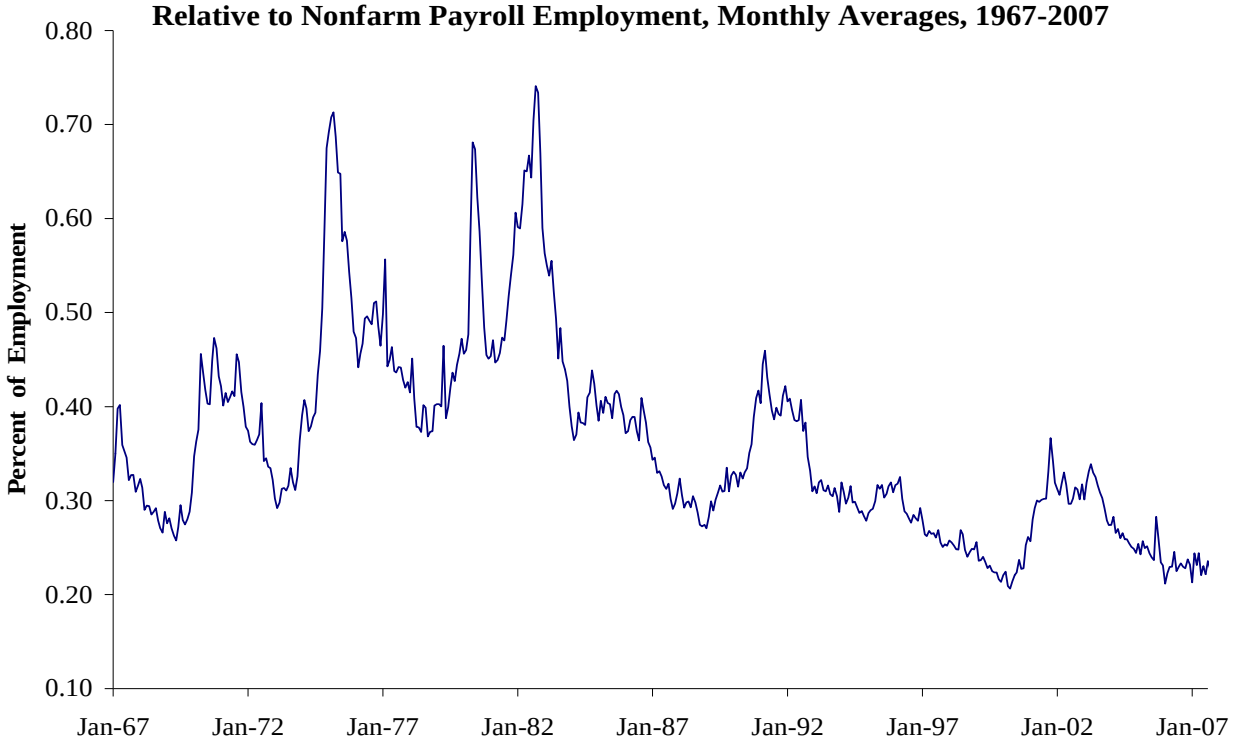
of monthly unemployment inflow rates, as measured from Current Population Survey (CPS) data on unemployment by duration. They report that unemployment inflows fell from about 4 percent of employment per month in the early 1980s to 2 percent or less by the mid 1990s and thereafter. Robert Shimer (2007, Figure 4) and Michael Elsby, Ryan Michaels and Gary Solon (2007, Figure 2) report a similar result. The downward drift in monthly unemployment inflows is more gradual than the post-1982 drop in new claims in Figure 1, but the basic pattern is otherwise similar.

Figure 1. Weekly New Claims for Unemployment Insurance Benefits Relative to Nonfarm Payroll Employment, Monthly Averages, 1967-2007



Source: Author's calculations using data on weekly new claims for unemployment insurance benefits (www.dol.gov/opa/media/press/eta/ui/current.htm, accessed 2 January 2008), expressed as a percent of nonfarm employment in the Current Employment Survey (http://data.bls.gov/cgi-bin/surveymost?ce, accessed 2 January 2008).

Shigeru Fujita and Garey Ramey (2006) estimate employment-to-unemployment flows using data on labor force status in short CPS panels rather than data on unemployment by duration in CPS cross sections. They also find dramatic declines in employment-to-unemployment flow rates since the early 1980s. Jay Stewart (2002) calculates transitions from employment to unemployment using March CPS data from 1976 to 2001. By combining data for the March survey reference week with retrospective data on labor market activity in the previous year, Stewart identifies job changes that involve an employment-to-unemployment transition with at least three weeks of unemployment. He considers full-time workers between the ages of 18 and 54 with at least one week of work and one year of potential experience as of the base year. Stewart's approach also yields dramatic declines in employment-to-unemployment flows since the early 1980s. The declines are concentrated in the 1990s for men and relatively uniform throughout the 1980s and 1990s for women.

The Displaced Worker Survey (DWS) provides yet another source of information about the incidence of job loss. The DWS has been conducted every two years since 1984 as a supplement to the CPS. It asks about job loss in the previous three years (five years before 1996) due to plant closure, layoffs and other reasons unrelated to the worker's individual performance. The DWS asks only about a single job loss episode within the recall window. This feature and the long recall window differentiate the DWS from the CPS-based measures of employment-to-unemployment flows discussed above. Questionnaire changes over time make it hard to use DWS data to assess long term changes in the risk of job loss. However, a series of papers by Henry S. Farber seek to adjust for these changes and create a consistent time series of job loss rates. Figure 10 in Farber (2007) shows that the three-year job loss rate in the 2003-05 period is

at or near its lowest level since the inception of the DWS, about one third below the 1981-83 period, and nearly identical to the corresponding rate for the 1987-89 and 1997-99 periods.

Measures of (gross) job destruction by employers also point to declining risks of job loss for American workers. The job destruction rate is calculated by summing employment declines over all employer units that shrink or exit during a given time interval and then dividing by the overall level of employment to obtain a rate. This measure captures the rate at which employers eliminate employment positions rather than the rate at which workers lose jobs but, not surprisingly, the two are closely linked: Layoffs are highly concentrated at declining establishments, job destruction and layoff rates move together over time, and layoffs rise steeply with establishment-level job destruction in the cross section. See Davis, R. Jason Faberman and John Haltiwanger (2006) for evidence.

The Bureau of Labor Statistics (BLS) produces quarterly job destruction statistics in its program on Business Employment Dynamics (BED). These data show sizable declines in the rate of private sector job destruction after the 1990-91 recession and again after the 2001 recession (Faberman, 2006 and BLS data). Private sector job destruction averages about 6.5 percent of employment per quarter from the first quarter of 2005 to the first quarter of 2007 (BLS data), lower than any other period back to 1990 (Faberman, 2006). Job destruction measures constructed from the Longitudinal Business Database at the Bureau of the Census also show a decline in private sector destruction rates after the early to mid 1980s (Davis et al., 2007). Quarterly data for the manufacturing sector pieced together from multiple sources suggest that job destruction rates have trended downward since the early 1960s (Davis, Faberman and Haltiwanger, 2006).

Summing up, a variety of indicators based on household surveys, establishment surveys and administrative records show a long term decline in the risk of job loss facing American workers. New claims for unemployment benefits and CPS-based measures of employment-to-unemployment flows imply dramatic declines in the risk of job loss since the 1970s and early 1980s. Job destruction measures from various sources also point to large declines in the risk of job loss. The DWS is something of an outlier in suggesting that essentially the entire long term decline in the risk of job loss reflects a recovery from the deep recession of the early 1980s.

This body of evidence is sharply at odds with populist rhetoric about declining job security for American workers, a view some economists have also espoused. I refer the reader to Davis (2007) for a detailed critique of claims that American workers have suffered a long term decline in job security. Here, I pause only to highlight a basic, but crucial, distinction between the risk of job loss and the durability of employment relationships.

Many observers interpret declines in the durability of employment relationships (e.g., declines in median job tenure) as evidence of an increased risk of unwelcome job loss and a decline in job security. This interpretation is unwarranted. Job tenure statistics do not inform us about job security or the risk of job loss for the simple reason that most employment relationships do not end with an employer-initiated separation. Indeed, data from the BLS Job Openings and Labor Turnover Survey imply that layoffs and discharges for cause account for only 36 percent of worker-employer separations in the 2001 to 2006 period, much lower than the percentage accounted for by workers who quit the job (Davis, 2007). The 36 percent figure may be an understatement, but even if employers initiate 70 percent of all separations – an extremely dubious proposition – one cannot form reliable inferences about job security and the risk of unwelcome job loss from statistics on the durability of employment relationships.

Moreover, workers are more prone to quit when labor market conditions are tight and job opportunities are plentiful. In light of this well-documented pattern and the high share of worker-initiated separations, one might just as well interpret declines in job tenure as evidence that workers now enjoy a greater abundance of attractive job opportunities. This interpretation merits just as much weight – and just as little – as the claim that shorter job tenures imply an erosion of job security for American workers.

II. Why the Decline of Job Loss Matters

A. Lower (Frictional) Unemployment

In search equilibrium models along the lines of Dale T. Mortensen and Christopher A. Pissarides (1994), less job destruction means fewer job-losing workers, smaller unemployment inflows and lower unemployment rates. Given the empirical evidence summarized in Section I, it is natural to ask whether this simple MP mechanism explains the large drop in U.S. unemployment inflows and unemployment rates since the early 1980s.

Davis et al. (2007) address this question by investigating the low-frequency response of unemployment inflows to the evolution of job destruction rates. U.S. data show that unemployment inflow rates trended downward by larger amounts in industries with bigger long term drops in the job destruction rate. Davis et al. estimate that a decline of 100 basis points in an industry's quarterly job destruction rate lowers its monthly unemployment inflow rate by 28 basis points. To put that estimate in perspective, I note that the quarterly job destruction rate dropped by 157 basis points in the U.S. private sector from 1990 to 2005. Multiplying this drop by its estimated effect yields a decline of 44 basis points in the unemployment inflow rate, which amounts to 48 percent of the total decline in the aggregate unemployment inflow rate from 1990 to 2005 and 20 percent of its average value. In other words, the results in Davis et al. (2007)

imply that the simple MP mechanism accounts for nearly half of the decline in unemployment inflow rates from 1990 to 2005. The MP mechanism also accounts for much of the decline in unemployment inflow rates over the longer period since the early 1980s.

Other important factors behind the long term decline in unemployment inflow rates include the aging of the work force and the increase in average worker experience after 1980. These factors matter because more experienced workers have stronger labor force attachment and lower quit propensities. Hence, they are less likely to flow into the unemployment pool after a worker-initiated separation or a temporary exit from the labor force. See Shimer (1998) for evidence that an aging labor force played a major role in long term unemployment declines after 1980.

What do these results imply for the unemployment rate, as opposed to the unemployment inflow rate? At its postwar peak in 1982 and 1983, the U.S. civilian unemployment rate exceeded 10 percent of the labor force. It fell by roughly half over the next half dozen years and reached successively lower cyclical peaks in 1992 and 2002. The average value of the unemployment rate from 1995 through the third quarter of 2007 is 5.0 percent, well below the average for the 1970s and 1980s.

In an accounting sense, lower unemployment rates since the 1970s and early 1980s are largely explained by the secular decline in unemployment inflow rates. This conclusion is apparent from a visual inspection of time series charts for unemployment inflow (job loss) and outflow (job finding) rates in Fujita and Ramey (2006), Davis et al. (2007), Elsby et al. (2006) and Shimer (2007). The job-finding rate exhibits pronounced cyclical fluctuations but little change over the longer term in recent decades. In contrast, unemployment inflow and job loss measures show large, persistent declines since the 1970s and early 1980s. Combining this observation with the result that lower job destruction rates explain nearly half the long term drop

in the unemployment inflow rate, it follows that the simple MP mechanism sketched above explains much of the longer term drop in the unemployment rate since the 1970s and 1980s. See Davis et al. (2007) for a fuller development of this point.

B. Reduced Costs of Worker Displacement

More than 10 percent of U.S. workers separate from their employers in an average quarter, many because of layoffs or discharges for cause. See Bruce Fallick and Charles A. Fleischman (2004) or Davis, Faberman and Haltiwanger (2006). Most job separations, including many employer-initiated separations, appear to involve little hardship for workers.

There is undeniable evidence, however, that job loss involves significant harmful consequences for workers and their families in some situations. Harmful consequences are most pronounced when high-seniority employees lose jobs in large-scale "mass layoff" events. An important study by Louis S. Jacobson, Robert J. Lalonde and Daniel G. Sullivan (1993) considers a large sample of workers with job tenure of six or more years, and who lose jobs in mass-layoff events during the early and mid 1980s. Their sample contains job separators from Pennsylvania establishments that, within a year of separation, have employment levels at least 30 percent below their maximum levels in the late 1970s. They further require that the employer have at least 50 employees in 1979, and that separators have positive earnings (in Pennsylvania) during each calendar year. Using this sample, Jacobson et al. estimate that mean earnings fall by 50 percent in the quarter of displacement, and recover by roughly half over the following six quarters. Five years after job loss in a mass-layoff event, mean earnings remain 25 percent below pre-displacement levels. Other studies also find large earnings losses for high-seniority workers who lose jobs in mass-layoff events.

A recent study by Sullivan and Till von Wachter (2007) investigates the effect of job loss on mortality for the same sample of workers. Their chief result is that job loss by high-seniority workers in mass-layoff events leads to a 15-20 percent increase in death rates over the following 20 years. As Sullivan and von Wachter remark, if this mortality effect continues beyond the 20-year period, it implies a life expectancy reduction of about 1.5 years for a high-seniority worker displaced at age 40 in a mass-layoff event.

It is worth stressing that these two studies do not, by design, consider representative job losers. Instead, they focus on high-seniority employees who lose jobs with larger employers in mass-layoff events. Each of these sample selection criteria is associated with bigger post-displacement earnings losses for job-losing workers and, probably, with more severe consequences in other respects. In addition, the 1980-1986 period covers the deepest U.S. recession and the highest unemployment rates since World War II. Thus, the workers who lost jobs in this period faced an unusually difficult labor market. For these reasons, I interpret these studies as providing powerful evidence that job loss involves persistent and significant economic hardship in certain circumstances, but not necessarily in other circumstances. Many studies provide evidence that job loss can involve other significant costs in the form of reduced employment stability, lower consumption, a loss of health insurance coverage, higher rates of depression, and a loss of self esteem. See Sullivan and von Wachter (2007) for references.

In light of the results from worker displacement studies, there is an important good-news corollary to the evidence summarized in Section I. In particular, the dramatic declines in job loss rates since the 1970s and early 1980s suggest that American workers are also much less likely to suffer from costly worker displacement events. It is possible that job loss events are, on average, more costly today than in earlier decades, but I am unaware of persuasive evidence to this effect.

In any event, it would take a very large rise in the average cost of job loss to offset the big long term decline in the incidence of job loss.

C. A Rising Tide of Economic Insecurity?

The evidence summarized in Section I cuts against claims that American workers and families faced a rising tide of economic insecurity in recent years. There are many dimensions of economic insecurity, but the risk of job loss is usually seen as one of the major economic risks facing individuals. That particular risk has declined substantially. At a minimum, the long term decline in job loss rates calls for some revision to alarmist views about rising economic insecurity for American workers and families. At least one major element of economic security has improved in recent decades.

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