Labor Market Shocks

Are There Lessons for Antipoverty Policy?

BY ANN HUFF STEVENS

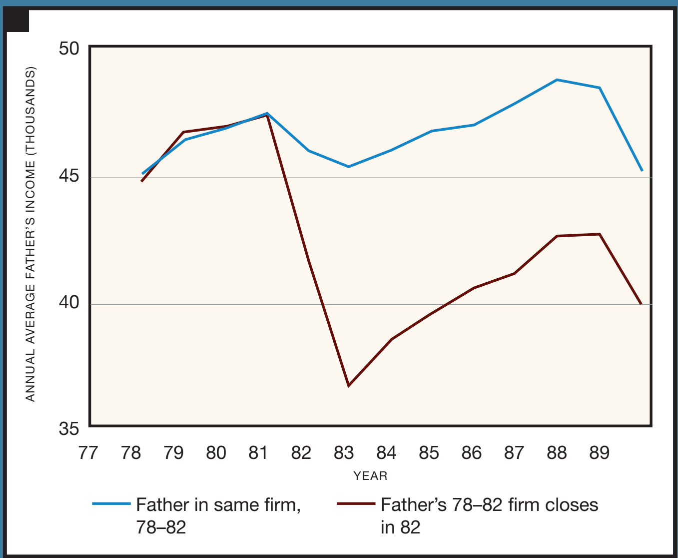
The Great Recession and its aftermath brought hardship to many American families; its full toll will likely not be realized or documented for many years to come. More than 8 million workers lost their jobs during the recession, experiencing dramatically reduced income, increased stress, and a variety of other negative outcomes for themselves and their families.

These effects are important to document and understand in their own right, but they also offer important lessons in how low or variable income may affect the well-being of children and adults in a more general sense—lessons with important implications for antipoverty policy. What are the effects of job loss, and what does that tell us about the lasting effects of low income more generally?

The research on the broad question of the effects of limited income has developed and advanced in recent years in ways that have not been fully appreciated by politicians, policymakers, and the public. Here, I will focus on the effects of job loss on future earnings and a host of other outcomes. Because jobs of course provide earnings, one can gain some leverage on whether money matters for later life outcomes by asking how much the loss of a job matters. The Great Recession provides an important experiment in this respect because—unfortunately—it delivered much in the way of job loss. It reminds us yet again that even those faring well in the labor market in one year can see fortunes change when the economy weakens. The seemingly random shock of a recession-induced job loss can go a long way toward identifying the true effect of losing a job and the income it provides.

The profoundly negative effects of job loss on individuals and families are quite well documented in academic work. I will review evidence accumulated by social scientists over the past two decades that makes clear that the negative income "surprises" that come from permanent job loss have large and persistent effects. This result suggests that long-term exposure to low and uncertain income may have similar negative effects. As mentioned above, the persistence and breadth of these effects have not been well appreciated by policymakers, nor perhaps by citizens who have not themselves been through the unfortunate experience of losing a job. By studying these effects, we can not only better understand how recession and job loss affect current and future generations, but we can also speak to critical policy questions concerning how low or uncertain income affects the well-being of adults and children.

FIGURE 1. Effects of Job Loss on Income



Longitudinal Analysis as the Key Breakthrough

What accounts for this recent growth of knowledge about the effects of job and income loss? The rise of longitudinal analysis is one of the key breakthroughs in this regard.

Although the effects of job loss on income have been studied for decades, in the 1990s longitudinal data became more widely available, enabling analysts to carefully document the persistence of reduced earnings and income that follow job loss over the long haul. Earnings fall steeply when people lose jobs, but even once new jobs are found, average earnings remain below—and sometimes far below—what they were before the initial losses. As time moves on, earnings and family income will recover somewhat, but the research shows that even in the sixth year following a job loss, average earnings are at least 10 percent lower than their starting point.[1] During a deep recession, when a great number of people experience job loss, long-term reductions in earnings may be as high as 25 percent. Although spouses' earnings and other income sources may increase to compensate for the reduced earnings of affected family members, these offsetting increases end up being relatively small contributions to total family income. In Figure 1, I have charted the steep income loss among fathers experiencing a firm closure (and hence job loss) in the early 1980s in Canada, a time when both the Canadian and U.S. economies were undergoing severe recessions.

Recessions Provide More Information on Effects

That job loss frequently leads to sizable and permanent changes in the family income of those affected may not be all that surprising. But job losses also indirectly affect other long-term outcomes, including health outcomes like mortality. I will discuss these indirect effects in more detail shortly, but first I discuss how recessions, in conjunction with longitudinal analysis, have provided much help in identifying the true causal effect of jobs and income. Although recessions may have little redeeming value in general, I will argue that they do at least provide some analytic leverage on the question of the effects of job and income loss.

If we want to understand how income or material resources affect families and children, job loss provides one important vehicle to do so, as families and children will typically experience dramatic change in income when a job is lost. But does an empirically observed job loss tell us much about its true causal effects? Typically, economists and other social scientists are careful to distinguish between correlation and causation. It is generally difficult to claim, for example, that the low income of parents *causes* any possible academic troubles among their children, because the background characteristics that led to their low income may have also caused academic difficulties.

For example, parents who are at risk of job loss are more likely to live in poor neighborhoods, and schools in poor neighborhoods may be of low quality and raise the chances of academic difficulties. However, studies of job loss provide a potential way around this problem, because we can observe families prior to job loss (when they have higher income) and can then study how the *change* in income, presumably driven by forces outside the family, leads to changes in other outcomes, such as children's achievement.

The obvious caveat: This causal inference will be warranted only if the job loss itself is not associated with individual characteristics that might also lead to worse outcomes for parents or kids. For example, a working parent may suffer a major health problem, such as depression, that leads to job loss. And while this parent's income does drop, it may be the deterioration in parental health that leads to negative outcomes for children, rather than the drop in income per se.

This is precisely why recessions are so useful for purposes of research. In particular, studying job losses that occur as part of broad economic downturns, firm closings, and mass layoffs makes it less likely that individual workers have been selected for dismissal for reasons that might also account for the outcomes of interest (e.g., children's academic achievement). In addition, we can often measure outcomes for the same individuals both before and after a job loss, sometimes even accounting for typical trends in those outcomes and, in this way, track the change in income to the change in outcomes. These approaches have helped establish that the long-term reductions in earnings are caused by job loss, and the same approaches can help tie the associated earnings reductions to changes in health, educational, and other outcomes.

This job-loss approach to exploring the effects of income is not without some problems. On the one hand, it may be that the sharp changes in family circumstances, or the uncertainty introduced by the need to find new employment, extend beyond the stress or lack of resources associated with low but stable incomes. This suggests the causal effects of job loss might overstate the causal role of income. For example, if the children's academic success falls following a job loss because a parent can no longer afford the child's private school, academic success could still rebound over a longer time span as the parent adapts to his or her newly low income. On the other hand, families with a previous history of higher, stable income may have assets and savings that make them better able to compensate for even permanent reductions in income, such that job loss could understate responses to low income when such resources do not exist.

The Wide Span of Consequences

With the preceding detour into methods of research that help establish causality, we are now in a position to lay out the wide span of consequences of job and income loss. And the span of consequences is indeed wide.

First, there is strong evidence that job losses lead to substantive changes in health outcomes for affected workers. Job losses from mass layoff events result in increases in mortality among laid-off workers over the next several decades. Important work by economists has followed workers who lost jobs as part of mass layoffs in the recessionary periods of 1980s Pennsylvania.[2] Among workers who lost jobs, the risk of death increased by 10 to 15 percent per year over the next 20 years. What leads to these increases in mortality? Here we know less, but there is evidence that the greater the income loss and the greater the variability of income after a job loss, the larger the increase in mortality.

Other studies have examined health after a job loss, but over a shorter time frame. Among the best of such studies, there is evidence that many conditions that are likely related to higher stress, including both physical and mental health problems, increase substantially in the years following a job loss.[3]

The effects of job loss extend beyond the person directly affected. Income losses, after all, are shared with the entire family. In this sense, the effects of economic shocks on children may shed some light on why low incomes might have causal effects that extend well into the next generation. For example, we know that kids whose parents have lost jobs are more likely to experience difficulties in school, such as being expelled or needing to repeat a grade.[4] At the aggregate level, researchers have shown that local firm closings can lead to reductions in school-level test scores, presumably reflecting the cumulative effects of many parents located in a single district experiencing economic stress.[5]

We also have evidence that effects of job losses on kids are extremely persistent. A study of Canadian parents who lost jobs in the 1980s found that their children had substantially reduced earnings when they were tracked down in young adulthood, with earnings roughly 9 percent below that of comparable kids whose parents had not experienced a job loss.[6] Such research suggests that labor market shocks can haunt the children of affected parents even into their own adult lives.

It also seems, though, that families in precarious financial situations *before* a job loss may be those most likely to be harmed when a job loss occurs. Some of the studies that looked at the effects of job loss on children have also examined whether the effects of job losses differ depending upon where in the distribution of income or socioeconomic background families start out. Job losses among families that begin with relatively high incomes are often found to have smaller effects than those occurring among those closer to the bottom of the income distribution. This points to potential non-linearities in the relationship between income and a host of associated individual and family outcomes. Put differently, a dollar transferred to middle-class families may not have the same effects as a dollar transferred to lower-income families.

A weakness of older studies that attempted to find a causal relationship between income and children's outcomes is precisely this failure to consider such non-linearities. But some studies have been large enough to look at effects on different segments of the population. For example, most of the effect of firm closures on the eventual adult earnings of affected children in the Canadian study was driven by families who started out in the bottom quarter of the earnings distribution.

What Does It Mean for Policy?

The evidence that job and income loss matter for many outcomes is compelling. A broad academic literature has come to understand the long-term, negative consequences that employment shocks have on affected workers. This evidence that job loss affects the income, health, and achievement of current and future generations speaks to the key role of income in helping or hurting poor families. The simple conclusion here: The loss of income and material resources does cause harm and suggests that income support and stability can play a role in reducing the long-term consequences of poverty.

Can we make more specific policy recommendations on the basis of such evidence? The instinct of course is to target policy precisely to causes. If, in other words, the loss of money is causing bad outcomes, then it might be argued that income assistance is the only or best type of intervention needed to improve the fortunes of poor families.

The latter conclusion, attractive though it may seem, ought not be reached unthinkingly. Better education policies, for example, may still be a more efficient and effective remedy to poor children's long-term disadvantages. What we can conclude, however, is that we need to undertake policies that—either directly or indirectly—address the key role that the lack of money plays in producing all sorts of bad outcomes.

The next step is to assess whether direct or indirect approaches to raising income are more likely to have payoff. All else equal, most would probably prefer approaches that provide a human capital foundation for raising income, as these will have enduring effects. It has to be appreciated, however, that policies promoting the development of human capital are sometimes just not enough. However much we ramp up human capital and make people more employable, we will still have far too much poverty, in part because market economies are intrinsically cyclical and have frequent periods of "creative destruction" in which many workers will lose their jobs. In the contemporary U.S. economy, less-skilled workers also face ongoing downward pressure on their wages because of global competition, skill-biased technical change, and other broad economic changes.

The long-term effects of job loss are really a combination of relatively short-term disruptions in employment and much longer-term reductions in wage levels even after workers are re-employed. It follows that policies to increase human capital are not the full answer for either displaced workers or the poor in general. We must also have policies that provide short-term assistance to individuals facing short-term difficulties for a variety of reasons. We know that income loss and stress associated with job loss have real consequences for individuals and their families. While those in chronic poverty may well have additional challenges, including the need to build their underlying skills or stock of human capital, what we have learned about the effects of job loss make it difficult to argue that effective income support policies should play no role in improving the lives of the poor. ■

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