# ORG Insights January 2013

*Candid Real Estate Investment Industry Observations by ORG Professionals*

## *Making Sense of Long-Term Unemployment*

- In more than 60 years of recordkeeping, the U.S. has never had such persistently high levels of long-term unemployment.
- Long-term unemployment is fundamentally one of the most important issues facing the U.S. economy.
- Sustained long-term unemployment places financial, physical and psychological strains on those who are unable to find work—as well as placing budgetary pressures on federal, state and local governments.
- Understanding the drivers behind the high-level of long-term unemployment will provide insight into future economic, monetary and fiscal policy.
- Persistent long-term unemployment could lead to structurally higher levels of overall unemployment.
- Today's high levels of long-term unemployment will constrain future economic growth.
- Slower economic growth will force investors to focus on current income over appreciation.

### *Where do we Begin?*

We can all breathe a sigh of relief—it's January 2013—and we're still here. Whether you thought the world would end on December 21st as the Mayans are said to have predicted—or December 31st as the political pundits predicted—the sun still rose on the 22nd, and the federal government still opened its doors in the New Year. But, for the millions of people in this country that have been out of work six or more months, it may seem like the Mayans had actually been right. In this issue of *ORG Insights*, we'll focus on long-term unemployment, the impact it's having on the nation as a whole, and how this will affect the investment decisions we need to make today.

Long-term term unemployment is defined by the U.S. Bureau of Labor Statistics as unemployment that lasts 27 weeks or longer—and it has become a major problem for the U.S. economy. Long-term unemployment takes its toll at many levels but, as Ben Bernanke's comments to the National Association of Business Economists last March illustrate, the personal toll is tremendous:

> "Surveys indicate that more than one-half of the households experiencing long unemployment spells since the onset of the recent recession withdrew money from savings and retirement accounts to cover expenses, one-half borrowed money from family and friends, and one-third struggled to meet housing expenses. Unemployment also takes a toll on people's health and may have long-term consequences for the families of the unemployed as well. For example, studies suggest that unemployed people suffer from a higher incidence of stress-related health problems such as depression, stroke, and heart disease, and they may have a lower life expectancy. The children of the unemployed achieve less in school and appear to have reduced long-term earnings prospects."[1]

In a report published last February, the Congressional Budget Office ("CBO") echoed Chairman Bernanke's comments:

> "Such persistently high unemployment has wide ranging repercussions: It places financial, psychological, and even physical strains on people who are unable to find

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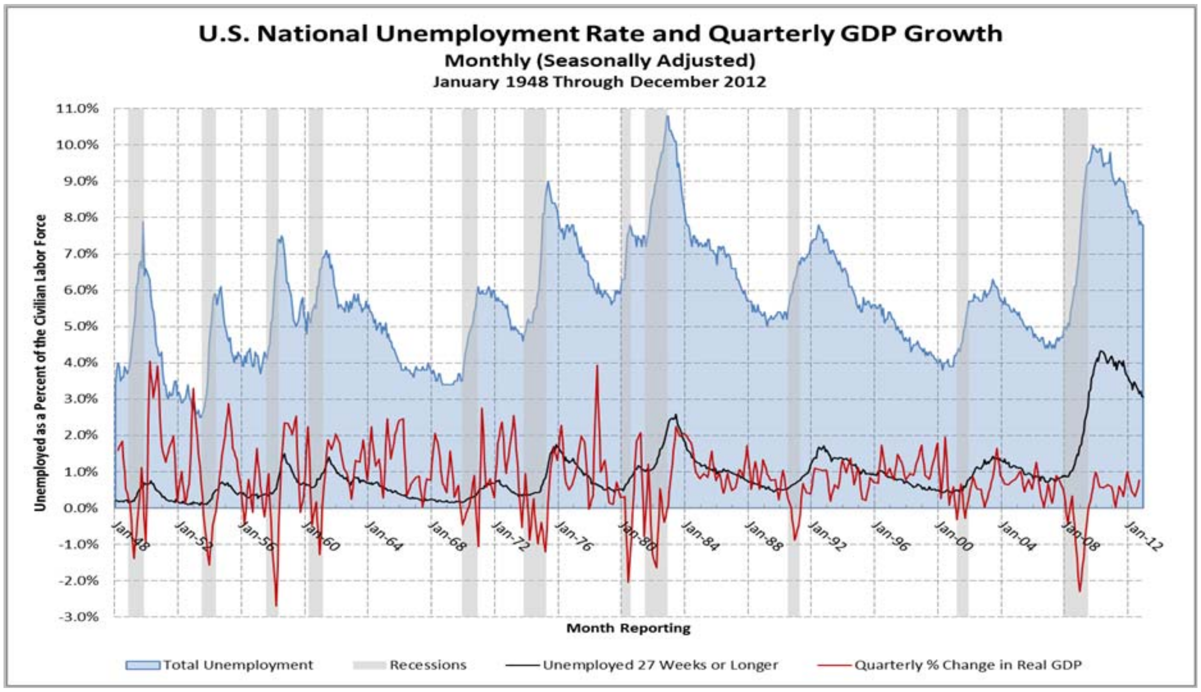
[1] "Recent Developments in the Labor Market"; Remarks by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to the National Association of Business Economists, Arlington, VA, March 26, 2012.

work and on their families as well; it places budgetary pressures on the federal government and on state and local governments, as tax revenues decline and expenditures increase; and it results in a long-term erosion of skills that will reduce the nation's productivity and people's income in the future."[2]

In essence, what the CBO is describing is the potential for a vicious and destructive economic cycle to form. If it does, the impact on future economic growth would be devastating.

**Figure 1: Economic Cycles and the Level of Unemployment in the U.S.**
*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013); U.S. Bureau of Economic Analysis (as of 12/20/2012); National Bureau of Economic Research*




## *How Big is the Problem?*

Economic growth and employment growth usually go hand-in-hand. The flip side of that is economic contraction invariably leads to job losses. As we can see in Figure 1, every time we've gone through a recession, unemployment has increased. We also see that the rate of long-term unemployment increases during these periods. Table 1 provides additional detail on all of the eleven recessions we have experienced since January 1948—how long the recession lasted, as well as the level of overall and long-term unemployment that resulted from that recession. In general, the longer the recession lasted the higher the rate of unemployment that came out of it. At 18 months, the recession that took hold in December 2007 was the single longest recession we've experienced since the end of World War II but, is still 25 months shorter than the recession that began in August 1929 and eventually came to be known as the Great Depression. The 43 month recession that marked the beginning of the Great Depression was followed four years later by a 13 month recession that began in May 1937, and extended the Great Depression through to the start of World War II.

[2]"Understanding and Responding to Persistently High Unemployment"; Congressional Budget Office, February 2012; p. vii.

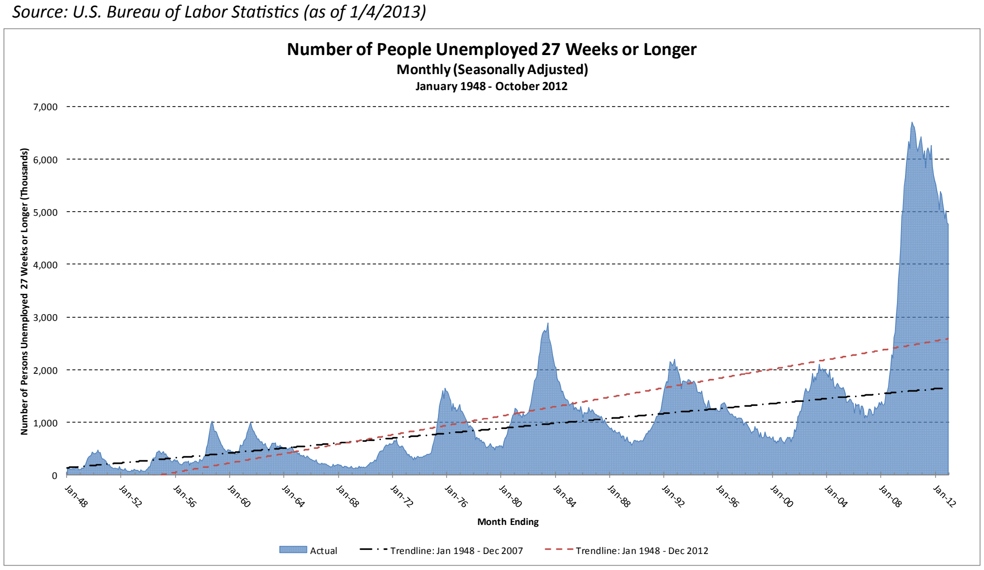
**Table 1: Unemployment and National Recessions**

*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013); National Bureau of Economic Research*

| Official Recessions | | | Total Unemployment | | | Long-Term Unemployment | | |
|---|---|---|---|---|---|---|---|---|
| Start | End | Duration (Months) | Peak Date | Lag to Recession's End | Peak Level | Peak Date | Lag to Recession's End | Peak Level |
| November 1948 | October 1949 | 11 | October 1949 | 0 | 7.90% | April 1950 | 6 | 0.76% |
| July 1953 | May 1954 | 10 | September 1954 | 4 | 6.10% | October 1954 | 5 | 0.71% |
| August 1957 | April 1958 | 8 | July 1958 | 3 | 7.50% | September 1958 | 5 | 1.50% |
| April 1960 | February 1961 | 10 | May 1961 | 3 | 7.10% | July 1961 | 5 | 1.40% |
| December 1969 | November 1970 | 11 | December 1970 | 1 | 6.10% | | | |
| | | | August 1971 | 9 | 6.10% | April 1972 | 17 | 0.78% |
| November 1973 | March 1975 | 16 | May 1975 | 2 | 9.00% | November 1975 | 8 | 1.75% |
| January 1980 | July 1980 | 6 | July 1980 | 0 | 7.80% | January 1981 | 6 | 1.17% |
| July 1981 | November 1982 | 16 | December 1982 | 1 | 10.80% | June 1983 | 7 | 2.58% |
| July 1990 | March 1991 | 8 | June 1992 | 15 | 7.80% | October 1992 | 19 | 1.71% |
| March 2001 | November 2001 | 8 | June 2003 | 19 | 6.30% | June 2003 | 19 | 1.43% |
| December 2007 | June 2009 | 18 | October 2009 | 4 | 10.00% | April 2010 | 10 | 4.34% |

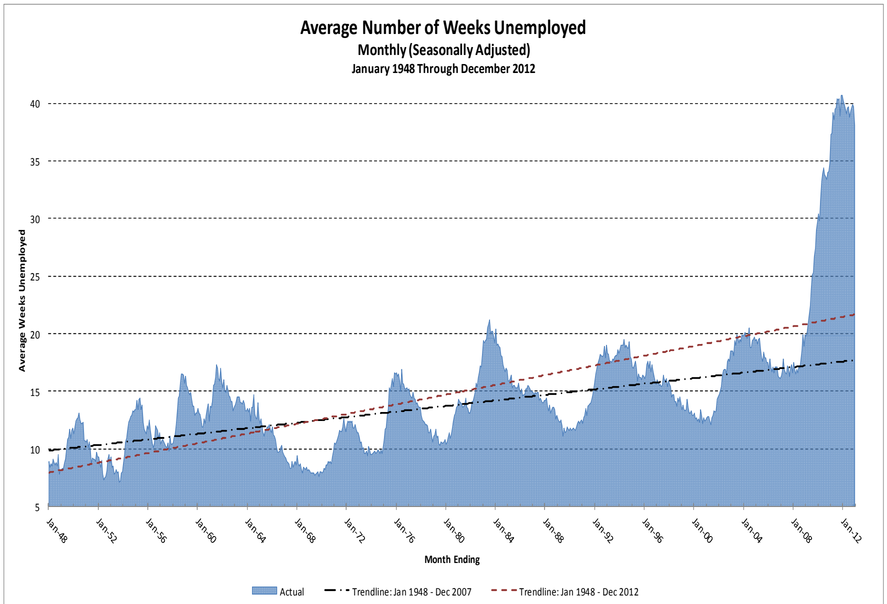
**Figure 2: Long-Term Unemployment Trends in the U.S.**

*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013)*



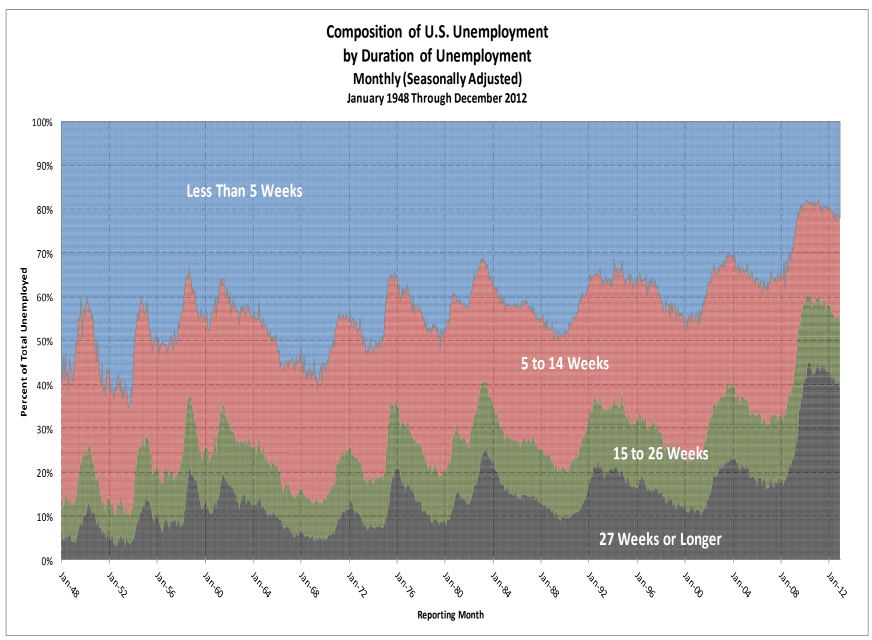

Since this was the longest recession we've experienced since the end of the Great Depression, it comes as no surprise that we reached high levels of unemployment. What is surprising though is the level of sustained long-term unemployment that has persisted for nearly three and a half years after the official end of the recession. At its peak, in April 2010, the number of people in this country unemployed for 27 weeks or longer surpassed 6.7 million (see Figure 2), or 4.34% of the civilian labor force. To put this in perspective, the previous peak, reached in June 1983—after two back-to-back recessions lasting 22 months in total and the complete collapse of the U.S. steel industry—reached 2.885 million, or 2.58% of the civilian labor force. By either of these measures, long-term unemployment today is orders of magnitude worse than anything we've experienced in living memory. To make matters worse, as of December 2012, 42 months after the end of the last recession and 32 months after long-term unemployment peaked, long-term unemployment still stands at 4.766 million, or 3.06% of the civilian labor force. By either of these measures, conditions are still far worse than they were at the previous peak in 1983.

**Figure 3: Duration of Unemployment Trends in the U.S.**
*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013)*




Another way to look at long-term unemployment is the average duration of unemployment. Measured in average number of weeks of unemployment for all unemployed people, average duration of unemployment is another measure of strength or weakness in the economy. As Figure 3 shows us, between 1948 and 2007, the average duration of unemployment has generally stayed between 10 and 20 weeks. When the economy was expanding, average duration of unemployment dropped; occasionally dipping below 10 weeks. When the economy was in recession, average duration of unemployment rose; occasionally reaching, or just surpassing, 20 weeks. But here again, the recession that started in 2007 was different. This time, average duration of unemployment peaked at 40.7 weeks. As a matter of fact, the average duration of unemployment has stayed above 30 weeks for 35 of the past 36 months (the only exception, a slight drop to 29.8 weeks in February 2010), and as of December 2012, stands at 38.1 weeks. On the positive side, this is the lowest level we have seen since February 2011.

**Figure 4: Composition of U.S. Unemployment**
*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013)*




For most of the 65 years for which the Bureau of Labor Statistics publishes unemployment data, the vast majority of the unemployed would have been characterized as short-term unemployed. For several years during the 1940s, '50s, '60s, and '70s, the majority of the unemployed were out of work for less than five weeks (see Figure 4). For all but a few months between January 1948 and January 2008, the vast majority of the unemployed were out of work for 14 weeks or less. However, by June 2009—for the first time since the end of World War II—the majority of the unemployed were out of work 15 weeks or longer. By December 2009, more than forty percent of the unemployed had been out of work 27 weeks or longer—eventually hitting 45.0% in April of 2009 and peaking at 45.3% in December 2009. Regardless of how you wish to interpret this data, this time things really are different.

## *IS THIS AN ANOMALY OR A FUNDAMENTAL CHANGE?*

In that speech last March, to the National Association of Business Economists, Ben Bernanke posed the following question: "Is the current level of long-term unemployment primarily the result of cyclical factors, such as insufficient aggregate demand, or of structural changes such as a worsening mismatch between workers' skills and employers' requirements?"[3]

[3] "Recent Developments in the Labor Market"; Remarks by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to the National Association of Business Economists, Arlington, VA, March 26, 2012.

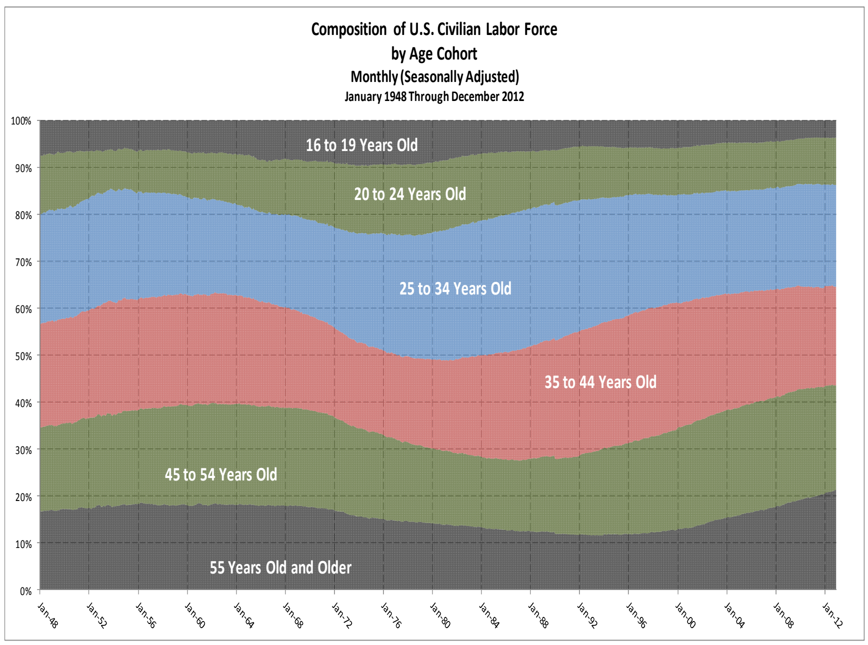
It's not the first time we've been faced with this issue. In a 1984 article from the *Monthly Labor Review*, Philip Rones argued that problems quite unrelated to cyclical declines in demand. Thus, when structural problems appear under the 'cloak' of recession, unemployment problems will persist after economic recovery is well under way."[4]

With the benefit of 30 years hindsight, we now recognize that what Mr. Rones was describing is in Chairman Bernanke's words, the result of *"a worsening mismatch between workers' skills and employers' requirements."* The steel industry—which had been an integral part of America's economic expansion in the latter-half of the 19th and the first-half of the 20th centuries—had for all intents and purposes, gone away. The adjustment for the millions affected was long and painful. The jobs they had lost were not coming back.

For better or worse, recent research is showing that we are not going down the same path as we did with steel in the 1980s. In a recent analysis of the rising duration of unemployment in this country, Daniel Aaronson, Bhashkar Mazumder, and Shani Schecter discovered that the long-term unemployed had become sectorally more diverse.[5] In 2009, the long-term unemployed were more likely to come from professional and business services and finance, insurance, and real estate, relative to 1983—while the share of manufacturing/factory workers went down. Generally, in this most recent surge, long-term unemployment was more equally weighted across industry, occupation, education, gender, and age groups, and was therefore more representative of the labor force and the population than it had been in the early 80s, when the steel industry was in decline.

**Figure 5: Composition of U.S. Civilian Labor Force**

*Source: U.S. Bureau of Labor Statistics (as of 1/4/2013)*




To be sure, structural decline of an entire industry is not the only potential driver behind the surge in long-term unemployment we are currently experiencing. In their analysis, Aaronson, Mazumder, and Schecter went on to posit that the changing demographic characteristics of the labor force are one potential source of rising unemployment duration.[6] Their research showed that all of the substantial rise in the average duration of unemployment between the mid-1980s and mid-2000s can be explained by demographic changes in the labor force, namely, the aging of the population and the increased labor force attachment of women. But, when they looked at the spike in long-term unemployment in 2009, they found that only one-half of the increase in average duration of unemployment relative to that of the early 1980s may be due to demographic factors. If we refer to Figure 2, the line marked *Trendline: Jan 1948 – Dec 2007* provides an approximate graphic representation of the rise in long-term unemployment due to demographic changes. Even without detailed statistical analysis, it would be apparent to just about anyone that the surge in long-term unemployment we experienced in 2009 was a substantial deviation from these naturally occurring trends. Their research showed that weak labor demand was a significant driver behind the sharp increase in unemployment duration in 2009. To a smaller degree—perhaps 10 percent to 25 percent—extensions in unemployment insurance benefits were found to have an impact on increasing duration of unemployment. Figure 5, which provides a view of the composition of the labor force by age cohort, shows that there is merit to their argument. It also underscores that the dramatic spike in long-term unemployment in 2009 cannot have been the result of changing demographics alone. Despite evidence that

[4] "Recent recessions swell ranks of the long-term unemployed"; Monthly Labor Review, February 1984; Philip L. Rones; pp. 25-26.

[5] "What is behind the rise in long-term unemployment?"; Economic Perspectives, Federal Reserve Bank of Chicago, 2Q/2010, Daniel Aaronson, Bhashkar Mazumder, and Shani Schechter, p. 34.

[6] "What is behind the rise in long-term unemployment?"; Economic Perspectives, Federal Reserve Bank of Chicago, 2Q/2010, Daniel Aaronson, Bhashkar Mazumder, and Shani Schechter, pp. 28-29.

this is a cyclical event rather than a secular one, if we don't act, this could quickly devolve into a structural change. As demonstrated by the following comments, this belief is clearly shared by the Fed Chairman:

> "We must watch long-term unemployment especially carefully, however. Even if the primary cause of high long-term unemployment is insufficient aggregate demand, if progress in reducing unemployment is too slow, the long-term unemployed will see their skills and labor force attachment atrophy further, possibly converting a cyclical problem into a structural one."[7]

## *Our Own Gordian Knot*

While economists often view unemployment as a natural, even important, part of a healthy economy—left unchecked, it can become self-perpetuating. Short-term unemployment is typically viewed as a mechanism by which participants in the labor force maximize their economic value—you lose or leave your job, and as a result of your increased experience and expanded professional network, you find a better, higher paying job. At least that's how it's supposed to work in a healthy economy. What Aaronson, Mazumder, and Schechter found was that the longer you are unemployed, the less likely you are to become reemployed.[8] They found that, in any given month, individuals with longer unemployment spells were less likely to be employed the following month. What this suggested was that the average ongoing term of unemployment is likely to remain longer than usual well into the economic recovery and expansion, plausibly keeping the unemployment rate above levels observed in past recoveries. Aaronson's analysis suggested that the unemployment rate is probably half a point higher than it would be if unemployment spell lengths were at more historical levels.[9] Given that their research was published more than a year and a half ago, and that overall unemployment and long-term unemployment have remained stubbornly high, this observation appears to be on target. Based upon what we see in Figure 3—with the average duration of unemployment continuing to hover near 40 weeks, or double the peak of any previous recession—it doesn't appear that we can expect unemployment to return to what were once considered "normal" levels any time soon.

Other research has shown that duration of unemployment is less important than the mere fact that you are unemployed. A recent survey-based analysis by Geoffrey Ho, Margaret Shih, Daniel Walters, and Todd Pittinsky found that:

> "unemployment stigma exists, occurs instantaneously (i.e., the moment an individual is unemployed), is unjustifiable (i.e., without regard to qualifications), difficult to alleviate (i.e., causal controllability of unemployment-onset did not affect stigma), and has negative consequences (i.e., leads to hiring biases against the unemployed)."[10]

Another survey from Bullhorn, a recruiting software company, found that hiring managers and recruiters believe it's easier to place a candidate who has a job—but who also has a criminal record—than a person who's been unemployed for more than two years.[11] These biases are certainly not new and can often be perpetuated by authoritative sources, as evidenced by this quote from the February 1984 Monthly Labor Review:

> "Those workers who had become unemployed early in the downturn often have the least skills and the least seniority, and it typically requires a sustained period of recovery for them to obtain employment."[12]

Because of the stigma that is associated with it, regardless of the reason for your unemployment, getting rehired can become a monumental task—particularly when confidence in sustained economic growth is lacking and so many others are competing for the same jobs.

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[7]"Recent Developments in the Labor Market"; Remarks by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to the National Association of Business Economists, Arlington, VA, March 26, 2012.

[8]"What is behind the rise in long-term unemployment?"; Economic Perspectives, Federal Reserve Bank of Chicago, 2Q/2010, Daniel Aaronson, Bhashkar Mazumder, and Shani Schechter, p. 29.

[9]"What is behind the rise in long-term unemployment?"; Economic Perspectives, Federal Reserve Bank of Chicago, 2Q/2010, Daniel Aaronson, Bhashkar Mazumder, and Shani Schechter, p. 45.

[10]"The Stigma of Unemployment: When Joblessness leads to being jobless"; Geoffrey C. Ho, Margaret Shih, Daniel J. Walters, Todd L. Pittinsky; December 12, 2011; p. 11 http://escholarship.org/uc/item/7nh039h1

[11]"Long-Term Unemployment Worse Than A Criminal Record When It Comes to Job Placement: Survey"; Huffington Post, Sept. 18, 2012.

[12]"Recent recessions swell ranks of the long-term unemployed"; Monthly Labor Review, February 1984; Philip L. Rones; p. 26.

The stigma associated with being unemployed has become a big enough issue that a number of states have addressed it through legislation.[13] In 2011, New Jersey became the first state to pass a law prohibiting discrimination against the unemployed. Bills were also introduced during the 2011 legislative sessions in Illinois, Michigan, New York and Ohio. In 2012, Seventeen states and the District of Columbia considered bills prohibiting discrimination against the unemployed in either hiring or advertising job openings. Oregon passed a law in March 2012 and the District of Columbia[14] passed a law that became effective in May 2012.

Long-term unemployment also has a direct impact on national economic and fiscal policy. Let's consider Ben Bernanke's earlier question about whether the current level of long-term unemployment is the result of cyclical factors or structural changes. The answer to that question will have a direct impact on policies at the Federal Reserve Bank, as shown by the following passage from a 2011 working paper from the Federal Reserve Bank of San Francisco:

> "The stubbornly high rate of unemployment in the face of ongoing GDP growth and rising job openings has raised concerns that the level of structural unemployment, or the natural rate of unemployment, has risen over the past few years in the United States. This is an important policy issue since short-run monetary and fiscal stabilization policies are not designed to alleviate structural unemployment and can be costly if misapplied."[15]

Arguing that today's long-term unemployment is predominantly driven by cyclical factors, not structural changes, Bernanke has stated that

> "the Federal Reserve's accommodative monetary policies, by providing support for demand and for the recovery, should help, over time, to reduce long-term unemployment."[16]

It's not just the Federal Reserve that has the responsibility and the power to address this important national issue. Early last year, the CBO published a report titled *Understanding and Responding to Persistently High Unemployment*. The report was prepared at the request of the Ranking Member of the House Committee on Ways and Means, and in keeping with the CBO's mandate makes no recommendations. But, the observations that were made in the report could have an impact on future legislation. It was noted that:

> "Initiatives that would reduce the marginal cost to businesses of adding employees or that would target people most likely to spend the additional income (generally, people with lower income) would have the largest effects on employment per dollar of budgetary cost in 2012 and 2013, CBO found. Policies affecting businesses' cash flow would have little impact on their marginal incentives to hire or invest and, therefore, would have only small effects on employment per dollar of budgetary cost."[17]
>
> In that report, the CBO concluded that:
>
> "Policies that would have the largest effects on employment per dollar of budgetary cost in 2012 and 2013 are those that would reduce the marginal cost to businesses of adding employees or that would target people most likely to spend the additional income. Such policies include reducing employers' payroll taxes (especially if limited to firms that increase their payroll), increasing aid to the unemployed, and providing additional refundable tax credits in 2012 for lower and middle-income households."[18]

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[13] National Conference of State Legislatures; http://www.ncsl.org/issues-research/labor/discrimination-against-the-unemployed.aspx

[14] Council of the District of Columbia; http://dcclims1.dccouncil.us/lims/legislation.aspx?LegNo=B19-0486&Description=%22UNEMPLOYED+ANTI-DISCRIMINATION+AMENDMENT+ACT+OF+2011%22.&ID=26794.

[15] "A Rising Natural Rate of Unemployment: Transitory or Permanent?"; Working Paper 2011-05, Federal Reserve Bank of San Francisco Working Paper Series, Sept. 2011, p. 20.

[16] "Recent Developments in the Labor Market"; Remarks by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to the National Association of Business Economists, Arlington, VA, March 26, 2012.

[17] "Understanding and Responding to Persistently High Unemployment"; Congressional Budget Office, February 2012; p. vii.

[18] "Understanding and Responding to Persistently High Unemployment"; Congressional Budget Office, February 2012; p. 14.

### *Summing it up*

The Rust Belt—those cities that were a remnant of America's industrial prime—was a tangible reminder of the havoc caused by the structural economic changes this country went through in the 1970s and '80s. While it may not have been apparent in the moment, many of the heavy industries that were responsible for the economic growth of this country over the prior century were in permanent decline. What was apparent was one of the painful symptoms of this decline—long-term unemployment. Flash forward 30 years, and we're suffering from that very same symptom, but it still isn't clear what the primary underlying cause of today's high level of long-term unemployment is. The Federal Government and the Federal Reserve Bank have a number of tools at their disposal to address this painful symptom but, to choose the right tools; they will need to understand the primary drivers that have caused the long-term unemployment in the first place.

The research that has been done on the subject seems to indicate that insufficient aggregate demand, rather than some larger structural change, is behind the extremely high level of long-term unemployment. Aaronson, et. al. found that in 2009 the long-term unemployed came from a diverse group of industries. Even though we can't point a finger at any one industry, are we—to paraphrase Mr. Rones—faced with a structural problem hiding under the cloak of recession? After all, our long-term unemployment problems have persisted for three and a half years after our last recession ended. Unfortunately, the answer to that question will only be clear in retrospect.

Regardless of what's driving our current high level of long-term unemployment, one thing is certain—these high levels will negatively affect both consumer demand and economic growth for a significant period of time. We will need to be prepared for a lower growth environment. Translating this to investment strategies, we will need to focus our attention on investments that provide stable and sustainable current income. While this isn't an argument that appreciation won't occur, we need to be cognizant that if we are faced with a slow growth environment, the factors that normally contribute to appreciation will be subdued—likely resulting in subdued appreciation. Although it's unlikely that we will be left with a physical artifact like the Rust Belt to remind us of this last recession, its effect on us will be no less memorable.

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