



Causes and Impacts of Job Displacements and Public Policy Responses

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Across the globe, both cyclical downturns and structural changes episodically eliminate substantial numbers of jobs and in the process create serious dislocations. For instance, the rise in joblessness because of the ongoing COVID-19 crisis is projected to be extraordinarily steep. As a response to job displacements, governments have implemented a range of measures to financially compensate displaced workers, assist them in finding reemployment, or both. The challenges should not be minimized: job losses have significant economic as well as social and psychological consequences; laid-off workers often lack the skills or geographic proximity to easily transfer to sectors that are growing; and providing adequate support can be expensive. Nonetheless, careful public policy responses can help mitigate the costs of job displacements and support workers in finding productive reemployment.

Causes and Impacts of Job Displacements

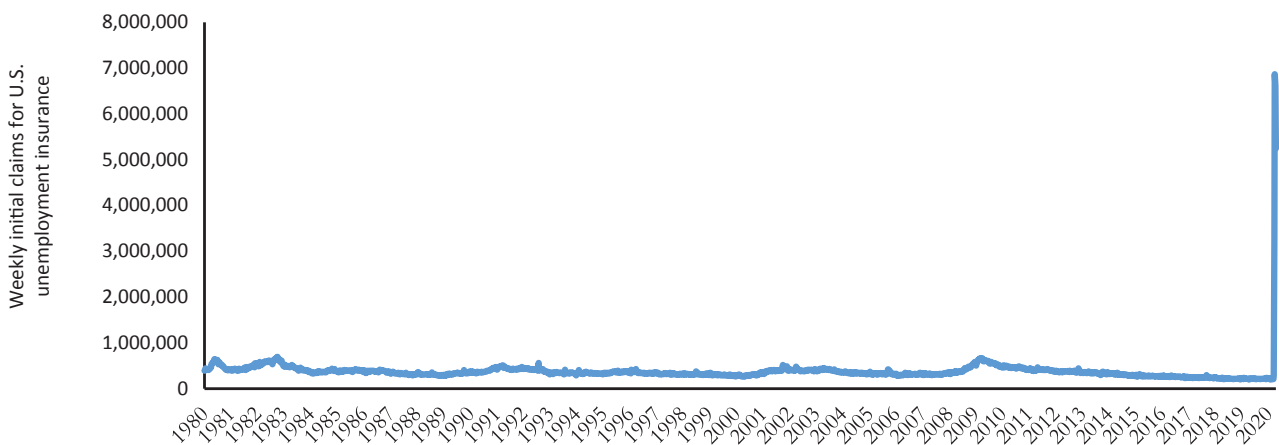
Across the globe, both cyclical downturns and structural changes related to shifts in trade patterns, consumer demand, technology, or other causes have episodically eliminated substantial numbers of jobs (Brand 2015). In the United States, roughly 10 percent of workers are displaced from their job—that is, laid-off on economic grounds—over a typical three-year period, Farber (2017) documents. Farber (2017) further shows that the rate of job loss is procyclical, amounting to around 12 percent even in relatively mild recessions; during the global financial crisis of 2007 to 2009 it reached 16 percent. Early indications like an unprecedented increase in the number of weekly applications for unemployment insurance benefits in the United States from 282,000 to 3,283,000 during the week ending March 21, 2020 and to 6,867,000 the following week suggest that the job loss rate during the ongoing COVID-19 crisis will likely be higher still (figure 1). As for structural changes, there are concerns that breakthrough technologies such as artificial intelligence and robotics will radically change the nature of work and dwarf previous waves of technological change in terms of labor market disruption (Chua, Loayza, and Schmillen 2018). These forces and prospects make it imperative to understand the impacts of job displacements and the advantages and drawbacks of possible public policy responses.

Over the past 25 years, a sizable literature, starting with Ruhm (1991) and Jacobson, LaLonde, and Sullivan (1993), has documented that job displacements have dramatic and long-lasting effects on the employment, earnings, and income prospects of laid-off workers, especially those in formal employment relationships and with

previously long job tenure. Research shows that many displaced workers have extended spells of unemployment and that once they find reemployment, they tend to suffer significant and long-lasting earnings reductions. U.S. workers displaced from previously stable employment relationships in the recession of 1982 suffered immediate losses in annual earnings of 30 percent as compared to similar nondisplaced workers, von Wachter, Song, and Manchester (2008) document. Even 15 to 20 years later, their average earnings losses amounted to 15 to 20 percent of their earnings before they were displaced. Effects of a similar size have been documented for displaced workers in Germany (Schmieder, von Wachter, and Bender 2010; vom Berge and Schmillen 2015) (figure 2). In addition, the literature shows that job displacements have detrimental and durable effects on consumption (Browning and Crossley 2008); health and mortality (Browning and Heinesen 2012); fertility (Del Bono, Weber, and Winter-Ebmer 2012); and other outcome variables; and that the effects of job displacements are strongly procyclical (Davis and von Wachter 2011).

Going even further, large-scale job displacement may have significant impacts on entire communities. The emerging literature on the size of such indirect effects has not yet reached a consensus: While vom Berge and Schmillen (2015) find no evidence of additional job losses for workers at establishments located in the vicinity of mass layoff events with average losses of around 200 to 300 jobs, Gathmann, Helm, and Schönberg (2019) argue that local spillover effects add further employment losses in case of larger mass layoffs with average direct losses closer to 2,000 jobs. Arguably, significant community-wide indirect effects are to be expected only in the case of

Figure 1. Weekly Initial Claims for Unemployment Insurance in the United States, Week of January 5 1980–Week of April 11 2020



Source: U.S. Employment and Training Administration.
Note: Data are seasonally adjusted.

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Figure 2. Earnings and Employment before and after Job Displacements in Germany, 2000–10



Source: vom Berge and Schmillen (2015), based on German administrative Social Security data.

Note: The analysis comprises workers in stable jobs who were displaced in a mass layoff in 2009, compares them to a control group that did not experience a mass layoff, and controls for individual-specific time trends.

particularly large-scale and geographically concentrated job displacements. This hypothesis is consistent with qualitative evidence that suggests that job displacements in Poland’s coal-mining industry in the 1990s led to the economic decline of affected communities and to various social problems including crime, alcohol and substance abuse, health problems, and the abandonment of housing (Haney and Shkaratan 2003).

While much of the literature on the impacts of job displacements has focused on developed economies, there is evidence that impacts of job loss are also significant and long-lasting for workers in developing countries—at least for workers in these countries’ formal sectors. China’s experience in the late 1990s and early 2000s is a case in point. During this time, tens of millions of workers were laid off as employment guarantees for employees of state-owned enterprises were removed. The sheer number of job displacements posed tremendous economic and social challenges. Empirical analyses document that for laid-off workers rates of labor force withdrawal were high and rates of formal sector reemployment were low. Many displaced workers found work in the informal sector, which cushioned some of the effects of the job displacement (Betcherman and Blunch 2008).

More broadly, the existence of a large informal sector is a characteristic feature of labor markets in developing economies. While this poses myriad challenges, this sector can also act as a countercyclical safety net in times of crisis (Loayza and Rigolini 2011; Colombo, Menna, and Tirelli 2019). Moreover, while direct evidence of the impact of job losses on informal sector workers is largely missing, it can be conjectured that because uncertainty and churn are usual features of work in this sector, the impact of losing any particular informal “job” might be relatively muted—at least outside of extraordinary circumstances like the ongoing COVID-19 crisis, which threatens to hit informal workers particularly hard (Loayza and Pennings 2020).

Public Policy Responses

While the challenges of job displacements should not be minimized, careful public policy responses in the form of temporary income support and active labor market policies can mitigate the human and social costs and support displaced workers in finding productive reemployment. In this context, international experiences—in terms of both successes and failures—can be informative. For instance, to mitigate the effects of tens of millions of job displacements in the late 1990s and early 2000s, China introduced a large-scale reemployment program that provided temporary income support and active labor market policies. As documented by Giles, Park, and Cai (2006), the

performance of the program was relatively poor in terms of benefit coverage, adequacy, and leakage. At the same time, it reached a large number of displaced workers and there is evidence of some positive labor market impacts (Betcherman and Blunch 2008). While beyond the scope of this Research & Policy Brief, certain place-based policies such as local economic development grants have also shown promise in mitigating community-wide impacts of large-scale job displacements. For instance, evaluations of the European Union’s regional policy show that such grants can have a long-term positive impact on a region’s economic growth, though their effects on employment tend to be less clear cut (Becker, Egger, and von Ehrlich 2010).

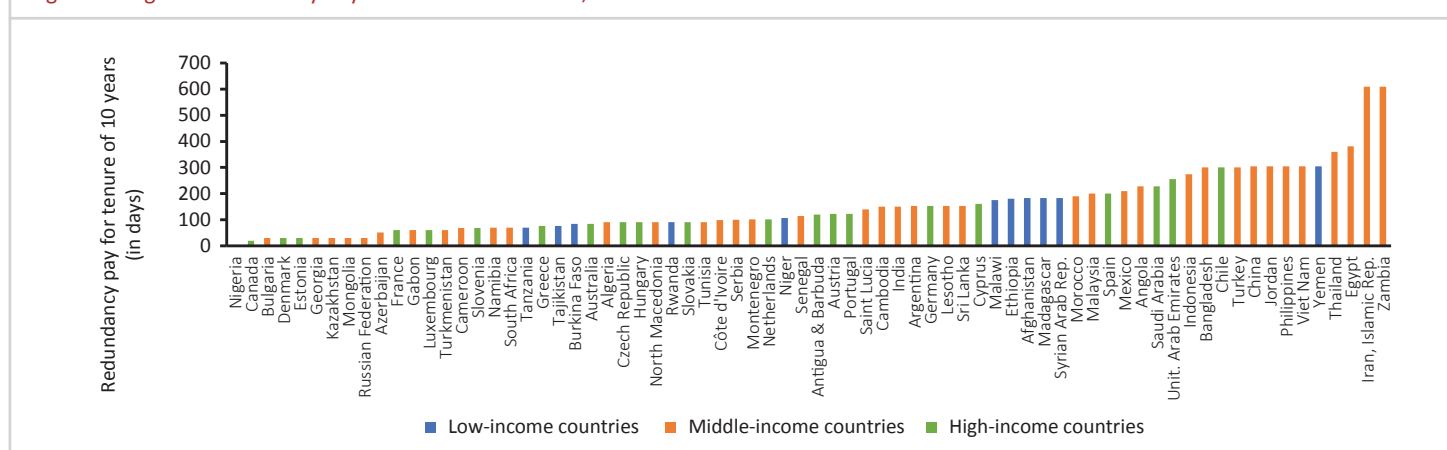
Temporary income support

The first widespread approach generally used to support laid-off workers is temporary income support. There are three main modalities for temporary income support to displaced workers: unemployment insurance, redundancy payments, and social assistance programs. How these instruments are designed and implemented has significant effects on the coverage and adequacy of income support and on workers’ incentive to look for jobs.

An *unemployment insurance system*, if it exists, provides a first line of support for laid-off workers in the formal sector. However, unemployment insurance systems are usually designed as insurance for relatively short-term, frictional spells of unemployment, not for longer-term spells that are typical of job displacements caused by structural change or extraordinary circumstances like the ongoing COVID-19 crisis. Some countries have tried to improve the support that unemployment insurance can offer in such situations. For example, the unemployment insurance system in the United States has an extended benefits feature that is triggered in times of high unemployment, whereas Canada ties benefit levels and duration to regional unemployment rates, so support is greater when and where joblessness is high. While unemployment insurance systems can offer extended income support to displaced workers, studies show that very long benefit periods can serve as a disincentive to search for work (Schmieder and von Wachter 2016).

Redundancy payments can also provide income support for displaced workers in the formal sector. Depending on the design, they can sometimes support these workers for a longer period than unemployment insurance. They can take the form of regular redundancy payments that firms fund and pay out upon separation on economic grounds or, in cases where large-scale layoffs occur, countries can set up special funds to dispense redundancy payments to laid-off workers in the affected industry or region. The generosity of redundancy payments varies considerably from country to country,

Figure 3. Regular Redundancy Pay for Tenure of 10 Years, Selected Countries



Source: International Labor Organization (ILO) EPLex database.
 Note: Redundancy pay expressed in daily wages. The latest year of available data is shown.

depending on factors such as the general level of development, employers’ legal and contractual right and obligations, and the strength of worker representatives in negotiations. Among upper-middle income countries, the mean benefit level for an employee with 20 years of tenure is 7.5 times monthly wages, Holzmann and Vodopivec (2011) find. Across the world, regular redundancy pay for a worker with 10 years of tenure ranges from zero to 20 times monthly wages, the EPLex database of the International Labor Organization (ILO) shows (figure 3).

Social assistance programs can provide a third line of support to displaced workers. Social assistance programs are noncontributory interventions usually based on need, rather than being targeted according to a (prior) employment relationship. In most countries with unemployment insurance systems, unemployment insurance benefits and social assistance benefits are coordinated. For example, a worker may be eligible to receive social assistance benefits only when unemployment insurance benefits have been exhausted. In other countries without an unemployment insurance system or with high rates of informality, a significant part of the income support to displaced workers will need to be provided through social assistance programs. This might also be the case in the ongoing COVID-19 crisis due to the widespread dismissal of informal-sector workers.

Active labor market policies

The second widespread approach to support laid-off workers is to offer services, programs, and incentives that will encourage reemployment. Such *active labor market policies* regularly include one or a combination of *employment services* (such as labor exchanges or mobility assistance), *education and training* (such as classroom-based or on-the-job training), and *business support or subsidized employment* (such as wage subsidies or community employment programs). Temporary income support and active labor market policies should be implemented not as substitutes for but as complements to each other.

International experience suggests that the effectiveness of active labor market policies is mixed and that costs per beneficiary vary widely (table 1). Programs administered in the context of large-scale job displacements during recessionary periods face particular challenges because workers may be unable to easily transfer to another sector or geographic area. They may lack appropriate skills, available jobs may be scarce, and/or moving to another region may be difficult.

Properly designed and implemented active labor market policies can nevertheless significantly increase the reemployment and

Table 1. Evidence of Effectiveness and Costs of Active Labor Market Policies

Type of active labor market policy	Typical direct costs per beneficiary	Impact on probability of employment		
		Short-term	Medium-term	Long-term
Employment services	\$15–\$30 (for labor exchanges)	☑	☑	☒
Education and training	\$250–\$1,000 (for institutional training) \$700–\$2,000 (for combined programs)	☑	☑☑☑	☑☑☑
Business support and subsidized employment	\$500–\$3,000 (for business support) \$300–2,400 (for subsidized employment)	☒	☒	☑

Source: Cunningham and Schmillen (forthcoming) based on Card et al. (2017) and other research cited therein.
 Note: ☑ denotes an impact on the probability of employment of less than 0.05 standard deviations, ☒ an impact of 0.05 to 0.1 standard deviations, and ☑☑☑ an impact of at least 0.1 standard deviations, all according to the meta-analysis by Card et al.
 Employment services include labor exchanges, vocational counseling, and mobility assistance. Education and training include institutional training, on-the-job training, and combined programs. Business support and subsidized employment include small business support, wage subsidies, and community employment programs.

earnings prospects for laid-off workers. The evaluation literature has identified key features of active labor market policies that are associated with positive impacts and cost effectiveness (Card, Kluve, and Weber 2017). Employment services can be very cost effective, but they are of limited use where labor demand is weak. Education and training have high direct and opportunity costs, but may be necessary for many displaced workers given their mismatched skills for emerging jobs. They can yield significant returns if accompanied by strong employer involvement to match education and training with market needs; in the State of Washington in the U.S. the equivalent of one year of community college education raises displaced workers' earnings by 9 percent for older men and 10 percent for older women, Jacobsen, LaLonde, and Sullivan (2005) report. Wage subsidies have been found to increase employment rates for eligible workers, but targeting and design are important to avoid displacing other (ineligible) workers. Community employment programs may be an effective way to provide temporary income support to displaced workers, but rarely enhance participants' future employability.

Two active labor market policies that may be particularly promising for some workers in the context of large-scale job displacements with limited local job opportunities are self-employment assistance and relocation incentives. The former can include access to both credit and technical assistance for potential entrepreneurs and microenterprises. The latter can be a useful instrument when labor markets are stagnant and opportunities exist elsewhere in the country or across the globe (World Bank 2018). Suitable targeting and statistical and case profiling is essential for any strategy involving active labor market policies (IFC 2005). Not all workers will be able to invest in new skills, search for jobs in new sectors, or move to a new location. But if appropriately targeted, many will be able to do at least one of these things.

Conclusion

The ongoing COVID-19 crisis might lead to an unprecedented rise in the rate of job displacements, exacerbating the challenges outlined in this Brief. For policy makers considering how to manage this situation, an important first step will be the development of an action plan based on a detailed, structured, and timely review of realities on the ground. As part of the action plan, properly designed and implemented temporary income support and active labor market

policies can help mitigate the employment impacts of the crisis (World Bank 2020). Critical complementary policies will include measures to ensure that displaced workers and their families have continued access to health and care services.

How will public policy responses to help mitigate the costs of job displacements need to be adjusted during the COVID-19 crisis? While a precise and complete response to this question would depend on the country context and is therefore beyond the scope of this Brief, it helps to distinguish between *relief measures* and *recovery measures* (Loayza and Pennings 2020).

During the COVID-19 crisis, short-term relief measures related to job displacements would necessarily need to focus on the provision of income support, in addition to policies that aim to prevent mass layoffs from happening in the first place. Short-term work schemes—in which workers agree to or are forced to accept a temporary reduction in work hours and pay, and the government bridges some of the resulting income gap—could form an important element of the public policy response during the ongoing crisis. While these schemes cannot successfully mitigate the impacts of permanent shifts in labor demand, they have been successfully used in Austria and Germany to protect jobs when there was a temporary lack of labor demand (Balleer et al. 2016). Medium-term recovery measures could be comprised of a more standard mix of income support and active labor market policies.

Two additional considerations can inform public policy responses to help mitigate the costs of job displacements during the COVID-19 crisis. First, *during the crisis, temporary income support and active labor market policies need to be designed in an inclusive way that broadens eligibility beyond workers in formal jobs*—particularly in developing countries, where an overwhelming share of poor and vulnerable workers are employed informally. This means a significant part of income support measures will need to be financed through general government revenue. Second, *all interventions will need to be implemented in accordance with public health and social distancing requirements*. For instance, as much as feasible, all payments of income support should be made digitally, such as through transfers into beneficiaries' bank accounts or mobile wallets. Similarly, the delivery of active labor market policies should preferably make use of online or mobile channels.

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