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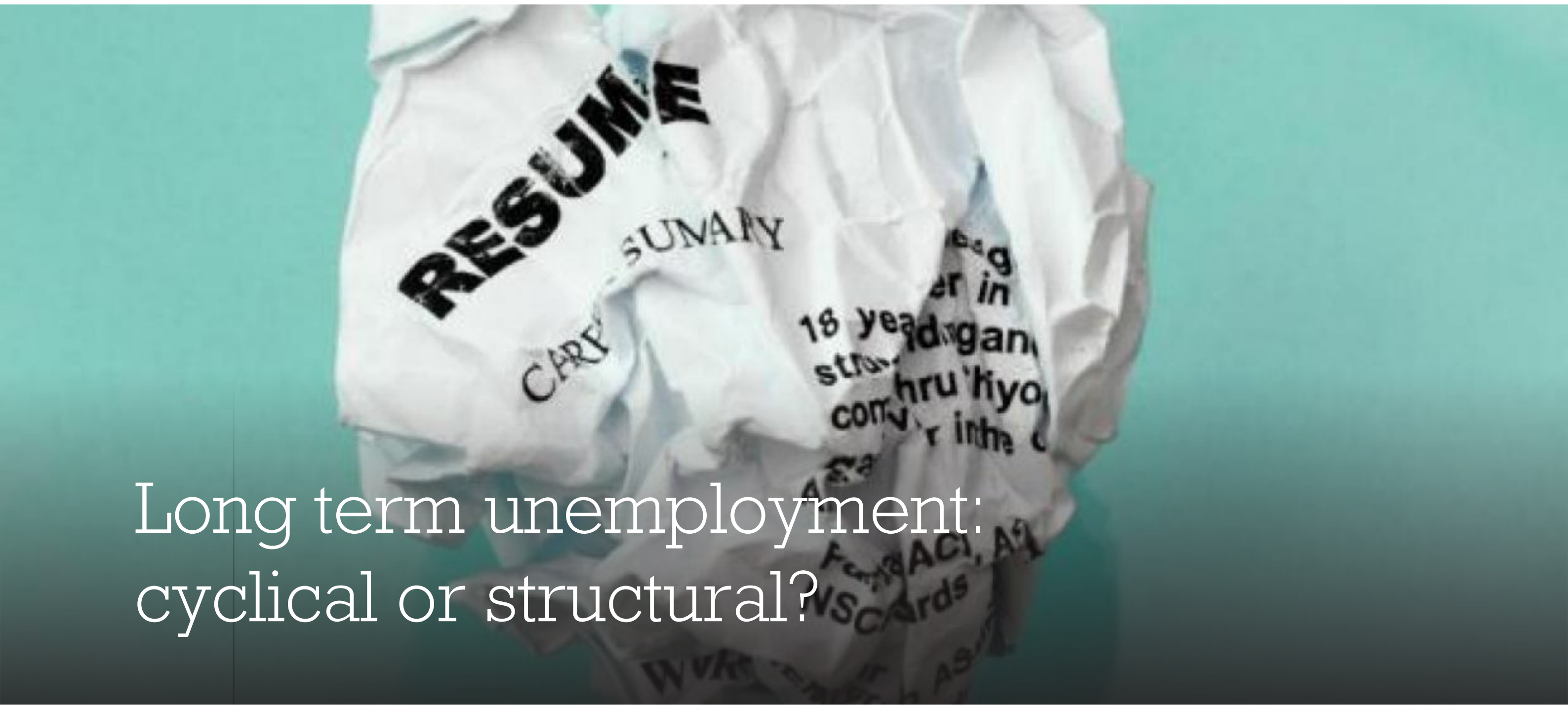


Long term unemployment: cyclical or structural?

The changing relationship between job vacancies and unemployment reflects growing inefficiencies in the labour market. What's the problem?

Since the global financial crisis started there has been a debate about how much of the increase in unemployment is cyclical versus structural. The significant shift in the relationship between job vacancies and unemployment (what is known as the Beveridge curve) in many of the EU countries was noted by Arpaia and Turrini in a recent **Vox post**.

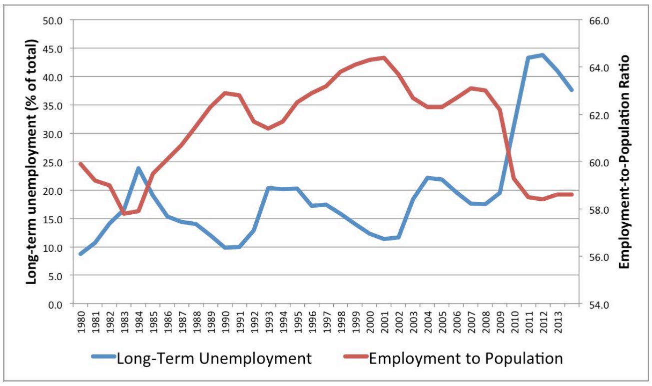
This shift, and further analysis of how unemployment reacts to changes in labor demand, leads them to conclude that there has been a decline in the matching efficiency of the labor market in these countries. They find that:

"... Unsurprisingly, matching efficiency has been falling mostly in the countries that witnessed a marked outward shift in the Beveridge curve, although some signs of stabilisation or even recovery are visible by 2013Q1"

In trying to understand the reason for matching efficiency to decline they test several hypothesis including a mismatch in skills, industry and regions. It is interesting that although the three play a role in the full sample none of them are statistically significant in the post-2007 period (only skills mismatch is close to being significant).

But out of the controls that they introduce in their regressions, there is one that shows up as a strong determinant of change in labor market efficiency: the change in long-term unemployment. In other words, one cannot reject the view that a deep recession resulted in a large increase in cyclical unemployment that turned into long-term unemployment because of the duration of the recession and this has led at a decline in the efficiency of the labor market. This is not far from what **Blanchard and Summers** (back in 1986) labelled as hysteresis - the dependence of a system on both current and past environment - in the labor market when describing the performance of European labor markets in the 70s and 80s. The added insight of Arpaia and Turrini is that the difficulty in reducing long-term unemployment is related to the fact that its high level reduces the overall matching efficiency of the labor market.

The role that long-term unemployment and hysteresis could be playing in the US during the current crisis relative to more structural factors is also a source of debate. What is clear from the data is that the increase in long-term unemployment during this crisis is a lot more pronounced than in any previous crisis, which matches well the deterioration of other labor market indicators (such as the employment to population ratio).



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