

**Discussion of Gallant, Kroft, Lange, Notowidigdo:
Temporary Unemployment and Labor Market Dynamics During
the COVID-19 Recession**

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October 2020

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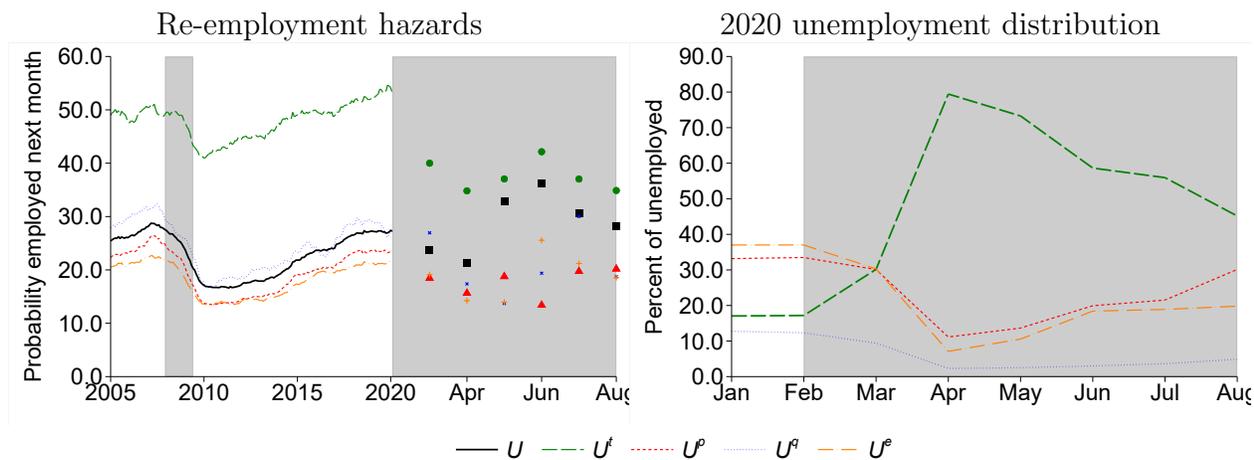
GKLN (as I will henceforth refer to the paper) provide a very nice summary of the COVID labor market to date and an optimistic forecast of the path forward. In this discussion, I will play the skeptic's role and elucidate the forces that may temper their optimism. To get there, I will start with a brief overview of the COVID labor market, then review the GKLN exercise, and finally present three key questions about the future of the recovery and highlight where their forecast omits potentially adverse forces.

Labor market overview. GKLN provide a comprehensive overview of the labor market in the early months of the COVID recession. Four features merit special emphasis. First, despite the unprecedented magnitude of the flows across labor market states, the matching process has remained relatively stable once one conditions on the type of unemployment. That is a key result in GKLN. Second, there has been a historically high share of unemployed on temporary layoff who traditionally have high re-employment rates. Third, separation rates into unemployment have remained high even as the labor market has recovered. The fourth is an implication of the previous: there is a lot of churn.

Figure 1, adapted from Chodorow-Reich and Coglianesi (2020), summarizes the unusual nature of transitions from unemployment into employment. The left panel shows the historical average re-employment hazard rates by type of unemployment and the hazard rates during the COVID recession, computed from the basic monthly CPS survey micro data files. After falling in March and April, the overall re-employment hazard from unemployment rose to a historically high level, as shown by the black squares. At the same time, the re-employment hazard for those on temporary layoff, shown in the green circles, and permanent layoff, shown in the red squares, fell relative to their historical average. The rise in the overall re-employment hazard despite the decline in hazards within unemployment type must reflect changes in composition, shown in the right panel. Temporary layoffs have been a historically high share of the unemployed, as high as 80% in April, and those on temporary layoff have much higher re-employment rates. Put simply, the fast labor market recovery to date is entirely driven by the historically high share of temporary laid off individuals.

GKLN exercise. The GKLN exercise is easily summarized. They extend a standard search-and-matching framework to account for heterogeneity among the unemployed. In particular, they allow for different job-finding rates for those on temporary layoff and not searching, who account for about three-quarters of temporary layoffs, those on temporary layoff and actively searching, by duration, and other unemployed by duration. The exogenous driving forces are the number of vacancies, the separation rate out of employment, transitions

Figure 1: Re-employment Heterogeneity



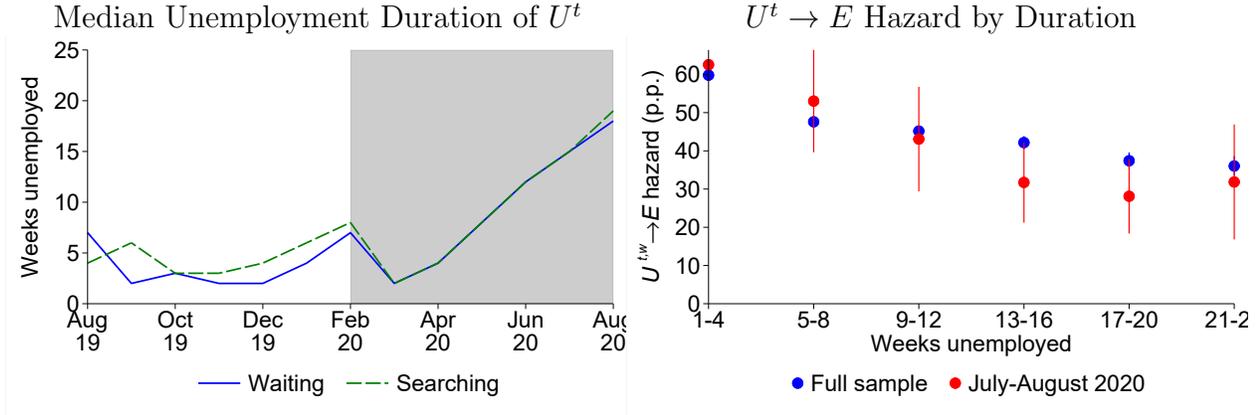
Notes: The left panel plots the re-employment probabilities from unemployment overall (U) and the sub-categories unemployed-temporary layoff (U^t), unemployed-permanent layoff (U^p), unemployed-quit (U^q), and unemployed-entrant (U^e) as twelve month moving-averages through February 2020 and the monthly values thereafter. The right panel plots the distribution of unemployment by status in 2020. Source: Current Population Survey and author's calculations.

among unemployment states and out of the labor force, and the re-employment rate for those on temporary layoff and not actively searching. The endogenous outcome is the job finding rate of searching unemployed, which varies with duration. So another way to view the exercise is as an assessment of the stability of a properly specified matching function. The model fits the data very well overall. The goodness-of-fit partly reflects the importance of the contribution of the temporary layoff not actively searching category, whose job-finding rates are fit exogenously. To put it more generously, the exercise makes clear the importance of temporary layoffs in accounting for flows so far during the COVID recession, formalizing the compositional point made by figure 1.

GKLN use their model to draw two stark implications for the future. First, they project a much more rapid labor market recovery than most government or professional forecasters. Assumed continued high rates of re-employment of those on temporary layoff and declines in new separations underlie this optimism. Recent downward revisions of the unemployment rate by professional forecasters lend some credence to their conclusion. For example, the median forecast of Federal Reserve Board members and Bank presidents in September anticipated an unemployment rate of 7.6% in 2020Q4, down from a median forecast of 9.3% in June.¹ Second, they foresee relatively little long-term unemployment, given how

¹<https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20200916.pdf>.

Figure 2: Duration Dependence of Temporary Unemployed and Waiting



Notes: The left panel plots the median self-reported unemployment duration for individuals on temporary layoff and searching (dashed line) or not (solid line). The right panel plots the coefficients $\{\beta_j\}$ from the regression: $\mathbb{I}\{E_{i,t+1}|U_{i,t}^{t,w} = 1\} = \delta_t + \sum_j \beta_j \mathbb{I}\{\text{Duration} = j\} + \epsilon_{i,j,t}$, where $E_{i,t+1} = 1$ if individual i is employed in month $t + 1$ and 0 otherwise and the sample includes individuals on temporary layoff and not searching in month t . Source: Current Population Survey and author’s calculations.

high the unemployment rate went. This conclusion comports well with Chodorow-Reich and Coglianesi (2020), which takes the very different approach of a factor structure of flows to project unemployment durations during the COVID recession.

I now raise three key questions, the answers to which will determine whether their optimistic forecast proves correct. The first concerns the re-employment hazards of the temporary unemployed, the second the separation rate going forward, and the third the general level of labor demand.

Re-employment from temporary layoff. As of August there were 6.2 million individuals on temporary layoff, which comes to 3.8% of the labor force. With an overall unemployment rate of 8.4%, rapid re-employment of these individuals would generate a fast labor market recovery. Figure 1 of this discussion already showed that the re-employment hazard rate from temporary layoff during COVID has been below its historical average. The GKLN baseline forecast assumes the recall rate *rises* back to its pre-COVID level (which was at a historical high) over the next 24 months, and their alternative scenario assumes it flatlines. In either case, individuals on temporary layoff are re-employed relatively quickly.

I will now suggest the possibility that the re-employment rate from temporary layoff could actually *fall* further instead. Why might this occur? As the share of the unemployed on temporary layoff declined after April, the average duration of unemployment for those still on temporary layoff rose. The left panel of figure 2 shows the median unemployment

duration for those on temporary layoff, separately for those actively searching and waiting. For both categories, the median duration rose from less than 4 weeks in normal times to 18 weeks in August. In other words, the median person on temporary layoff in August first became unemployed as part of the huge separation surge in April.

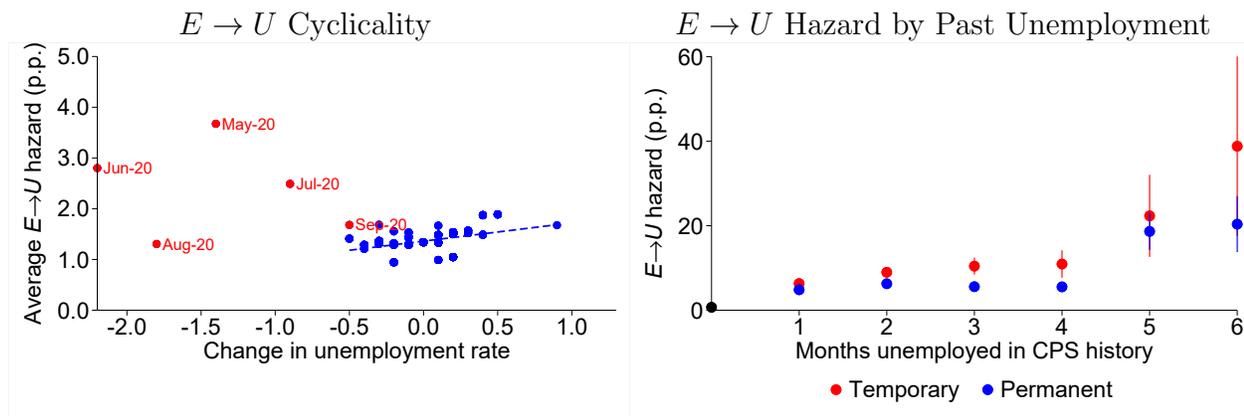
The GKLN model accounts for duration dependence among those who are on temporary layoff and searching, but not those on temporary layoff and waiting. The right panel of figure 2 shows the declining hazard rate among those on temporary layoff and waiting, the counterpart to GLNK’s figure 8 that shows the declining hazard among those on temporary layoff and actively searching. The blue dots plot the duration coefficients from a pooled regression over 1994-2020 of an indicator for returning to employment from temporary layoff on bins of unemployment duration and month fixed effects. The red dots plot the duration relationship using only the most recent CPS survey in August. The pattern is if anything more pronounced in the current episode. For a paper that otherwise shines in its attention to duration dependence among the unemployed, the absence of duration dependence for the temporary laid off not searching, who account for about three-quarters of all temporary layoffs, is an important lacuane.² Accounting for it would suggest that the overall re-employment rate from temporary layoff may decline rather than rise in the coming months, eventually resulting in a concomitant increase in the stock of unemployed not on temporary layoff. This scenario more closely resembles a counterfactual that GLNK relegate to the appendix, where the recall rate of temporary unemployed not searching falls exogenously over the next several months, generating a substantial increase in unemployment relative to their baseline scenario in the paper.

Separations into unemployment. An extremely unusual feature of the COVID labor market has been the continued high rate of separations from employment into unemployment despite an overall falling unemployment rate, as shown in the left panel of figure 3. The blue dots show that typically the $E \rightarrow U$ hazard is lower when the unemployment rate is falling. The red dots show May-August 2020. Separations have remained well above the historical norm despite unprecedented declines in unemployment. This finding echoes the historically high levels of new unemployment insurance claims that have persisted despite the fall in the unemployment rate.

Forecasts of the overall unemployment rate more pessimistic than GKLN implicitly assume

²There is substantial scope to further condition these hazard rates on observable characteristics such as age, sex, industry, and geography of the worker that might shed additional light on the recall hazards going forward.

Figure 3: Separation Hazards and History Dependence



Notes: The left panel plots the hazard rate for separating from employment into unemployment, by month. For readability, the scatter plot excludes the month of April 2020, which had a 10.3 percentage point increase in the unemployment rate and 11.2% $E \rightarrow U$ hazard rate. The right panel plots the coefficients $\{\beta_j^s\}$ from the regression: $\mathbb{I}\{U_{i,t+1}|E_{i,t} = 1\} = \delta_t + \sum_{j \in \{1,2,3,4,5,6\}} \beta_j^t \mathbb{I}\{U_{i,j}^t = 1\} + \sum_{j \in \{1,2,3,4,5,6\}} \beta_j^p \mathbb{I}\{U_{i,j}^p = 1\} + \epsilon_{i,j,t}$, where $U_{i,j}^t$ and $U_{i,j}^p$ index whether individual i was on temporary or permanent layoff, respectively, in CPS month-in-sample j . Source: Current Population Survey and author's calculations.

these high separations continue. This could come from aggregate forces, as I discuss next. History dependence may also contribute. GKLN do not model history dependence among the employed. However, a recent literature on exactly this topic finds that those with recent spells of unemployment return to unemployment more quickly. A key question concerns whether this history dependence reflects true causality or instead selection, which might be less important in the current episode. (The same question applies with equal force to the previous discussion of exit hazards from unemployment by duration.) The literature has not reached consensus on this question. One obvious dimension of heterogeneity concerns history dependence for those previously on temporary versus permanent layoff. Chodorow-Reich and Coglianesse (2020) explore this dimension by analyzing separation hazards of respondents who are employed in their seventh CPS interview month, condition on their employment status in the previous six interviews. The right panel of figure 3 follows that analysis and plots the separation hazard by past months of unemployment, separately for temporary and permanent layoff. Perhaps surprisingly, if anything previous unemployment matters more if the spell was temporary, and this result does not appear driven by seasonality. Thus, incorporating heterogeneity in separation hazards of the employed would suggest that high separation rates may continue as the recovery progresses.

Overall labor demand. Third, probably the most important driver of the labor market recovery is overall demand. The path of overall labor demand is not a question this paper is well-suited to answer; the driving forces — recall rates, vacancies, new separations — all depend on the overall level of labor demand. Nonetheless, we can speculate. The optimistic scenario is simple: a fully functional vaccine arrives quickly, or there is dramatic improvement in testing capacity or treatment. A pessimistic scenario might involve a new wave of infections as flu season ramps up and diminished policy support due to political gridlock. Unfortunately, the pessimistic scenario appears highly plausible. For example, the September forecast of The Institute for Health Metrics and Evaluation had as its baseline outcome a new daily high of COVID deaths in December, stemmed only by the re-imposition of social-distancing measures.

Conclusion GKLN provide what should become a touchstone overview of the early months of the COVID labor market as well as a useful forecasting exercise. I fully agree with their emphasis on temporary layoffs. However, I have offered reasons for caution in adopting their optimistic view of the path forward.

Already their forecast provides grounds for concern. In both simulations shown in the paper, the stock of unemployed individuals not on temporary layoff peaks in July 2020 (see figure 16). In fact, this stock rose in August and September. If this trend continues, the labor market will recover slower than GKLN forecast.

References

Chodorow-Reich, Gabriel and John Coglianesi. 2020. “Projecting Unemployment Durations: A Factor-Flows Simulation Approach With Application to the COVID-19 Recession.” Working Paper 27566. National Bureau of Economic Research.