

THE  
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# An Economic Strategy to Renew American Communities

Michael Greenstone and Adam Looney



## MISSION STATEMENT

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments. We believe that today's increasingly competitive global economy requires public policy ideas commensurate with the challenges of the 21st century. Our strategy calls for combining increased public investments in key growth-enhancing areas, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers — based on credible evidence and experience, not ideology or doctrine — to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first treasury secretary, who laid the foundation for the modern American economy. Consistent with the guiding principles of the Project, Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that “prudent aids and encouragements on the part of government” are necessary to enhance and guide market forces.





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BROOKINGS

# Abstract

When hit by recessions or other economic shocks, some communities have persistently low rates of economic growth that cause them to fall behind the rest of the country. The recovery period for these distressed communities is longer and more painful than necessary. Communities that were disproportionately hit by the 1980–82 recessions still have not recovered and to this day have lower incomes, lower employment rates, and lower income growth than other areas. In addition to these negative economic effects, concentrated poverty may increase social problems like crime. Distressed communities continue to suffer, in part because of a mismatch between the skills of local workers and the needs and wants of business and industries. To address this situation, we propose a three-pronged approach: attract businesses to distressed areas, invest in displaced workers, and match workers to jobs. A component of all these approaches is a commitment to rigorous evaluation of the policies themselves. A failure to evaluate these policies would be a missed opportunity to demonstrate policies that work, and would continue to disadvantage residents of communities that suffer distress. Addressing the problems of distressed communities is particularly relevant today as a result of the Great Recession that began in 2007.

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# Introduction

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In 1950, Buffalo, New York, was the nation's fifteenth largest city, with almost 600,000 residents. It was a nexus of manufacturing and automobile and aircraft assembly, and home to the world's largest steel mill. Its boomtown prosperity radiated out across Great Lakes shipping lanes and railway hubs, and attracted migrants from across the country. As manufacturing employment surged through the midcentury, Buffalo continued to prosper. Families made it their home and raised children; parents had every reason to believe that if their children stayed in school and out of trouble, the standard of living of the next generation would be greater than theirs. They lived the American dream. As the president of Bethlehem Steel—operator of the steel plant—said of the city in 1970, “You can't help but believe that a tremendous decade lies ahead” (Goldman 1983).

But four incredibly harsh recessions between 1969 and 1982 pushed Buffalo—and many other manufacturing-based cities—off this path to prosperity. During each period of recession, manufacturing employment in the United States

**...no city should suffer the persistent distress that this city and others like it have endured—it should not take forty years for a city to recover.**

plummeted between 9 and 15 percent. These were not temporary layoffs—jobs were eliminated, shifts were cut, and plants were closed. The steel mill, which had employed 20,000 workers in 1965, was shuttered in 1982. Unemployment in the Buffalo area, which had hung well above the national average for at least a decade, spiked above 12 percent that year. Local income, which was more than 6 percent above the national average in 1970 on a per person basis, languished; today, it is 9 percent below average. When jobs disappeared so did workers—in droves. By 2000, the population of Buffalo had fallen by half. Property values dropped, and neighborhoods

crumbled into disrepair, pocked with abandoned homes. More than a quarter of city residents lived in poverty.

Today, Buffalo remains distressed and poverty in the central city remains very high, but the situation is improving. The Buffalo metropolitan area's unemployment rate of 7.6 percent is below the national average. Employment rates have increased, and income, while still below average, is no longer falling farther behind. New businesses have moved in. Developers, drawn to low property values, have started to enter the local real estate market and families have followed. In 2010, Forbes Magazine rated Buffalo one of “America's Best Places to Raise a Family,” a distinction based on factors such as cost of living, prevalence of homeownership, median household income, commuting time, crime, and high school graduation rates (Levy 2010).

The Hamilton Project is optimistic that Buffalo and other distressed cities can return to growth. However, no city should suffer the persistent distress that this city and others like it have endured—it should not take forty years for a city to recover.

Today, the United States is facing a new and urgent challenge. The unequal impact of the Great Recession and the continuing restructuring of the American economy raise the prospect of creating a new set of economically troubled communities. History

suggests that most communities will bounce back quickly from economic shocks like the Great Recession, but it also suggests that some places—distressed communities—are at risk of experiencing persistently low rates of growth that cause them to fall behind the rest of the country.

This paper draws on economic research, including previously released and forthcoming papers from The Hamilton Project, to argue that a national economic strategy to aid distressed communities is both appropriate and necessary. The Hamilton Project believes that there are opportunities to develop and

implement policies that can deliver more success stories with faster recoveries, even in the wake of a rapidly changing economy.

We have three areas of focus. We first illustrate the consequences of economic shocks and how they affect people and communities. Most communities recover quickly, but a subset of places experience shocks that are especially severe; for them, returning to growth is a long and slow process. For example, average incomes in the 20 percent of counties hardest-hit in the 1980–82 recessions grew at one quarter the rate of the rest of the nation over the past thirty years. The human toll of these extended periods of distress can be measured in economic terms, but is more plainly evident in the decaying neighborhoods that had once sustained workers and their families.

...average incomes in the 20 percent of counties hardest-hit in the 1980-82 recessions grew at one quarter the rate of the rest of the nation over the past thirty years.

We then argue that it is in the national interest to have a policy on distressed communities because the country simply cannot afford to watch another generation of Americans suffer the tragedies that we witnessed in the early 1980s. Indeed, from an economic perspective, it is clear that the long-term benefits of an evidence-based national policy would exceed its costs, from both budgetary and social perspectives.

Finally, we provide a framework for thinking about the right policies, rather than proposing a specific set of parameters. Recognizing that every community is different, and that there is no “one size fits all” solution for the challenges facing these economically distressed communities, The Hamilton Project proposes a basket of options that could begin the process of restoring local workers to good jobs. The most effective suite of policies is likely to include policies that attract new businesses, facilitate the development of the skills necessary to work in new industries, and, in some cases, help workers relocate to new communities where their skills are in greater demand. These approaches include the following:

**Attracting New Businesses.** A dearth of good jobs in distressed communities results in high unemployment and stagnant wages. Evidence suggests that certain place-based policies can help attract business investment to targeted areas and can boost the productivity and wages of workers in those areas.

**Aiding Displaced Workers.** Workers displaced in a plant closing or other events when jobs disappear permanently suffer long-term earnings losses lasting as long as twenty years. For these workers, traditional safety-net programs like unemployment insurance offset only a small fraction of their income loss. Wage insurance (explored in prior Hamilton Project discussion papers by Kletzer and Rosen 2006 and Kling 2006) and retraining and enhancing skills of displaced workers are two approaches to putting people back to work and boosting their incomes.

**Matching Workers to New Jobs.** The process of adjustment requires matching unemployed workers to new jobs. One route is to augment and improve the nation’s One-Stop Career Centers to help the unemployed build new skills and find new jobs. Another route is for the unemployed to seek opportunities in places

where their skills are in greater demand. Statistics show, however, that geographic mobility is at an historic low: underwater homeowners are unable to sell and residents have few resources to seek employment beyond their local labor markets. Helping workers move in search of a better job could aid job matching and reduce the length of unemployment for some workers.

As we consider new policy options to aid distressed communities, a central ingredient must be the commitment to and resources for rigorous evaluation. Over the past several decades, policy ideas on urban redevelopment have come into and out of favor as if on a merry-go-round. Without a serious commitment to evaluation, we will never learn definitively what works and so will continue to expose cities and their populations to longer periods of economic distress than is necessary.

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# Chapter 1: The Problem of Distressed Communities

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**W**orkers and their families living in especially hard-hit neighborhoods and communities face a number of challenges. Unemployment in persistently distressed areas often arises from plant closings or mass layoffs associated with declines in specific industries and businesses. Unlike other types of joblessness, these losses often imply a permanent reduction in the marketable skills and opportunities for local workers. In addition, evidence suggests that local economic shocks have long-lasting effects on local labor markets. Even today, we still observe differences between the communities hardest hit in the recessions of the early 1980s and other communities. The geography of the Great Recession raises concerns that additional communities are at risk of becoming distressed.

## A. THE CONSEQUENCES OF LOSING A LONG-TERM JOB

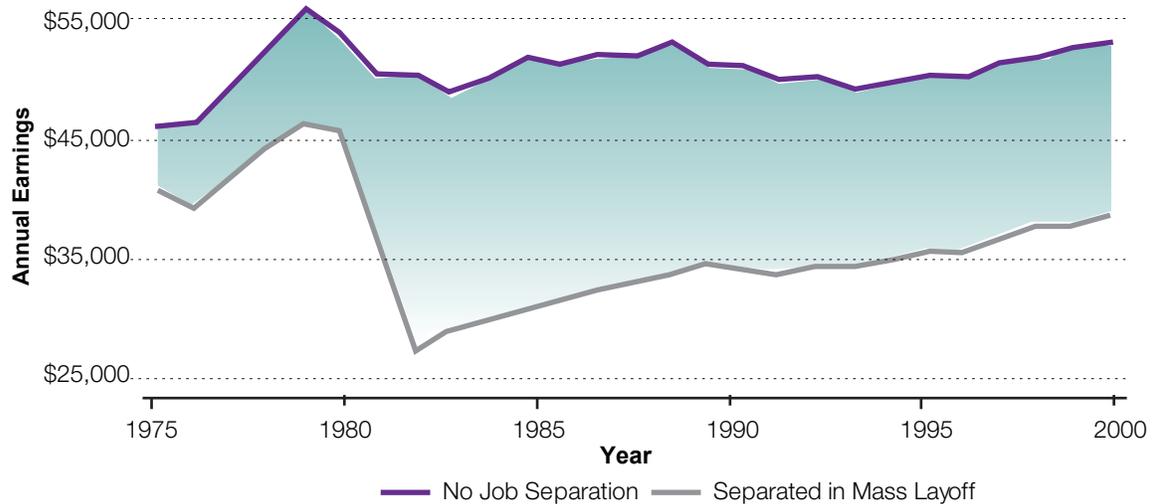
Unemployment is perhaps the most economically devastating consequence of an economic downturn for workers and their families. For workers in distressed communities, concerns about unemployment and long-term prospects for finding another good job are even more relevant. Localized distress is often a function of the decline of a local business or industry. When industries decline and businesses close, jobs are not temporarily absent—they are eliminated. The consequences of this kind of job loss are severe and long lasting.

Losing a long-term job does not just result in a temporary period of unemployment—it also often leads to a decades-long reduction in earnings even after workers are reemployed. Workers displaced from high-tenure jobs in Pennsylvania

earned 25 percent below their previous wages even six years after losing that position (Jacobson, LaLonde, and Sullivan 1993). Research that followed workers who became unemployed during the recessions in the early 1980s found workers in previously stable jobs reported immediate losses in earnings of 30 percent in the year after losing a job; ten years on, the earnings of these workers were still 20 percent lower than nondisplaced peers; and twenty years on, the effect was still evident (von Wachter, Song, and Manchester 2007).

As severe as unemployment is for ordinary workers, the consequences for workers that lose jobs in mass layoffs or at plant closings—events often associated with localized economic distress that affects entire communities—is much greater. Figure 1 summarizes evidence from a study that compares the earnings trajectories of workers who lost their jobs in a sudden mass layoff in the early-1980s recessions to workers who maintained their jobs throughout those recessions (von Wachter, Song, and Manchester 2009). Prior to the recessions, the earnings of displaced and nondisplaced workers followed a similar pattern. After the recessions, however, displaced workers faced devastating long-run earnings losses. Even in 2000, almost twenty years after the 1980s recessions, a sizable earnings gap remained. According to the study, the net loss to a displaced worker with six years of job tenure is approximately \$164,000, which exceeds 20 percent of the average lifetime earnings of these workers. These future earnings losses dwarf the losses associated from the period of unemployment itself.

**FIGURE 1.**  
**The Earnings of Displaced Workers**



Source: von Wachter, Song, and Manchester 2009, Figure 1A, p. 30.

Note: Annual earnings in 2000 dollars. Earnings are at all jobs for men in a stable job from 1974 to 1979, and who separated in a mass layoff and did not separate in 1981.

Beyond its effect on workers' earnings, job loss also has negative economic and noneconomic effects on workers health, their families and their communities. Men with high levels of seniority when they are displaced from their jobs experience mortality rates in the year after unemployment 50 to 100 percent higher than otherwise would be expected (Sullivan and von Wachter 2009). These elevated rates of mortality are still evident even twenty years after the job loss and may reduce these workers' life expectancies by twelve to eighteen months for a worker who loses his job at age forty.

The children of these workers also appear to suffer. Children whose fathers were displaced have annual earnings about 9 percent lower than similar children whose fathers did not experience an employment shock (Oreopoulos, Page, and Stevens 2008).

Young people are penalized for entering the work force when their local labor market has high rates of unemployment. Students entering the labor market during times of economic distress earn considerably less than their peers elsewhere, even ten years after leaving school (Kahn 2010; Oreopoulos, von Wachter, and Heisz 2008).

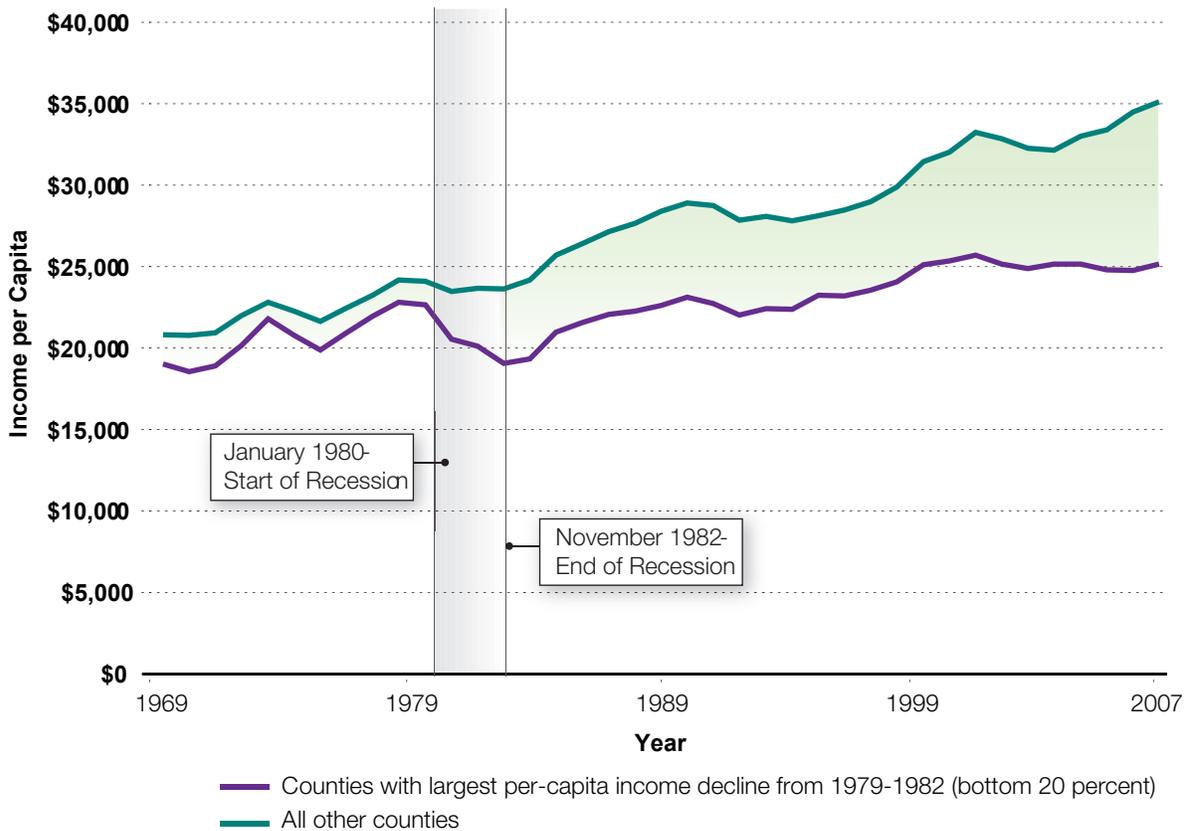
## B. THE LONG RUN CONSEQUENCES OF CONCENTRATED ECONOMIC DISTRESS: EVIDENCE FROM THE 1980-82 RECESSIONS

A sharp economic shock permanently affects communities just as it does workers. For communities experiencing the largest economic contractions during recessions, the impact on employment and income appears to be extremely persistent. While unemployment rate differences between distressed areas and the rest of the country dissipate within a decade, this adjustment appears to be driven largely by an exodus of workers rather than by a resurgence of job opportunities (Blanchard and Katz 1992).

Figure 2 shows per capita income for the 20 percent of counties that experienced the largest drops in inflation-adjusted income per capita during the early-1980s recessions. About 10 percent of U.S. residents were living in these counties. Prior to those recessions, average incomes in these counties (the purple line) moved in lockstep with incomes in the rest of the country (the green line). During the recessions, however, incomes in these counties plunged by 14 percent more than average per capita incomes elsewhere.

FIGURE 2.

## Income Per Capita in Hardest-Hit Counties



Source: Bureau of Economic Analysis, Table CA04.

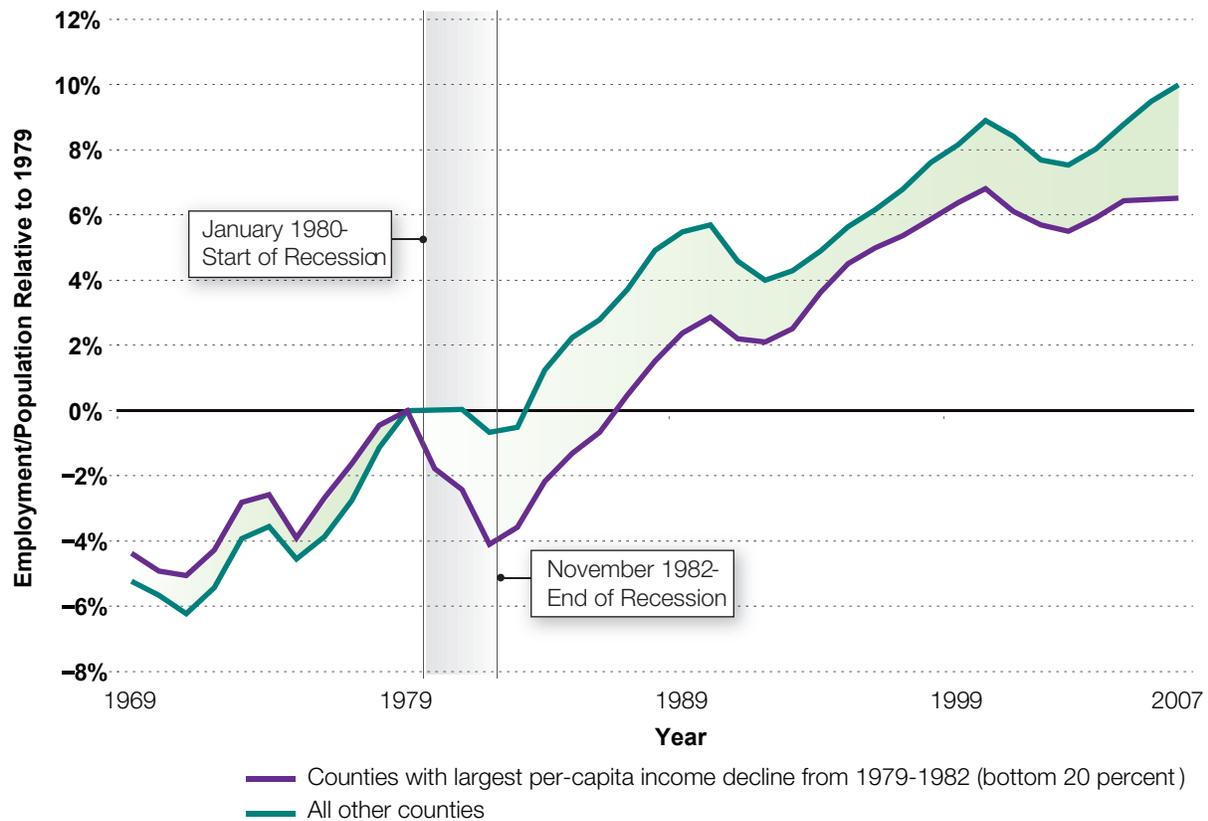
Note: Income per capita includes total income excluding transfers. Dollar values adjusted to 2009 using CPI. The 1980–81 and 1981–82 recessions are grouped together.

For most of the country, it took less than two years after the end of the recession for average incomes to return to their prerecession levels; for the hardest-hit communities, it took more than six years just to get back to where they started from. Figure 2 shows that, after the recessions, incomes in these counties began to grow again but at a lower rate than in the rest of the country. Instead of catching back up, these communities lagged farther behind. Indeed, today, almost thirty years later, there is a gap of almost \$10,000 in average per person income between the hardest-hit counties in the 1980–82 recessions and the rest of the nation.

The same story is true for employment. Figure 3 illustrates the path of employment—defined as the share of local residents with a job—relative to where communities started in 1979 just prior to the start of the recessions. Over the course of the recessions, employment in the hardest-hit areas plunged—roughly 4 percent of the population lost jobs. While employment growth eventually returned and roughly followed the trend in the wider economy, the gap has still not closed. There are simply fewer working adults in these areas even today.

FIGURE 3.

## Changes in Employment in the Hardest-Hit Counties



Source: Bureau of Economic Analysis, Table CA04.

Note: The 1980–81 and 1981–82 recessions are grouped together.

More generally, these hard-hit counties appear very different today on a wide variety of economic measures. Table 1 summarizes some measures of economic well-being from prior to the 1980s recessions versus those same measures today.

Over the course of the past thirty years, average earnings in the hardest-hit communities grew only 12 percent, about one quarter the rate of the rest of the country. Employment as a share of the population increased by much less in those areas than elsewhere, and the population of these areas grew more slowly. The demographics of these areas changed—they became older, with fewer young people and more retirees and elderly. Because of these changes in population, employment, and income, demand for housing was weaker and home prices increased by less than elsewhere. Although falling prices and lower rents could help workers stretch their smaller budgets, they are unlikely to have fully offset the decline in workers' income.

The statistics in the table hint at the difficulties and costs these communities faced when adjusting to the shock of the early-1980s recessions. Blanchard and Katz (1992) describe the adjustment process in technical terms: “Shocks to labor demand first lead to movements in relative wages and unemployment. These in turn trigger adjustments through both labor and firm mobility, until unemployment and wages have returned to normal.” But, in more personal terms, the story is that when good jobs disappear, local wages stagnate and fall behind wages elsewhere. Workers looking for better jobs search more broadly for work and relocate for work, taking their families with them. The population falls and ages: families leave, young workers graduating from school move to new communities to start work, and older workers and retirees stay put. As workers leave and put their homes on the market, land prices depreciate relative to elsewhere.

An optimistic view is that these changes—declining wages and falling land prices—will ultimately spark a renaissance by attracting new businesses and providing new residents with

TABLE 1.

## The Hardest-Hit Counties in the 1980–82 Recessions

**Table 1: Comparing Employment and Earnings Data since 1980–82 Recession**

<b>Earnings per Capita (\$)</b>	<b>1979/1980</b>	<b>2007/2008</b>	<b>Change</b>
Hardest-hit 20% of counties	\$23,178	\$25,946	11.9%
Remainder of country	\$24,050	\$35,097	45.9%
<b>Employment-to-population ratio</b>			
Hardest-hit 20% of counties	46.5%	53.1%	6.6 p.p.
Remainder of country	50.8%	60.9%	10.0 p.p.
<b>Total population</b>			
Hardest-hit 20% of counties	23,002,765	27,655,986	20.2%
Remainder of country	207,294,950	276,376,500	33.3%
<b>% of population aged 18 or less</b>			
Hardest-hit 20% of counties	30.0%	24.6%	-18.0%
Remainder of country	27.4%	24.3%	-11.3%
<b>% of population aged 65 or more</b>			
Hardest-hit 20% of counties	11.1%	13.6%	22.5%
Remainder of country	11.1%	12.7%	14.4%
<b>Average median housing price (\$)</b>			
Hardest-hit 20% of counties	\$108,269	\$131,390	21.4%
Remainder of country	\$134,348	\$176,398	31.3%

Source: U.S. Census, BEA, BLS, and authors' calculations.

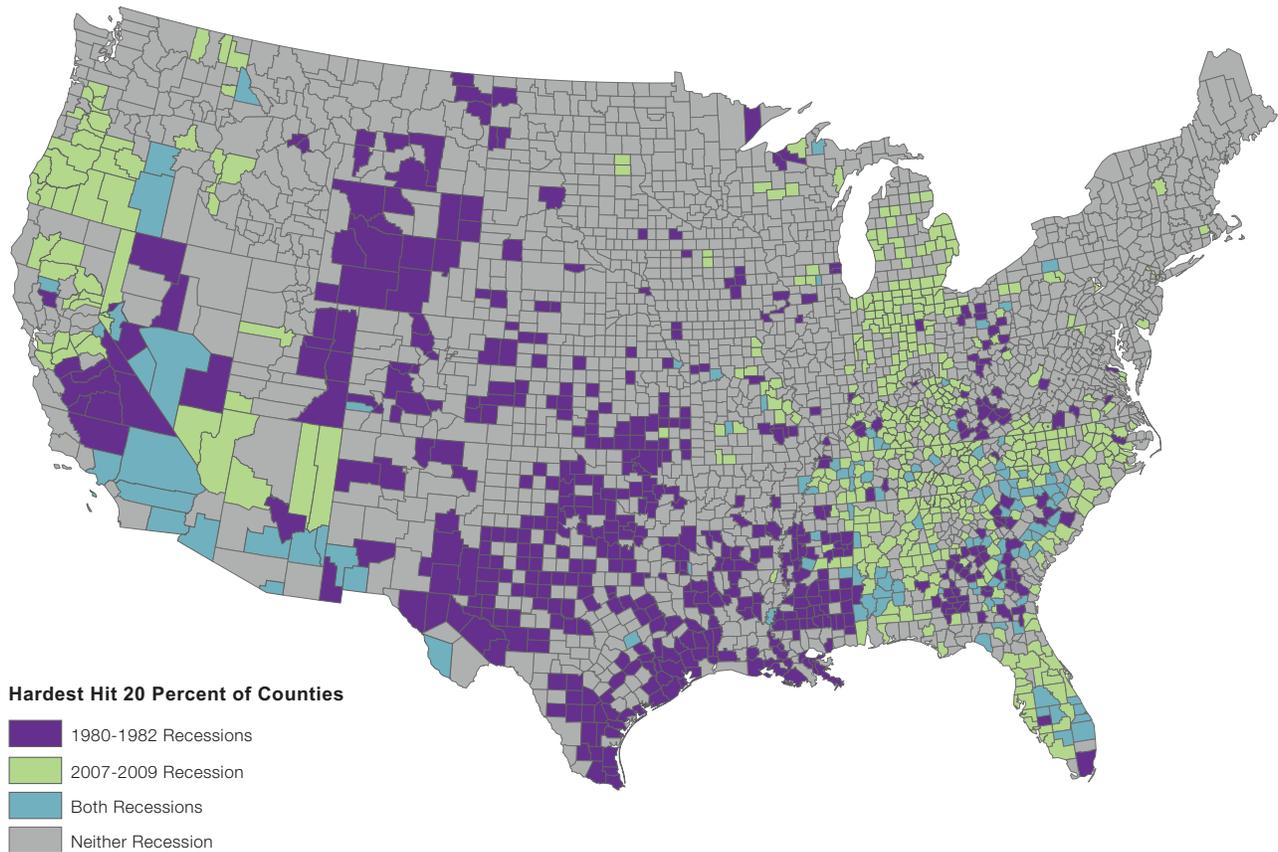
Note: Hardest-hit counties are the 20 percent of counties experiencing the largest decline in per capita income from 1979 to 1982. Median housing price reflects 1980 and 2000 data. p.p. denotes percentage points.

better homes at lower costs. Indeed, in cities like Buffalo it is economic factors like these that are attracting businesses and families, especially those looking for more-affordable homes and a lower cost of living. But this path of adjustment is clearly a costly one, and stabilization takes many years. That a recession could temporarily cause these impacts is not surprising. The fact that its toll remained and by some measures was greater a quarter-century later, however, is sobering.

### C. THE DISTRESSED COMMUNITIES OF TOMORROW?

Concerns about distressed communities are particularly relevant today. The unequal impact of the Great Recession and of the ongoing restructuring in manufacturing, construction, and other industries raises risks of creating a new set of distressed communities. Furthermore, it could worsen conditions of communities that were already struggling.

**FIGURE 4.**  
**The Hardest-Hit Counties, 1980–82 and 2007–09**



Source: Bureau of Labor Statistics (BLS) (Years 2007-09); Card (Years 1980-82)

Note: Hardest-hit counties are the 20 percent of counties experiencing the largest increase in unemployment during the period of recession. The 1980–81 and 1981–82 recessions are grouped together.

Figure 4 compares the geographic impact of the Great Recession to that of the 1980–82 recessions. The map highlights the hardest-hit 20 percent of counties in each recession, as measured by the increase in their unemployment rates.

In the Great Recession, the hardest-hit counties reflect the geography of declining manufacturing activity in the Midwest and Southeast, and the bursting of the housing bubble in states with the greatest run-up in home prices. Unemployment is concentrated in the “Rust Belt” in the industrial Midwest—Michigan, northern Ohio, Indiana, and western Pennsylvania; in states that also have significant manufacturing operations, like Alabama; and in states where home building had been an important source of economic growth, such as California, Nevada, Arizona, and Florida.

The fact that the geographic pattern of unemployment tends to reflect the pattern of employment in specific industries is particularly concerning: unless these industries return to full

capacity or new industries move in, these communities could face long-lasting economic hardship.

It is important to note that the geographic pattern of the Great Recession is very different from the pattern of the recessions thirty years ago. Relatively few counties appeared in the bottom 20 percent both in the 1980s recessions and in the Great Recession. In the 1980s, oil- and gas-producing states such as Texas, Oklahoma, Louisiana, and Wyoming were among the places that experienced the largest increases in unemployment rates.

The fact that the pattern of distress differs so widely is important because it implies that the shocks that communities face vary from recession to recession, that the risks are idiosyncratic—it is relatively unpredictable which counties will be hardest hit from recession to recession—and that the problems are widely dispersed across state lines. Policies that address distressed communities must accommodate these facts.

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## Chapter 2: The Case for a National Policy for Distressed Communities

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The problems of distressed communities often reflect the unequal distribution of benefits and costs of economic changes like technological innovation, new patterns of trade, and the rise and fall of new industries. For some, the emergence of new technologies and industries can be disruptive and can cause job losses and the erosion in the value of skills and knowledge amassed by workers. The history of individual distressed cities and neighborhoods is punctuated with anecdotes of industries in decline, ranging from steel and heavy manufacturing down to textiles, furniture, even shoes. Because industries are not spread evenly across the country, industry-specific shocks can translate into local economic disasters. This is especially true in manufacturing because individual plants frequently employ hundreds or even thousands of workers.

It is important to recognize, however, that the growth of new industries, broader trade, and technological innovation ultimately leads to higher living standards for the country as a whole; sustained economic growth requires an environment that is hospitable to new ideas and innovation. Two hundred years ago, 90 percent of Americans farmed for a living; today only 2 percent do. Advances in agricultural productivity—better seeds, fertilizers, irrigation, and machinery—and increases in trade have allowed far fewer people to produce the food that society demands, and to do so in much greater quality and variety. While this change was itself disruptive—leading, for example, to the rapid growth of cities ill-equipped to handle the influx—few look back and lament it. Improvements in agricultural productivity allow today’s workers to specialize in new fields and advance new industries that improve our well-being.

The juxtaposition of national benefits but idiosyncratic and large localized costs suggests one rationale for federal involvement: providing insurance against unforeseen risks. At the individual level, a number of programs do just that, including unemployment insurance, disability insurance, or Medicaid for long-term care. The Hamilton Project believes that there also are reasons that the federal government may consider policies directed specifically at distressed communities. At their core, these rationales recognize that communities are greater than the sum of their individual parts.

Perhaps the strongest argument for federal involvement is the finding in the previous section that the period of adjustment is longer and harsher than has been previously recognized. In market economies, technological change will naturally cause individuals, industries, and places to experience declines in income. However, the finding that for many of these places the postrecession rate of economic growth remains below the rest of the nation for decades suggests that there are substantial barriers that limit the ability of these areas to participate in the nation’s economic growth. In addition to affecting the well-being of current residents, the long periods of distress reduce the ability to invest in future generations and could weaken the popular tolerance for innovation, undermining long-run living standards.

In the current fiscal environment, it is even more important that government focus on activities where the benefits exceed the costs. In economics jargon, opportunities for such welfare-improving government interventions are termed “market failures” because private market activities do not lead to the best possible economic outcomes. We outline four such rationales for federal involvement in aiding distressed communities: promoting agglomeration economies, avoiding tipping points, facilitating skill acquisition, and minimizing adjustment costs.

### A. PROMOTING AGGLOMERATION ECONOMIES

Research shows that people and firms are more productive when they cluster, especially when those people or firms work in the same industry (Greenstone, Hornbeck, and Moretti 2010). For example, improvements in manufacturing processes and other efficiencies tend to diffuse to nearby neighbors: when one firm does better, other firms also improve. These spillover benefits are not captured by the private market; a firm does not choose to locate near other businesses so that they can benefit. But if businesses were encouraged to group together, all could benefit from these “agglomeration economies.”

These untapped benefits from collocation of businesses are one rationale for policies that encourage new business investment in a specific area. If an economic shock leads to a firm or an industry’s decline in a city, there may be unforeseen costs on nearby firms. Targeted programs to attract new businesses could help offset those costs. It is important to recognize that

the rationale for intervention in this case is not to help a specific firm, but rather to generate spillovers that benefit many local businesses; thus, policies should be pursued judiciously to distinguish cases where location subsidies generate spillovers from instances when subsidies narrowly benefit the recipient.

## B. AVOIDING TIPPING POINTS

Research suggests that persistently elevated unemployment can have a devastating impact on important social outcomes like crime, teenage pregnancy, mental health, and others. William Julius Wilson in *The Truly Disadvantaged* (1990) and *When Work Disappears* (1996) argues that many of the social problems today are fundamentally the result of the disappearance of work. Wilson and others argue that concentrated areas of economic distress and joblessness result in a breakdown in other social structures; as the unemployment rate rises, negative social indicators increase at an increasingly rapid rate.

In one version of the theory, when unemployment reaches some tipping point negative consequences become much more severe. For example, an increase in the unemployment rate from 14 to 15 percent might have a much larger negative impact on a community than an increase in the unemployment rate from 4 to 5 percent. This theory suggests that there may be gains from efforts to reduce unemployment in concentrated areas, even at the expense of unemployment elsewhere.

Although the theory is compelling, the empirical evidence is mixed. Crane (1991) finds that increases in the number of professionals in communities have increasingly large effects on a variety of social outcomes; Patterson (2008) finds similar evidence of tipping points in neighborhood characteristics and poverty. However, Kling, Liebman, and Katz (2007) fail to find evidence of these threshold effects.

## C. FACILITATING SKILL ACQUISITION

Education and training are investments that pay off in higher future earnings. But unemployed workers, younger workers, and workers in distressed neighborhoods may not be able to afford to make such an investment, even if the returns from that investment exceed the costs. Unlike loans for cars or homes, the private market underprovides loans for training and education, in part because workers cannot use future earnings as collateral. This underprovision of loans for education and training is an important rationale for the federal student loan program.

In distressed communities, workers displaced from long-term jobs often have skills that are best suited to industries or occupations in decline—their skills are worth less in the new marketplace. As described above, this is reflected in their lower reemployment earnings.

While evidence suggests that some of these workers would benefit from retraining and education, these workers may underinvest in retraining. In addition to the barriers to educational loans, they may lack good information about the returns to undertaking training programs. Moreover, some of the returns to training and higher earnings may accrue to others through higher income taxes and lower receipt of social insurance. Government investments in the right kind of training for certain displaced workers could yield benefits greater than the costs of that training.

## D. MINIMIZING ADJUSTMENT COSTS

History suggests that mobility—the movement of families to new communities—is a primary way that communities adjust to economic shocks in the long run. This process of adjustment is itself costly and potentially wasteful.

The costs of moving go beyond the costs of selling a home and shipping furniture. Families often have strong bonds to their communities. When a family moves, children are uprooted from schools. Family members must leave friends, social routines, memories, and local knowledge, and relearn and reintegrate into a new community. These costs are significant and yet there are few ways for the residents of a declining city to avoid them or to mitigate them; no such insurance policy exists. In some sense, this is a market failure—families and workers cannot protect themselves against the risk that a local employer will fail or that a vibrant industry may become obsolete.

A similar argument can be made about infrastructure. It is impossible to ship a road or bridge to follow changes in population. When a city or community declines, it leaves a base of infrastructure meant to service a larger population. The result is that previous investments in infrastructure are not being utilized efficiently. In other areas, immigrants may lead to congestion and require new investments in infrastructure.

Even when the benefits to residents of moving are large, there may be barriers to prevent them from moving to a community that has better job prospects. In this circumstance, moving is an investment in future earnings, just like an investment in education. And just like unsecured educational loans, loans to facilitate moving are difficult or impossible to get, leaving workers unemployed or underemployed when they could do better elsewhere.

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## Chapter 3: Approaches to Helping Distressed Communities and Displaced Workers

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Addressing the economic and social costs associated with persistent, localized economic distress requires a different set of policy tools. Most existing policies and most social insurance spending is directed to people facing economic hardship rather than to places. This includes policies like unemployment insurance, health insurance for children of unemployed or underemployed adults, food stamps, and other forms of assistance. Moreover, these programs are intended to be temporary solutions for short-term problems: unemployment insurance in normal times lasts only twenty-six weeks, and some programs include time limits. In addition, most are conditioned largely on nonemployment rather than underemployment: they protect against poverty caused by absence of a job but not against lower wages. In short, these policies do not directly address the causes and costs of long-term economic distress on workers, their families, and their communities.

The approaches we recommend are motivated by the observation that long-term localized distress is characterized by a mismatch between the supply and skills of local workers and the demand for their work from local businesses and industries.

To address such concerns, we examine approaches that could promote economic recovery and shorten the duration and depth of economic distress by directly targeting residents, workers, businesses, and infrastructure in distressed communities. In the current fiscal and economic environment, it is even more important than usual that these programs have benefits that exceed their costs. Furthermore, these programs should be targeted at communities that meet objective criteria for persistent distress (e.g., high rates of unemployment or low rates of income growth over multiple years).

The approaches we recommend are motivated by the observation that long-term localized distress is characterized by a mismatch between the supply and skills of local workers and the demand for their work from local businesses and industries. In the case of Buffalo, the sudden decline in local steel and manufacturing left thousands of skilled, hardworking local residents without work. The skills and experience these workers had accrued in their previous lines of work were not as valuable in rising industries. Subsequent declines in population, total employment, wages, and home prices were the long-lasting symptoms of this imbalance.

We recommend a three-pronged approach to aiding distressed areas that is motivated by this root imbalance. Because distressed areas are characterized by declining older businesses and little new business growth and investment, the first approach seeks to attract new business to these areas.

Attracting new businesses to distressed areas would provide new jobs, raise wages, and provide local services.

The second approach seeks to put displaced workers in a better position to confront economic shocks or declines in demand for the goods they produce. As Chapter I demonstrated, workers whose jobs have been eliminated because of plant closings, declining industries, or technological change

experience large and sustained earnings losses even after they are reemployed. For these workers, typical social insurance programs like unemployment insurance do not offset their long-term earnings losses. Income security for these workers requires a better form of insurance or a means to refresh their skills.

Finally, markets adjust dynamically. Matching workers to jobs can be a lengthy process, especially in periods of high unemployment. Facilitating faster and better matching would lower unemployment, boost earnings, and raise productivity.

The remainder of this section discusses each of these three approaches in detail. It concludes by calling for a commitment to evaluation and learning what works.

#### A. ATTRACTING NEW BUSINESSES TO DISTRESSED AREAS

Distressed communities often present a poor environment for business investment. Plant closings and mass layoffs result in falling incomes and increasing poverty for local residents—residents who also are consumers. Detroit provides a particularly poignant example: there is no longer a single national grocery chain with an outlet in that city (Grossman 2010). In addition, shrinking tax bases can lead to cuts in key services, like the size of the police force, the quality of schools and physical infrastructure, and even basic services like waste disposal and snow removal, raising the costs of doing business. Finally, residents may not have skills suited to new industries or may have lost skills during long spells of unemployment.

To attract businesses, communities have tried a wide variety of approaches with mixed success. A typical approach of state and local governments has been to provide subsidies or tax breaks for new businesses. These types of policies have been tried for several decades, but the evidence of their effectiveness is weak. Tax cuts reduce business costs overall but may not rise to meet the substantial level of investment needed by businesses in distressed communities. Also, businesses may be wary of investing their own resources on programs such as job training that are not guaranteed to benefit them exclusively, and they cannot be expected to improve public infrastructure.

Attracting businesses to revitalize distressed communities requires a holistic approach that targets all of the major problems faced by these communities. Tax cuts may be especially effective when combined with expansions in public services and infrastructure investment. To address the problem of low levels of skill among the labor force, on-the-job training

can help make labor costs in distressed communities more competitive. Other options include programs that provide direct consulting assistance to employers—for instance, in terms of technological and capital investments.

Timothy Bartik’s proposal is one variant of this approach. His discussion paper “Bringing Jobs to People” (2010) argues for a return to the original Empowerment Zones created in the 1990s, which combined tax cuts for businesses with grants to state and local governments for public services. Further grants would be available to businesses to invest in customized training—training that is tailored to meet the needs of the specific employer. Bartik also argues for the enlargement of the Manufacturing Extension Program, especially within distressed communities. This program offers subsidized consulting services to small- and medium-sized manufacturers and has been demonstrated to improve their productivity and profitability. Recognizing that the body of evidence on the efficacy of place-based policies is mixed, Bartik’s proposal includes methods to evaluate the programs as they are expanded so that policymakers can determine which approaches are most successful.

#### B. AIDING DISPLACED WORKERS

The available evidence indicates that when jobs are eliminated during mass layoffs or plant closings, the workers displaced experience long-lasting reductions in earnings. For these workers, the major cost of job loss is not the period of unemployment, which may only last a few months. Instead, the major cost is the reduced wages upon reemployment—costs that for longer-tenured workers exceed \$100,000 over a lifetime (von Wachter et al. 2009). While transfers like unemployment insurance can mitigate the temporary lack of income during unemployment, we do not have programs that address these massive reductions in lifetime earnings.

One option in these circumstances is to provide “wage insurance.” Wage insurance continues to pay an unemployment insurance–like benefit to workers even after they find new jobs, but only if they are unable to find work at a wage close to their predisplacement earnings. For example, if a worker is reemployed at a wage 30 percent below her predisplacement earnings, wage insurance might fill

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25 percent of the earnings gap. In past discussion papers (Kling 2006; Kletzer and Rosen 2006), Hamilton Project authors have examined how a wage insurance proposal might operate.

Another alternative is to improve the skills of those workers, and thereby increase their future earnings. The best available evidence suggests that job training through community colleges can help restore some of the income that displaced workers lose. Indeed, an analysis of displaced workers in Washington State finds that the equivalent of a year of

## The best available evidence suggests that job training through community colleges can help restore some of the income that displaced workers lose.

community college increased displaced workers' earnings by 9 percent for men and 13 percent for women—a sizable return in itself. Even a few courses at community colleges resulted in substantial earnings returns.

However, the benefits of training vary strongly by the types of courses students take and the type of student seeking training. Curriculums in quantitative subjects, science, and health care boosted earnings by 14 percent for males and 29 percent for females. These gains begin to come close to offsetting the losses from displacement. These education and training investments were greatest for younger workers and workers that had previously demonstrated academic success (Jacobson, LaLonde, and Sullivan 2005).

These results indicate the potential benefits of developing an effective retraining program for displaced workers that focuses on the courses with the highest returns to workers and that supports the institutions that provide these courses. As discussed in Chapter II, due to a lack of savings and credit constraints, displaced workers may underinvest in retraining that could help them achieve higher earnings. But state and local governments may also underprovide training opportunities. Tight budgets brought on by falling incomes and tax receipts tend to result in budget cuts for education at exactly the same time that workers are most likely to seek retraining. Programs that help support retraining during economic downturns could ensure training opportunities are available to workers.

In the Hamilton Project discussion paper “Retraining Displaced Workers,” authors Robert LaLonde and Daniel Sullivan (forthcoming) propose extending Pell Grant eligibility to training-ready displaced workers even after they are reemployed. Their paper also argues that a mechanism for distributing aid for education and retraining during recessions is needed to counteract the tendency of state and local governments to cut funding during those periods. To encourage training in fields with higher returns, LaLonde and Sullivan suggest that extra support be devoted to courses in technical fields and health care, which are often more costly for community colleges to offer. Both investments in community colleges and subsidies for retraining should be accompanied by measures to design financial aid policies to encourage completion rates of students and programs

to establish standardized curricula, evaluate the returns to different programs, and disseminate information to help students make informed choices.

Wage insurance proposals and LaLonde and Sullivan's proposed Pell Grants are just two promising approaches to offsetting some of the earnings losses of displaced workers while still encouraging speedy reemployment.

### C. MATCHING WORKERS TO NEW JOBS

Losing a job is a harrowing experience for workers and their families. For many of the unemployed, finding a job that is an adequate replacement for the job lost is a stressful waiting game, while workers and their families lose the value of forgone earnings and use up hard-earned savings.

Some workers are able to adjust to job loss without government aid. These workers are generally well educated and have substantial savings. Other workers without these advantages, especially lower-skilled workers, often suffer longer durations of unemployment, with larger costs for them and their families. The wider economy also suffers: faster and better job matching has national economic benefits, reducing the waste of resources from prolonged unemployment and underemployment.

One means to encourage better matching is through augmenting and improving America's One-Stop Career Centers. As explored in a previous Hamilton Project discussion paper (Jacobson 2009), improvements in the job search assistance and counseling services offered by One-Stops, particularly in terms of selecting high-return training

programs, can help improve workers' skills and match them to better jobs.

The job search process can mean looking beyond one's immediate community to regional and national labor markets; indeed, this widens the net of job openings available and may provide job seekers a higher-paying job opportunity or a quicker job match than a search restricted to a more limited geographic area.

While over time many American families will move from cities where job opportunities are limited to other parts of the country to find work, moving tends to fall during economic recessions as unemployment rises and the benefits of moving—job opportunities and higher wages—stagnate along with the wider economy (Saks and Wozniak 2007). This pattern was even more pronounced during the Great Recession: residential mobility rates in the United States are currently at a historical low even relative to past recessions, and have reached their lowest levels since World War II. In 2007–08, only 11.9 percent of Americans changed residence—the lowest rates of annual mobility since migration statistics were collected beginning in 1947–48 (Frey 2009).

Moving has both direct financial costs and nonpecuniary costs—people value the familiar people and places of their home communities. For unemployed or underemployed workers, these costs of relocating for employment are front-

**A failure to develop and implement a tool chest of policies that are known to work will condemn our country to having more distressed communities, with the accompanying human and social costs, than is necessary.**

loaded and difficult to finance. Furthermore, loans to finance moves are either costly or unavailable—banks generally do not make such unsecured loans to unemployed people, even if the person is moving to accept or look for a job. These financial barriers are one cause of the gap in postdisplacement moving rates between college graduates, who may be better able to finance a move, and less-educated workers. For workers who do move, the rewards can be significant in terms of increased earnings.

To address this issue, Jens Ludwig and Steven Raphael call for a creation of a loan program to finance employment-related

moves in their Hamilton Project discussion paper, “The Mobility Bank” (2010). The mobility bank could facilitate and speed up the moving process for some workers, increasing economic recovery in distressed areas. Ludwig and Raphael’s mobility bank would offer loans to individuals who want to look for employment in a new area or start work at a job already found. So as not to be burdensome for movers who found only lower-wage jobs, monthly loan repayments would depend on reemployment earnings. The mobility bank would be accompanied by increased use of national job banks that search more broadly for jobs to meet a given worker’s qualifications, illuminating the full set of options available to dislocated workers. With better opportunities available to them and a mobility bank from which they could draw loans, more workers may be encouraged to leave distressed communities. This could speed recovery in distressed areas by reducing the glut of unemployed labor and could have a positive effect on workers’ long-term earnings.

#### **D. IMPROVING POLICY BY LEARNING WHAT WORKS**

An important impediment to designing local development policies is a lack of conclusive evidence about which local development programs work and which do not. In the absence of reliable evidence, local development strategies have included a wide variety of programs, often coming and going more quickly than a trusted evaluation method can be developed. In some cases, outcomes are not tracked at all; in others,

there is no rigorous attempt to separate the effect of the programs on positive outcomes from other economic and policy trends. The design of the programs often does not facilitate research even though slight modifications would make these programs easier to evaluate. The lack of definitive evidence of effectiveness undermines support even for programs that may be working, and creates a perception that local development projects are not cost-effective investments.

The Hamilton Project believes that the best way forward involves constant and rigorous evaluation to find what works and that, from there, the most promising approaches should be scaled up. Achieving this requires a financial commitment and a commitment in political will to evaluating these approaches using the most credible empirical methods including randomized control trials whenever feasible. A failure to develop and implement a tool chest of policies that are known to work will condemn our country to having more distressed communities, with the accompanying human and social costs, than is necessary.

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## Chapter 4: Conclusion

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Americans across the country are struggling as a result of the Great Recession. In the hardest-hit communities, however, unemployment rates are much higher and the prospects for employment are much weaker. As evidence from previous recessions shows, these problems could prove to be long lived for some communities. A number of approaches could help these communities recover faster by attracting businesses, stabilizing displaced workers' reemployment earnings, and matching workers to jobs more quickly. It is essential that we evaluate the policies we implement to learn which policies can help to achieve these goals. With this knowledge, the nation can help future distressed communities avoid or shorten the decades-long period of adjustment that previously distressed communities have endured.

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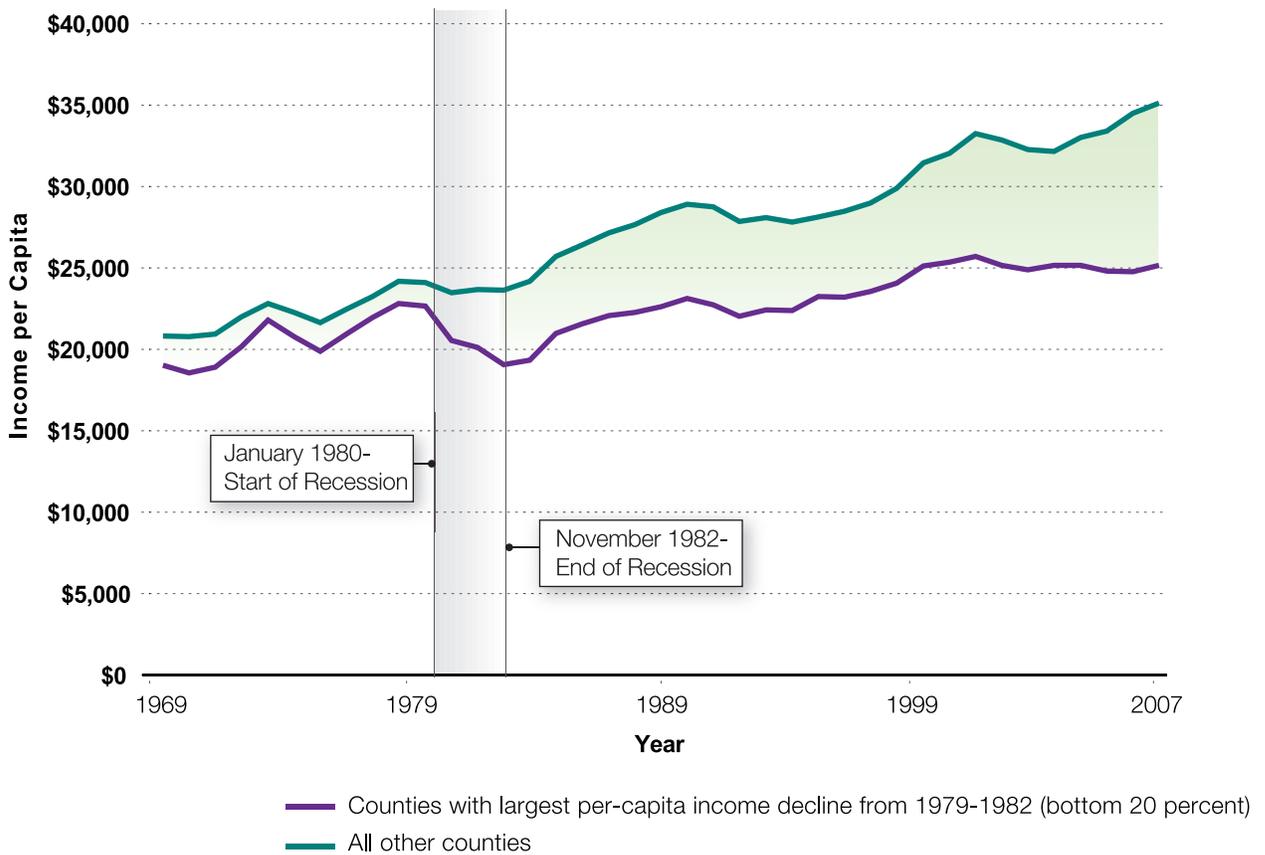
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A sharp economic decline can have long-term effects on local communities. Thirty years after the 1980 recession, many of the hardest-hit areas still have not recovered.

FIGURE 1:  
Income per Capita



Source: Bureau of Economic Analysis; Regional Economic Accounts - Local Area Personal Income. Table CA04. Dollar values adjusted to 2009 using CPI. Income per capita includes total income excluding transfers. The 1980-1981 and 1981-1982 recessions are grouped together.



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