

Forward Thinking on unemployment with Sir Christopher Pissarides

The Nobel Prize–winning economist talks job loss and creation after the pandemic, plus what economic researchers should be addressing today.



In this episode of the McKinsey Global Institute's Forward Thinking podcast, hosts Michael Chui and Anna Bernasek interview Sir Christopher Pissarides about how he developed the matching theory of unemployment, how COVID-19 affected his research, and what might be in store for labor markets after the pandemic.

An edited transcript of this episode follows.
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Michael Chui: We've got a really great episode today because we're talking about unemployment. It's a great episode, I promise you, even though it's a bit of a depressing topic. We're talking about unemployment with a Nobel Prize-winning economist. He basically wrote the book on unemployment.

Anna Bernasek: That's such a hugely important topic right now. Millions of people have lost their jobs, and the jobs that are going to be available coming out of the pandemic might be really different from those that were available even a few years ago. Just think about some of the jobs that employed a lot of people before, [in-person services like personal care, dining, travel, and leisure](#). All those things have been decimated by the impact of COVID. Michael, I wonder how many of these are actually going to be coming back.

Michael Chui: It's a great question, and there are other questions, too. How do we help unemployed workers find new jobs and new career paths? What support do they need along the way? Would we or could we even get to no unemployment? What really works when it comes to policies to address these problems? How do we even know they're working?



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Anna Bernasek: I had the opportunity to ask these questions to Sir Chris Pissarides. He's the professor of economics at London School of Economics and professor of European studies at the University of Cyprus. Chris specializes in labor markets, macroeconomic policy, economic growth, and structural change.

He's advised European governments on economic policy. In 2010, as we mentioned earlier, he won the Nobel Prize in Economics for his work on the functioning of labor markets, particularly the interplay between unemployment, job loss, and job creation.

Michael Chui: Let's hear what he has to say about the biggest challenges for workers, businesses, and governments during the economic recovery, and, most importantly, what to do about it.

Anna Bernasek: Chris, welcome to Forward Thinking. So when I think about where we are today, I can't think of a more important time to really be discussing your work than in the middle of this pandemic. Because we've seen that some entire industries have been devastated.

Jobs have been devastated. I really want to get to discussing that. But I want to start at the beginning with you and ask you, of all things, why did you get interested in the labor market? When I look at your career, it doesn't look like you've done a lot of job switching yourself. Chris, how did you get interested in the labor markets in the first place?

Sir Christopher Pissarides: Well, when I started doing economics, I liked it as a subject because I like the formal side of it, the mathematics and all that. But then I've always been interested in important problems. I wouldn't just spend my time solving problems that are of no significance.

When I was finishing my undergraduate studies, the big problem was the rise in unemployment. We got used to very low levels of unemployment, about 2 percent, after the war. Come the late 1960s, it was still around there, although the States had a little bit higher.

But then you get into the '70s, and suddenly you see unemployment shooting up, going from 2 percent to 4 percent to 5 percent, and people didn't really know why that was happening. We had economists saying,

"It's a classic demand deficiency, let government borrow and spend, and unemployment will go away."

Some governments tried it, and they got inflation instead. Others were saying, "No, there are shocks in the supply side." Jeffrey Sachs and Michael Bruno wrote a book that was addressing that issue, and Robert Solow as well made some influential statements.

We couldn't understand, what is a supply shock? What do we do with it? I thought, that's a really interesting problem, in need of some formalization and some thinking. It's extremely important, because unemployment is a very serious problem that I think governments should always be dealing with. It's a cause of poverty, of disenfranchisement from the labor market, of misery. And there it was. I got into it, and it's still the problem that I'm always thinking about and writing about and talking about.

Anna Bernasek: The paper that you wrote with Dale Mortensen in 1994, *Job creation and job destruction in the theory of unemployment*, became really influential. Why do you think it had such a big impact?

Sir Christopher Pissarides: Well, you see, before we did that work, people were thinking of unemployment as a kind of stock of workers, as a number of workers if you like, who could not get a job. They would start from the top end of the market and say, "This is how much output this economy needs, that's how much is demanded. Then how many people do you need to produce that output?"

Then you would come up with a number. And then they would say, "Well, how many workers want jobs?" If there are more workers that want jobs, you call the difference unemployment. Now, the problem with that is that you cannot do anything with it other than say, "Oh, increase the output that the economy produces, and that's it, you get rid of unemployment."

But how do you do it? It was already shown in the marketplace that if government tries to increase output through demand, it doesn't work. What we did was to start from below, saying the outcomes in the labor market are the result of workers looking for jobs, companies looking for workers.

The two need to come together. They need to agree that the qualifications of the worker are the right ones for the firm. That once the firm has the capital, that worker needs to make the best use of his or her skills. That unemployment insurance policy might influence the incentives that the worker needs to take a job.

The tax policy might influence the incentives of the company. Once you open the field up like that, it gives you unlimited possibilities for research in that area and working out the impact of these different policies or different features of the labor market on unemployment. And many, many people got into it. They tried the model out and it was working, it was giving them the right answers. And that's how models become influential in the end.

Anna Bernasek: Okay, let me see if I've got it. The way that I understand it is that before you came along, the dominant view in economics was that if you lost your job, you'd find another one before too long. What you really did in your model was kind of take into account the way the world really worked, the sort of frictional delays in employment matching, as well as job market changes that really prevent matching workers to jobs. Did I capture it as well, or not?

Sir Christopher Pissarides: Yes, you did. What we said is that okay, the workers will get a job eventually. But the time that it takes to find that job depends on how many jobs are being offered in the labor market, what types of skills firms want, what incentives the worker has to accept the jobs, what's the structure of production, the profit that the firm expects to make, conditions overall in the market.

All those things influence the duration of unemployment. Therefore you could study there—how long does the worker remain unemployed? What could influence that duration? What could make it shorter? What would make it longer if you did certain things?

On that basis, you derive good policies towards unemployment, and they are still the policies that governments use, in fact widely, to work out how long people remain unemployed and what the implications of their unemployment are. Although the work mismatch existed before, it really couldn't be studied.

It couldn't be understood very well until we produced the concept of the matching function, which is how well firms with vacancies are matched to the existing labor force. Therefore you have measures of the gap, if you like, in skills, which is commonly known as mismatch. That's why our theory is known as the matching theory of unemployment as well as some other names that people use.

Anna Bernasek: What really are the implications of your work for policy?

Sir Christopher Pissarides: Firstly, lower unemployment than what might exist is not always a good thing for the labor market, because some unemployment is good because of the matching problem. If a worker becomes unemployed, or if a new worker leaves school, a person leaves school, gets into the labor market, is a new worker, it wouldn't be a good idea to accept the first job that is offered on day one and get into it.

Because it may not be the job that would bring out the best [productivity](#) from that worker, or the job that that worker would like best. Now, you might say it's obvious, and I now think it is, but when we were working on it, this didn't exist.

People were always saying, "Why do we have unemployment? Let's cut it down to zero. Why do people stay unemployed for so long before they find a job?" So there is an idea there that some unemployment would be good because it improves the match, the quality of the job.

On the other hand, it also implies that if you offer unemployment compensation, which is necessary to reduce poverty caused by unemployment, then you have to be careful when you're doing that, because if you just offer it unconditionally, it's going to create disincentives for people to take jobs, and it's going to lengthen the duration of unemployment.

Therefore it's going to increase your unemployment incidents. You are going to see more people unemployed, because they stay unemployed longer, collecting benefits. Now, that's been exploited a lot by politicians. I don't agree with that way, that they say, we have to cut benefits because of these incentives.

A better way of dealing with it is to say, we need to structure our unemployment compensation policy in

such a way that it deals with the poverty issue, but at the same time it doesn't create those disincentives that you might get if you offer it unconditionally.

The leading countries that develop policies that give exactly the answer to the question I've just posed, how to structure it, are mainly the Scandinavians—Denmark, Sweden, Norway. And other countries have followed them now, and most of them do follow this advice of structuring the benefit in such a way that the incentives are not harmed very much when you are dealing with the poverty issue of unemployment.

Anna Bernasek: Let's talk a little bit about what all this means for today in the middle of this pandemic. At MGI we just released a major report on the [future of work after COVID](#), which I know you were a key adviser on. Our research is showing that we are seeing the sort of disruption to the labor market being accelerated by the pandemic, and particularly for low-wage jobs. Many of these might not even be coming back. My question to you is what are you seeing in terms of the labor market right now? And why is it critical that we focus on this and address what's happening?

Sir Christopher Pissarides: The report really addresses all the big issues that we are facing with COVID. It's an excellent, comprehensive discussion of what we are expecting to see. On that basis, you could derive what might be optimal policies towards unemployment. The report is long enough as it is.

It doesn't go too deeply, as you might need, on that issue if you are designing an optimal policy. But I would say that the main thing that comes out of the report, and the main policy that you would want to follow, is that the challenge that is being faced because of the additional disruption in the labor market is how to make sure that whatever jobs are opened up in new sectors of the economy, that the workers transition easily into these new jobs.

Because the jobs they are losing now are jobs, one, that due to increased automation in the labor market, so you might include the [manufacturing jobs](#), are routine jobs that can be done by computers. That has accelerated a lot, so the job loss due to that has accelerated.

Second, jobs that traditionally were considered to be safe, for example in the food preparation business,

in the entertainment business, suddenly are being lost because people want to avoid this proximity to other human beings by going to a restaurant. You eat at home, for example.

Now, those workers were under the impression, or at least we were, the economists, talking about what jobs would survive, that those jobs would survive for a longer period to come. In fact, they are not surviving. Those workers might need to change sector of employment.

Again, the best policy that the government can follow there is [to provide this dual support](#). On the one hand, make sure that these workers don't sink into poverty, because they are already low-income workers. On the other hand, provide both incentives and financial support for the retraining of these workers into new types of employment that will come up after the pandemic.

Now, you will have every right to ask me, "What jobs are going to come after the pandemic?" And that's the difficult question, because there is so much uncertainty about what we are seeing. It's certainly the case that healthcare will be a big, big, big sector of job creation.

The workers, for example, losing jobs in the food preparation industry could retrain to go into personal care. That's where the government might step in and help in these transitions. I also think, actually, that because of high standards of living in Western countries, [productivity will start rising again](#), that the leisure industry will come back.

Travel for tourism will come back. Other forms of entertainment or personal assistance in the home. I cannot imagine people continuing to do their own cleaning, their own cooking, their own everything at home like they are doing now. So those sectors will create jobs eventually.

Maybe not as many as they were anticipated before, but they will certainly come back. And there you might need government help, again, with training. But the important thing, though, is that governments should provide support, income support now while workers are making the transition. Otherwise inequalities will grow even bigger, and we're running serious risks of social unrest even.

Anna Bernasek: That's exactly what I wanted to focus on with you, is that transition. Because if you think about a country like the United States, and I'd like to ask you the difference with Europe as well, but just US, you sort of feel like you're on your own here.

What you're saying is that the key areas for government to help is, number one, provide income support while you have a disruption to income, and at the same time, I guess the retraining, the opportunity to retrain. But it seems to me in this country that's easier said than done. For a person, you have to have the money and know what to retrain in. It's daunting, really. It's not that easy.

Sir Christopher Pissarides: It isn't. No one's standing outside the market, like us economists or more importantly some government department. They will not know what skills are exactly needed in the market. Only companies know that. Retraining needs to be provided by companies, because they're the ones that would know in what to train and to what extent.

Now, for training to succeed, however, it has to be funded from outside as well, because no company, except for the very big ones, I guess, will take on workers on expensive training programs if they are running the risk that some other company will come and take their workers away from them after they get trained.

There is this poaching problem. Government needs to come in and support it. The government collects the cost in the form of tax from the company sector as a whole, and then gives it back to those companies that are offering approved training programs.

Then the other issue is that training succeeds when the worker owns the training, in the sense that the worker is doing the training not because someone forced that worker to do the training, but because they believe that it's good for them and their career, and it's going to give them career progression and a pay raise.

For that to happen, governments need to think a little bit more carefully about how they're supporting the training, that they shouldn't be supporting it just by unconditionally giving money to companies and saying to them, "Okay, train."

Somehow maybe part of the amount should be given to the worker, then the worker chooses how to spend it. They cannot take it as money, but they could draw on a fund, a training fund. Singapore has a very good scheme like that. I think it's called [SkillsFuture](#). Some other countries are introducing it. It's not an easy thing, but we have enough experience now to know how to plan those kinds of training support schemes.

Anna Bernasek: Chris, is this really a two-part problem as we come out of the pandemic? There's one part where we need to help people immediately, and then there's another part where we really have the longer-term issues of how we all—it's often said we don't have a job for life anymore. We have to get used to multiple jobs, multiple careers. So is there a short-term and a long-term way to view coming out of the pandemic?

Sir Christopher Pissarides: Now, what you are saying is absolutely correct, because the income support issue has to come immediately. The restructuring and the training is something that, even if it's starting now, we're not going to see the effects of that for another up to five years, maybe.

It looks like a longer-term issue. But it's not something to postpone because it's longer term. It's something that has to start immediately, and we're going to start seeing the effects of that in small measures immediately. But they will grow and grow in the future as we are moving on. In fact, the McKinsey study, the recent McKinsey study on post-COVID labor markets that you just mentioned, it has a horizon out to 2030.

Anna Bernasek: Can we talk a little bit about the difference between the US and the European approach? Do European governments have a different approach to this problem than we do in the US?

Sir Christopher Pissarides: The European Union has been very supportive towards its members. It's giving them a lot of money to restructure after the pandemic. And it's not giving it unconditionally. It's saying, "Submit programs that will support workers out of jobs, job creation, the environment, sustainability," which are very important issues with the Green Deal in the EU.

Generally, the European model is one of higher taxation and higher support, which at this juncture, where we are now, is something that is really needed. Britain is doing something very similar with the furlough program, which is still there.

It's coming to an end soon, but I'm sure very soon new programs will be announced to support employment. After the pandemic, we need to have new concepts about good jobs, what jobs are created. The environment will be very important. I am heading, in fact, in London the Institute for Future Work, where we have lots of reports on this issue and recommendations about the resilience of the labor market.

In the States, of course, such support doesn't really exist. More attention needs to be paid there, in that you have an economy that's going down, and the stock market keeps going up. But now there's a change in the Biden administration. Those in charge, especially Janet Yellen at the Treasury—I think she's lived in Europe. She does support this kind of European policy, at least from her academic work that I know. I expect to see changes in the States as well. But it's a long way from where Trump was to the European current model.

Anna Bernasek: Chris, do you see that it could be harder for us in the US, then, to sort of make this transition than it is for Europe?

Sir Christopher Pissarides: You really need it, I believe, just to stop the social unrest. We see so much social unrest taking place in the States, so much poverty, so much depending on race, minorities suffering whenever there is a problem. It's just not right for the richest country in the world to have such a big section of its population getting that rotten deal.

And it's really down to government. We're living in democracies. You elect a government to look after its people, and it's just not looking after that section of the population. It's a very big section. Quite honestly, I think it's shameful, actually, quite honestly. I think governments should do something.

Anna Bernasek: I don't think you'd be alone in that. I think there is a lot of agreement on that. Can I ask you, when you look at this pandemic, has it changed your perspective in any way on the labor market and how it functions and what we know about it?

Sir Christopher Pissarides: Not really. The way I look at it is that the framework we have, that structure is there, but it got a shock which we've never seen before. And it opens up so many research avenues and so many important policy problems that we have to address that we should just get into it and address them.

The [McKinsey report](#) actually put it beautifully, in the sense that there is now a new element in the labor market that we need to take into account when we are explaining what's been happening, and this is personal contact. Whereas before when we were talking about what jobs are sort of closing down, the usual story was that, oh, we have to see which jobs can be automated, what tasks can machines do, what is it that only humans can do?

The answer back then was, the personal care and personal touch, and this empathy that we show towards other human beings in need, only humans can do, not machines. Well, now humans cannot do it because you cannot get close to those people to show them what's going on.

It's a new challenge, and then it's a new problem, which we didn't have before. But it hasn't changed my view of what is the structure of the labor market and how should we think about the labor market. Think of it in the same way with some new shock that comes in that tells you some things that you consider safe are no longer safe.

Anna Bernasek: If we sort of broaden it out from the labor market and think about the pandemic, it's sort of been a real-time economic experiment. Are there any things more broadly that we've learned from this pandemic, or that we need to do more research and more thinking about?

Sir Christopher Pissarides: I'm talking as an economist, but you always throw the ball in someone else's court. But the medics should do a lot more research and tell us how risky it really is that we might get more of these viruses coming out of animals. In fact, there is a lot of research taking place about viruses that transmit, if you like, from animals to humans and what they might be doing, and how do we deal with this situation?

I think that's important, because it has a huge impact on the economy. Now, what we can do as economists is something that we haven't done

before—actually at all. That if the medics are telling us, which is what they seem to be telling us, that, look, COVID-19 is not a one-off event, after all, we had SARS before, we had Ebola, and all that, and it might come again, is to learn how to adapt to these shocks better, and not wait until they hit us.

It's a little bit like our response to [climate change](#), actually. There is mitigation, measures you take beforehand so that you don't get into these problems, but also adaptation, which is things that you do so that if you get hit by some disaster, then you are quick to deal with it and you don't wait until you observe the worst before you do something.

Anna Bernasek: Chris, I'm curious, when you look at economics today and the problems, what do you see as the most significant questions that economic researchers should really be addressing?

Sir Christopher Pissarides: I think the most significant, actually, my general feeling is [inequality](#). It's something that's been going on for about 20 or 30 years now in the States. It's spreading elsewhere. Every time there is some new technology, some new disaster and all that, it's always the poorest sections of society that get hit worst.

It's a very difficult problem. I think the only way that it can be dealt with is not by aiming always for the technology that is going to give us the best profit and is going to automate best. Follow a more stakeholder kind of approach. Think of

your employees, if you are a big company, as your stakeholders.

Make sure that you do your R&D and you invent your technologies in the direction that gives you better jobs, more support for all your employees. The kind of thing that will reduce inequality, not necessarily just go for your maximum profit and then if the government wants to reduce inequality, tax the rich and give the money to the poor.

That is not a sustainable long-term solution. Of course, government does have a very important role to play in providing good-quality public services, employing people with good pay, good work conditions, not squeezing them out because high taxes lose you votes, and therefore throw them into poverty.

Although they might be working as nurses and giving important care and all that, they just don't get paid as much as they should be. But inequality is definitely the big problem. I got so motivated to understand unemployment when I was starting. I keep telling students that come to the LSE now, or to the University of Cyprus, and say, "What research should I be doing?" I will say to them, "Just get motivated to understand the inequality and you'll become famous one day."

Anna Bernasek: Thank you so much, Chris, it's been such a pleasure to talk to you. I really appreciate it.

Sir Christopher Pissarides: Thank you. Thank you very much.

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