Will's job market paper is my favorite kind of exercise: Take some well-established microeconomic fact, incorporate it into a macro model, and show that it has important macro implications that are not present until you match the micro reality. In Will's case, the micro fact is that exogenous spells of unemployment have a "scarring effect" on subsequent earnings. The micro literature has made the usual heroic efforts to establish that the measured scars are not due to some form of selection on unobservables - they are, as best one can tell, a causal consequence of an exogenous unemployment shock. The simplest interpretation is that the spell results in a negative shock to idiosyncratic human capital. (Other explanations, like a job ladder or match quality, would have the same consequences).

Although a large microeconomic literature documents these scars and explores its sources, few macroeconomic papers consider its implications for macroeconomic dynamics. The contribution of Will's job market paper is to quantify the macroeconomic impact of these scars on business cycle fluctuations and in the transmission of fiscal policy.

To bring these facts to macroeconomics, Will embeds a micro structural model of unemployment into a general equilibrium setting, matches the facts on scarring, and explores the consequences, which include: (a) a unit root in GDP that arises from the permanence of the scarring; (b) a permanent (or highly persistent) increase in income inequality; and (c) a reduction in the effectiveness of fiscal austerity. Specifically, he finds that unemployment scarring introduces a dimension that allows his model to capture both failure of GDP to rebound to its former levels following the Great Recession and the swift rebound in GDP from the COVID Recession.

Furthermore, he shows that scarring provides an explanation for why income inequality seems to have been permanently increased by the Great Recession but only increased temporarily during the pandemic recession. In Will's model (and in the micro literature), temporary layoffs do not cause permanent scars to earning capacity, which is why the large fraction of temporary layoffs during the pandemic was not accompanied by a permanent decline in GDP or a permanent rise in income inequality. In particular, Will demonstrates that if the majority of layoffs during the pandemic had been permanent rather than temporary, GDP would have failed to fully recover, stabilizing at a new trend 2 percent below its pre-recession trajectory.[1]

In the final exercise of his job market paper, he considers a counterfactual where the U.S. pursues fiscal austerity to reduce its debt-to-GDP. He finds that austerity is four times less effective in reducing debt-to-GDP because of unemployment scarring and induces a long lasting rise in income inequality.

[1]As a reference for the magnitude of the 2 percent deviation, GDP settled on a new trend 8-10 percent below its pre-recessionary following the Great Recession (e.g. see this FEDS note comparing the recovery from the pandemic against the recovery from the Great Recession, figure 10 in Will's job market paper, or figure 8 in **?**)