The United States needs to jump-start its stalled jobs machine and recoup employment with recovery

by Richard Freeman and William Rodgers

Jobless recovery: whatever happened to the great American jobs machine?

In terms of employment creation, the US economic expansion since 2001 has been the worst in over half a century. Richard Freeman and William Rodgers explore what’s been going on in the labour market during this ‘jobless recovery’.

During the 1990s, the US labour market drew plaudits around the world for the large number of jobs it created. The rate of unemployment fell to levels below those of most other advanced economies and the percentage of the population in employment rose to its highest level in history, as even the less skilled and former ‘welfare mothers’ found jobs. At the same time, productivity grew smartly, real wages rose after decades of stagnation or decline, the seemingly insurmountable rise of inequality ended and poverty fell. Europe marvelled at the ‘great American jobs machine’ and sought solutions to European problems in US policies and practices.

What a difference a few years makes. In the 2004 election, the question in the United States is not how the great American jobs machine functions but why the economy has produced a ‘jobless recovery’. Three years after the Bush administration claimed that the trough had been reached, fewer people were working than at the outset of the recovery. Although by historical standards, the percentage of the population in employment remains quite high, it is now two percentage points lower than three years ago.

Economic and political fallout from the jobless recovery

The jobless recovery since 2001 has created greater economic problems for Americans than the sluggish job performance of Europe in the 1990s created for Europeans. The United States has only a limited safety net for workers. Those who lose their jobs risk losing health care or seeing their family drop from the middle class into poverty. American welfare policy is full employment not a social welfare state.

The jobless recovery has also created political problems for the Bush administration since it suggests to many that ‘trickle-down’ economic policies are more trick than treat for Americans on middle incomes and below. The weakest area of support for the administration in opinion polls has been in economic issues. For example, in the spring 2004 Work Trends survey by the Heldrich Center for Workforce Development, only 7% of workers said that the president was doing an excellent job in handling issues related to jobs. This compared with 32% who said he was doing a poor job. Among employers, only 18% said he was doing an excellent job while just over a fifth rated his job as poor.

Since GDP and productivity have grown smartly since 2001, the underlying reason for this low rating must have been the jobless recovery. In the long run, the massive balance of trade deficit and fiscal deficit may exact a greater toll on the US economy, but jobs are what seem to matter most to voters. Of the 1,100 likely voters surveyed by the Los Angeles Times in September 2004, 46% said Kerry would do a better job at creating jobs; 39% picked Bush. And the CNN/USA Today/Gallup poll of 9/10 October found that 28% of likely voters put the economy on par with terrorism as the most important issue. Gallup reported that since July, the economy has been the first or second most frequently chosen issue among likely voters.

These concerns cut across the income scale. As an example of how the jobs issue affects an upper income suburban community, more parents have requested scholarship support for the extended day care programme in Brookline, Massachusetts in recent months than in the past decade or so. This programme enables an unemployed parent to look for work and accept a job immediately if they get an offer.

US employment patterns across different groups, states and sectors

Our research is examining the operation of the US labour market in the jobless recovery. Because the country is in the middle of this phenomenon, ours is a real-time analysis, some of whose conclusions could change if the recovery stalls or employment grew suddenly. But even rapid change in the labour market will not gain the surprising US failure to generate jobs for so long in this recovery.

Our first finding is that the current recovery has been the worst in recent US economic history for employment creation (see Figure 1). The failure of the great American jobs machine is not a matter of election year hype. Employment growth looks bad in comparison to all previous post-World War II recoveries, including the 1990s recovery, when employment also took what appeared to be an extraordinarily long period to recover. Typically, employment growth lags business cycle recoveries by three to four months. In the 1990s recovery, the lag was a little over two months. In the 2001 recovery, the underlying reason for this low rating must have been in economic issues. For example, in the spring 2004 Work Trends survey by the Heldrich Center for Workforce Development, only 7% of workers said that the president was doing an excellent job in handling issues related to jobs. This compared with 32% who said he was doing a poor job. Among employers, only 18% said he was doing an excellent job while just over a fifth rated his job as poor.

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Figure 1: Cumulative employment growth during the seven most recent recoveries

We have been surprised to find that there is little difference in the employment paths that these and other states have taken during the current recovery. This suggests that either compositional shifts in industry employment – for example, the decline of manufacturing jobs – and other non-economic factors must explain why the election was so competitive in these states.

Wages, inequality and poverty

It is more difficult to pin down what has happened to wages and inequality in the jobless recovery. Some data show gains in real wages after three years of recovery: others don’t. Some measures of inequality show modest improvements; others show little change. But as the recovery has proceeded, wages of workers at the bottom of the distribution have improved, at least up to mid-2004. Between the second quarter of 2003 and the second quarter of 2004, earnings for the bottom 10% of the wage distribution fell by 1.9%. Over the same 12-month period, earnings for the bottom 10% of the African-American wage distribution fell by 3.2%.

Of course, changes in real wages are not the fundamental problem of the jobless recovery: rather, it is sluggish employment growth. But what is clear is that the combination of stagnant employment and sluggish real wage growth has meant that poverty has risen in this recovery, albeit modestly. This contrasts with the usual pattern of poverty falling as GDP grows.

In political discourse, the Bush administration has sought to treat the rise in poverty as old news, likely to be reversed as employment rose in late 2004. But several key labour market statistics that are correlated with poverty show no improvement at the time of writing. The employment of
Americans who have no more than a high school degree or who are of African-American heritage have not improved since the Census Bureau collected the poverty data. Specifically, in the year to September 2004, the percentage of high school dropouts and African-Americans in employment remained at 41% and 57%. The equivalent numbers for single mothers did not improve either.

**Explaining the jobless recovery**

Is it possible that the jobless recovery is simply a matter of the NBER incorrectly dating the end of the recession? While there is a range of uncertainty around the dating of a recovery, aside from jobs, the current recovery looks reasonably normal. Profits have risen, GDP has grown and productivity has increased at the rapid rates of the 1990s. Industrial production has grown less rapidly than in previous recoveries but this reflects the continuing shift toward a service economy.

Is it possible that the jobless recovery reflects greater rigidity in the US labour market, consistent with the orthodox explanation of weak employment growth in Europe in the 1990s? Clearly not. Neither the Bush administration nor the Clinton administration enacted new regulations on employment unemployment or welfare benefits that might affect adversely the level of employment.

Could the jobless recovery reflect conservative central bank policy of the type that the European Central Bank adopted during the 1990s? Again, clearly not. The Federal Reserve has kept interest rates low during the recovery. As far as we can tell, Alan Greenspan has not lost his nerve or realistic view about the US economy.

So how come the great American jobs machine has stalled? While we cannot claim to have any definitive answer, our research has uncovered a set of factors that seem to have had some effect in creating the jobless recovery.

**US performance in the international economy**

The first is the poor performance of the United States in the international economy. In the current recovery, the trade deficit has risen to levels that are unprecedented in recent US experience. Between the fourth quarter of 2001 and the second quarter of 2004, the ratio of exports minus imports relative to GDP increased from -4.2% to -5.4%. This is larger than the normal increase in trade deficits in a recovery, but it is not the largest on record. In the 1980s recovery, the trade deficit rose from 0.5% to -2.4%.

What is unprecedented is the huge drop in foreign direct investment in the United States as a share of GDP: from 1.6% in 2001 to 0.3% in 2003. In the two previous recoveries, foreign direct investment rose as a share of GDP, presumably directly creating jobs in the United States.

The Bush administration’s Council of Economic Advisors was recently criticised for downplaying the significance of jobs being ‘offshored’ in the jobless recovery. But government statistics do not provide even crude measures of the number of jobs being offshored in the service industries. For example, while Indian exporters report several billion dollars of exports in computer related and telecom services and many major US companies proudly proclaim offshoring of service sector work as way to improve profits, government statistics record less than a billion dollars of service sector imports declining over time and only a minus-cule number of job losses attributable to offshoring.

The Government Accounting Office recently examined the quality of official statistics and found them virtually useless in measuring job losses. We have greater faith in the Indian statistics and in business announcements that offshoring has cost the United States a significant number of jobs. But simply ascribing some of the jobless growth to international factors like trade, foreign direct investment and offshoring does not give a complete explanation. That the value of the dollar fell relative to the euro and pound despite rapid increases in productivity demands some deeper explanations as to why the United States did not do better in international markets.

**The impact of health care costs**

The second factor behind the jobless recovery is the US mode of funding medical insurance. Health insurance spending per employee has risen sharply in the United States, albeit over a longer period than in the current recovery. It adds a substantial marginal cost to employing workers, and many firms have sought ways to operate without committing themselves to permanent workers who obtain such benefits.

The Kaiser Family Foundation finds that between 2000 and 2003, employment of people with employer-sponsored health care coverage fell by 2.8%, which is considerably greater than the overall fall in employment in that period. This is at least consistent with the notion that some of the stagnant employment growth may be associated with rising health care costs, and ultimately with the country’s distinct mode of financing health insurance.

**The impact of the fiscal stimulus**

The third factor is the nature of the fiscal stimulus, which gave the vast bulk of the tax cuts to wealthy people whose propensity to spend quickly is likely to be less than that of people on middle incomes and below. Table 1 shows that between 2001 and 2003, the US fiscal deficit rose by 3.0 percentage points relative to potential GDP: from a surplus of 1.1% to a deficit of 2.8%. This exceeds the increase in the deficit and the size of stimulus in both the 1980s and 1990s recoveries.

Actual GDP grew by just 8% between 2001 and 2003 despite the huge stimulus. This is a lower growth rate than in the two previous recoveries when the fiscal stimulus was weaker. We suspect that the larger stimulus had a smaller impact on GDP growth because the tax cuts were slanted to the super-rich.

**The impact of structural change**

Fourth, continuing structural change, the permanent relocation of workers from declining industries to growing ones, has contributed to the jobless recovery. Erica Groshen and Simon Potter show that the share of total employment in industries undergoing structural change was 51% during the mid-1970s and 1980s recoveries and 57% during the 1990s recovery; it is 79% during the current recovery. Their research suggests that the United States is in the middle of a period of reaction to the over-expansion of the 1990s, making structural employment shifts the dominant source of changes in employment.

**The impact of increased productivity**

Finally, we reject the idea that increased productivity explains the jobless recovery. This is a circular argument. Increases in productivity due to technological and other innovations in the country’s aggregate supply curve, which increases the growth of potential GDP and permits greater growth of employment without inflation than would otherwise be the case.

The puzzle is why increased productivity coupled with the fiscal stimulus and low interest rates have not generated enough GDP growth to crank up the great American jobs machine as quickly as they did in all previous recoveries. The surprisingly slow employment recovery raises serious doubts about the Bush administration’s economic policies that a few years ago might have looked reasonable in terms of their likely impact on employment even though they were distributionally skewed in favour of the wealthy. Approaching the election, the administration defended its stimulus package, hoping that eventually employment will pick up. After the election, we hope that whichever party has won, it will look at the surprising jobless recovery more forcefully. The United States needs to jump-start its stalled jobs machine and recouple employment growth with GDP growth lest the current jobless recovery gainsays the label of ‘peak capitalist economy’ that many bestowed on the country in the 1990s.

Richard B Freeman holds the Herbert Ascherman Chair in Economics at Harvard University. He is also director of NBER’s labour studies programme and Senior Research Fellow in CEP’s research programme on labour markets.

William M. Rodgers III is Professor of Economics at the Edward J. Bloustein School of Planning and Public Policy at Rutgers, the State University of New Jersey. He is Chief Economist of the Hudson Center for Workforce Development and a Senior Research Affiliate of the National Poverty Center, University of Michigan.

**Further reading**


Table 1: The fiscal stimulus as a percentage of potential GDP was larger in the jobless recovery than in two preceding recoveries

<table>
<thead>
<tr>
<th>Recovery</th>
<th>Surplus or Deficit (%)</th>
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<tbody>
<tr>
<td>1993</td>
<td>-1.1</td>
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<tr>
<td>1994</td>
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<td>Change</td>
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<td>1995</td>
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<td>1991</td>
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<td>Change</td>
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<td>2001</td>
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<td>2003</td>
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<td>Change</td>
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Source: Congressional Budget Office. Figures are the standardised budget surplus or deficit as a share of potential GDP.

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