

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 inexorable 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 Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) declared that the country

was in economic recovery and nearly four 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/Gallop poll of 9/10 October found that 28% of likely voters put the economy on par with terrorism as the most important issue. Gallop 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

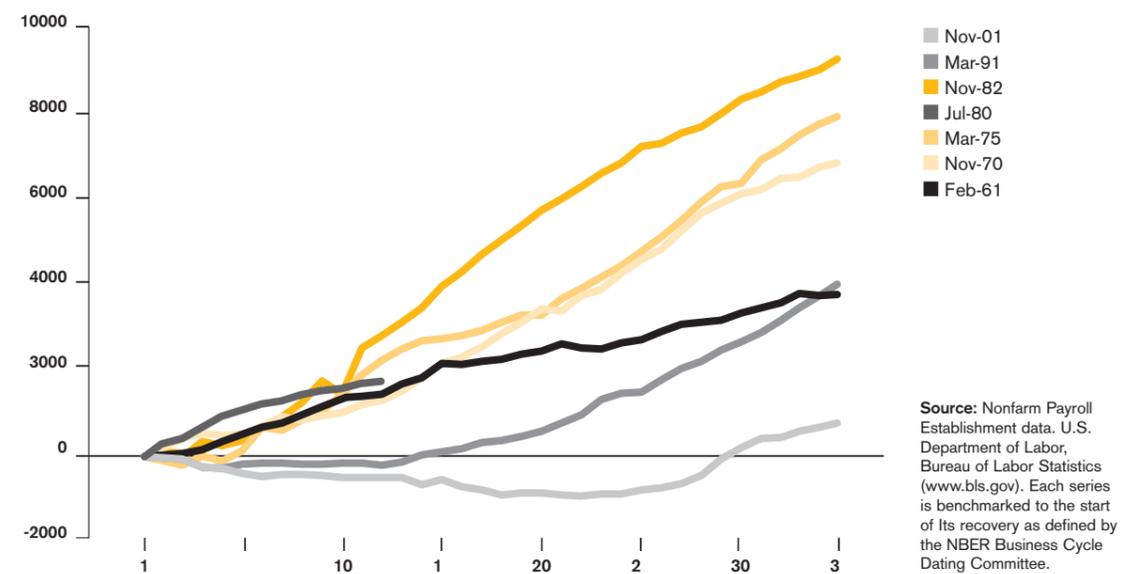
community, more parents have requested scholarship support for the extended day care programme in Brookline, Massachusetts in recent months than in the past decade or so. This programme enables an unemployed parent to look for work and accept a job immediately if they get an offer.

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 stalled or employment grew suddenly. But even rapid change in the labour market will not gainsay 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

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



White-collar workers have had more trouble finding jobs than in virtually any other recovery

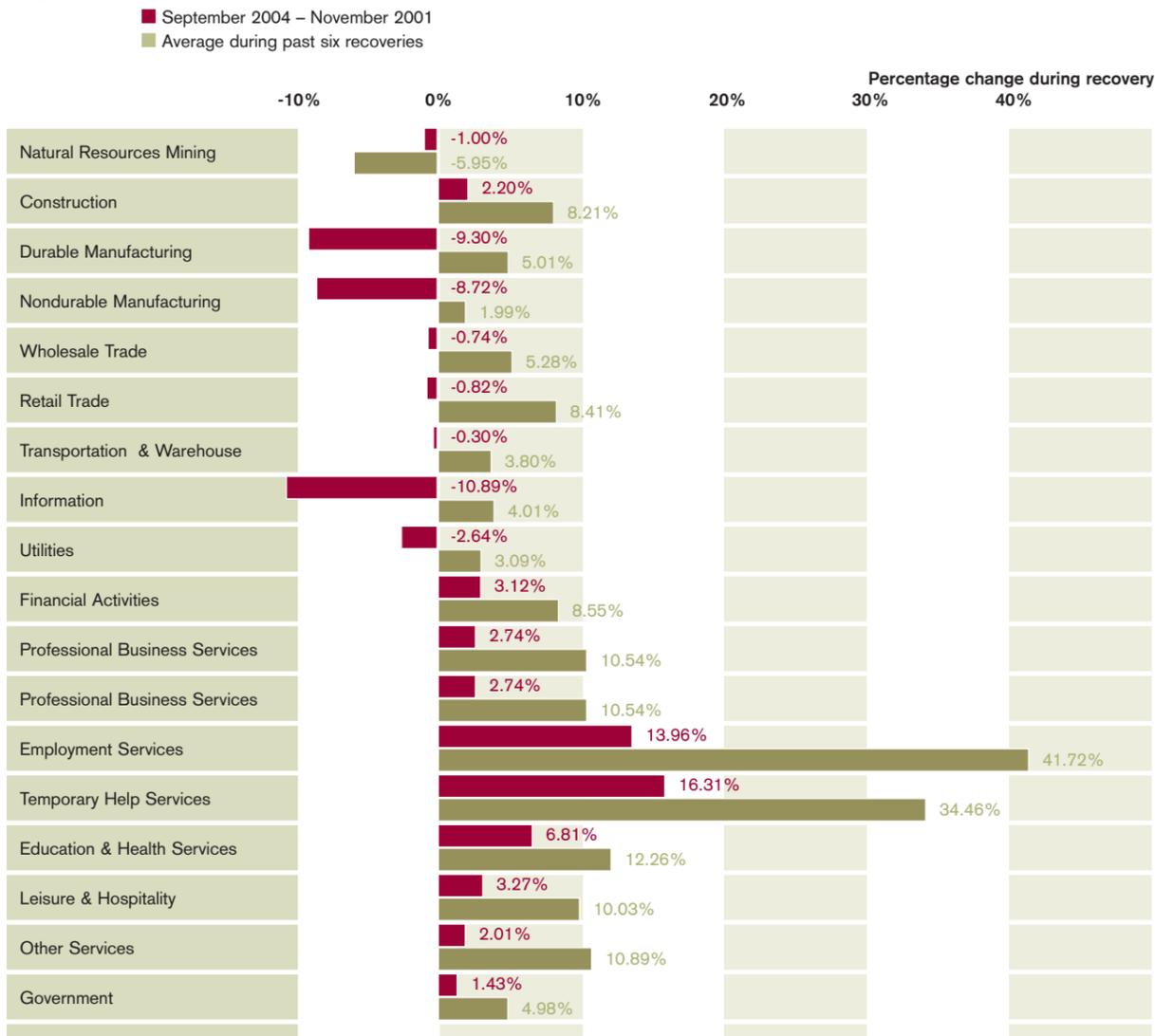
years. In the current recovery, the lag is three to four years and, at the time of writing, the labour market has shown only twitches of recovery.

We have examined the growth of employment sector by sector, anticipating that we would find some sectors with employment growth that looks normal for a recovery and others with abnormal employment experience. This would have provided valuable clues to the cause of the jobless recovery.

We have been surprised to find that in many private sector industries, employment as of late 2004 is markedly below

employment at the start of the recovery. For example, in August 2004, employment was 9.1% lower in durable manufacturing and 8.5% lower in non-durable manufacturing than when the recovery began. Employment was also down in retail, wholesale and transportation. It had grown modestly in education and hospitals, government, finance and insurance, and some other services. But it had fallen in many other service sectors, including the broad 'information' industries (telecoms, newspapers, movies, cable TV, etc.), a major part of the new economy that is supposed to be producing good jobs to replace declining employment in traditional manufacturing. Figure 2 compares these growth numbers with previous recoveries.

Figure 2 Employment growth at similar points in the recovery



Disadvantaged groups have had worse employment experiences relative to other workers than in previous recoveries



We have examined employment growth among groups especially sensitive to the swings of the business cycle: African-Americans, new labour market entrants and the less skilled. Historically, recessions take their first toll on these groups but in recoveries, they benefit from larger increases in employment than more advantaged groups. The evidence is that African-Americans and new labour market entrants have had worse employment experiences relative to other workers than in the previous two recessions and recoveries.

We have also examined the labour market for the highly skilled. One of the most stunning facts about the post-2001 labour market is that the rate of unemployment among electrical engineers has exceeded the national unemployment rate. White-collar workers have had more trouble finding jobs than in virtually any other recovery.

Analysing employment growth by state, we find that compared with the current recovery, the typical state's employment grew 2.6-4.8% faster in the 1990s recovery and 4.5-6.3% faster in the 1980s recovery. Current employment growth is substantially weaker across the board, with two distinct patterns emerging.

Employment growth in states that have experienced any increase in jobs during the current recovery has been slower than in past recoveries. Arizona and Florida are good examples of this pattern: employment growth in these states was just over 1% between 2001 and 2003, but during comparable periods in earlier recoveries, it was two to four times higher. Elsewhere, in contrast with the 1980s and 1990s recoveries, there has been a contraction in employment. Michigan and Ohio fit this pattern: during the current recovery, employment in these states fell by 1-4% compared with modest increases in the earlier recoveries.

We have also studied employment growth in the so-called

battleground states of the election, which comprise about one-third of total non-farm employment. 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 not 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

The trade deficit, falling inward investment and offshoring have all contributed to the jobless recovery

Americans who have no more than a high school degree or who are single parents or African-American 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 unemployment insurance 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 telecoms 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 minuscule 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

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

Recovery	Surplus or Deficit (-)
1982	-1.1
1984	-3.6
Change	-2.5
1991	-2.4
1993	-2.8
Change	-0.4
2001	1.1
2003	-2.8
Change	-3.9

Source: Congressional Budget Office. Figures are the standardised budget surplus or deficit as a share of potential GDP.

The fiscal stimulus has been bigger in this recovery than previous ones but has had a smaller impact on GDP growth

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 3.9 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-wealthy.

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 shift out 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 forthrightly. 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.

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Further reading

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