

COMMENTARY

Why have so few jobs been created in the United States in the past four years? As Richard B. Freeman and William M. Rodgers III document, this has been the weakest recovery from a U.S. recession in the past forty years—employment creation in the 2001-04 period has fallen short of job growth in the recovery phase of all of the last six U.S. recessions—by a substantial margin. The basic question the authors ask is: *why?*

For Americans, the answer is important because, as Freeman and Rodgers state: “As long as the United States makes full employment its main ‘welfare state’ protection for workers, the country has to attain something akin to the late 1990s tightness in the labor market for economic growth to be shared among the entire population.” With a system of unemployment insurance that offers very low benefits compared with those of European nations and very limited access to social assistance, unemployed Americans face financial hardship much faster than the unemployed elsewhere—with the added burden that insurance for health care costs is often lost as a by-product of job loss. There is also the added wrinkle that the lifetime limit on social assistance benefits written into the Temporary Assistance for Needy Families reforms of 1996 was not generally a binding constraint until 2001—but it is now increasingly relevant to more people.

For the rest of the world, the answer is important because the United States seems to have already fired most of its available macroeconomic ammunition—in monetary, fiscal, and exchange rate policy—to disappointingly limited effect in

terms of jobs. Starting in December 2000, the Federal Reserve cut the federal funds target rate from 6 percent to a forty-year low of 1 percent by mid-2003. Tax cuts, temporary investment incentives, and a rapid increase in government outlays shifted the structural fiscal balance by some 5 percentage points of GDP after 2001. Between 2001 and 2004, the U.S. dollar’s real effective exchange rate depreciated approximately 25 percent. It is hard to imagine how macroeconomic stimulus could have been more stimulative—but job creation has lagged badly while the current account deficit has surged to just under 6 percent of GDP. Hence, when even the International Monetary Fund has gone public with its concerns about the mounting dangers to global financial stability if present trends are not reversed,¹ non-Americans have reason to be concerned about the types of pressures for policy changes that might emerge if job creation does not become much more robust relatively quickly.

For the United States in 2004, the question “Why has job creation in this recovery been so weak?” can therefore be decomposed into the twin questions “With this much policy stimulus, why hasn’t there been more GDP growth?” and “Why has *some* recovery in GDP growth produced so *little* growth in employment?” Freeman and Rodgers focus mostly on the second question, although they do note that a budget deficit inflated by tax cuts tilted toward the very rich, with their relatively low marginal propensity to consume, will tend to provide an ineffective stimulus to aggregate demand. (One

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could add the fact that hi-tech foreign wars may be very expensive financially, but they provide little domestic U.S. job creation.) Freeman and Rodgers rightly reject the argument that rapid productivity growth should take the blame for slow job creation, emphasizing that productivity improvements increase the noninflationary growth rate of potential GDP. Their examination of measures of consumer confidence does not suggest that greater uncertainty has produced a change in consumer sentiment that has depressed consumer demand. Hence, because the authors do not argue for additional fiscal or monetary stimulus to aggregate demand, and they do not suggest any tendency to reduced labour supply, they must look primarily for “structural” explanations.

Much of the paper is therefore devoted to charting the distribution of employment and wage changes, by demographic group and education category, as a possible source of clues to an explanation for the current weakness of the GDP-jobs link. No “smoking gun” emerges. “Off-shoring” of jobs has been highly visible in the media, but this is really a long-run trend. In recent years, the impact may have shifted collar color somewhat, from blue to white; but to explain the *difference* in total job creation between 2001-04 and the recovery from previous recessions, one needs a very large acceleration from trend, for which there is little evidence.

Similarly, by financing most medical costs through health insurance premiums as a fringe benefit of employment, the United States has chosen a system that creates a substantial fixed cost to firms in terms of new hires and thereby provides an incentive to employers to ask for longer weekly work hours, instead of hiring new workers, when product demand recovers. This has always been a U.S. problem—but there is no recent institutional change to explain why this recovery is different. Freeman and Rodgers suggest that rising health costs may have recently tipped the balance, and if so, this will imply greater labour market inflexibility—that is, of firms—in future years in the United States than in other Organisation for Economic Co-Operation and Development (OECD) nations. But this remains a conjecture.

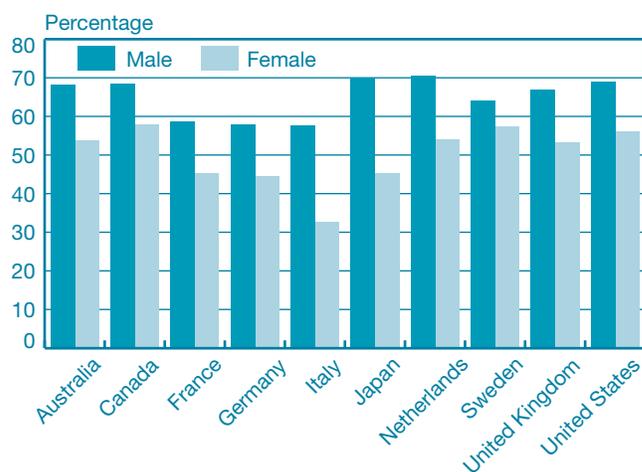
A final possible explanation is offered by accelerating structural change. Some structural trends should have produced a faster rebound in jobs in this recession than in previous times—such as the much greater use of the Internet in job searches in recent years²—because faster job finding should have resulted in greater employment at any given time. However, the crucial characteristic distinguishing unemployment due to structural change from “cyclical” or “demand deficient” unemployment is the fact that “structural unemployment” occurs when workers are unable to fill *available* jobs because they lack the required skills or do not live where jobs are available. This implies that the number of

vacancies is an upper bound to the extent of structural unemployment. Since there is little evidence for a recent increase in the number of unfilled vacancies in the United States, the case for a recent increase in structural unemployment *mismatch* seems somewhat dubious.

In addition, appealing to structural change to explain recent job-creation trends leads naturally to the question “What’s *different* about U.S. structural change?” Other countries also have the Internet, advanced computer technologies, and other innovations, and a defining characteristic of “globalisation” is an acceleration of the rate of international diffusion of innovations. If structural change is causing anaemic job growth in the United States, one should see signs of similarly slow job creation elsewhere—but one does not. Between December 2000 and December 2004, total nonfarm employment in the United States barely moved—indeed, it fell by 0.08 percent, from 133,308,000 to 133,200,000.³ By comparison, Canada, arguably the country most institutionally similar to the United States, saw a 7.3 percent increase in employment over the same period.⁴

Job creation in the United States now lags job creation in several other countries (see chart). By 2003, the employment-population ratio in the United States—particularly for men—was not much different than the ratio in many other OECD nations. There is more variation across countries in female than in male employment, and the combination of earlier retirement and higher unemployment has depressed the employment rates of French, German, and Italian men. However, Japan and the Netherlands had higher—and Canada and Australia had only marginally lower—male employment rates than the United States did in 2003.

2003 Civilian Employment-Population Ratios by Country



These other nations also have more social supports available for the jobless—in the form of income transfers, health care provision, and public services—than the United States does. The problem therefore is that a nation with an above-average dependency on healthy job growth is now generating only an

average level of employment. One suspects that this is not going to be perceived as “good enough,” and that it will not be long before a cruel choice will be made between better job creation and macroeconomic stability in government debt and inflation.

ENDNOTES

1. See International Monetary Fund (2004).
2. See Kuhn and Skuterud (2004).
3. See <<ftp://ftp.bls.gov/pub/suppl/empsit.compaeu.txt>>.
4. Employment rose from 14,974,500 in December 2000 to 16,098,800 in December 2004 (see Canism II Series V2064890).

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