“Not Good Enough to be Average?
– Comments on “The Weak Jobs recovery: whatever happened to the great American jobs machine?” by Freeman and Rodgers

Lars Osberg

Department of Economics
Dalhousie University
6214 University Avenue
Halifax, Nova Scotia
B3H 3J5
CANADA
Email: Lars.Osberg@dal.ca

January 31, 2005

Why have so few jobs been created in the US in the last four years? As Freeman and Rodgers document, this has been the weakest recovery from a US recession in the last 40 years - employment creation in the 2001-2004 period has fallen short of job growth in the recovery phase of all of the last six US recessions, by a substantial margin. The basic question they ask is: <u>why</u> ?

For Americans, the answer is important because, as Freeman and Rodgers put it: “As long as the US makes full employment its main “welfare state” protection for workers, the country has to attain something akin to the late 1990s tightness in the labour market for economic growth to be shared among the entire population.” With a system of unemployment insurance that offers very low benefits compared to 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 also often lost as a by-product of job loss. As well, there is the added wrinkle that the lifetime time limit on social assistance benefits written into the TANF reforms of 1996 was not generally a binding constraint until 2001 – but is now increasingly relevant to more people.

For the rest of the world, the answer is important because the US seems to have already fired most of the available macro-economic ammunition – in monetary, fiscal and exchange rate policy – to disappointingly limited effect, in terms of jobs. Starting from 6% in December 2000, the Federal Reserve cut the

Federal Funds Target Rate to a 40-year low of 1% 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 real effective exchange rate of the US dollar depreciated by approximately 25%. It is hard to imagine how macro-economic stimulus could have been more stimulative – but job creation has lagged badly, while the current account deficit has surged to just under 6% of GDP. Hence, when even the International Monetary Fund has gone public[1] with its concerns about the mounting dangers for global financial stability if present trends are not reversed, non-Americans have reason to be concerned about what kinds of pressures for policy changes might emerge if job creation does not become much more robust, relatively quickly.

For the USA in 2004, the question "why has job creation in this recovery been so weak?" can therefore be decomposed into the twin questions: [1] "With this much policy stimulus, why hasn't there been more GDP growth?" and [2] "Why has *some* recovery in GDP growth produced *so little* growth in employment?" Freeman & Rodgers focus mostly on the second issue, 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 could add the fact that hi-tech foreign wars may be very expensive financially, but they provide little domestic US 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 non-inflationary growth rate of potential GDP. Their examination of measures of Consumer Confidence does not suggest that greater uncertainty has produced a change in consumer sentiments that has depressed consumer demand. Hence, since they do not argue for additional fiscal or monetary stimulus to aggregate demand, and they do not suggest any tendency to reduced labor 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 educational category, as a possible source of clues to an explanation of the current weakness of the GDP/jobs link. No 'smoking gun' emerges. "Offshoring" of jobs has been highly visible in the media but this is really a long-run trend. In recent years the impact may have somewhat shifted collar color, from blue to white, but to explain the *difference* in total job creation between 2001-2004 and the recovery from previous recessions, one needs a very large acceleration from trend, for which there is little evidence.

Similarly, in financing most medical costs through health insurance premiums as a fringe benefit of employment, the US has chosen a system which creates a substantial fixed cost to firms of new hires, and thereby provides an

---

[1] See IMF Country Report No. 04/230 United States: 2004 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion, July 2004 available at:
http://www.imf.org/external/pubs/ft/scr/2004/cr04230.pdf

incentive to employers to ask for longer weekly work hours, instead of hiring new workers, when product demand recovers. This has always been a US 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 "labor market inflexibility" – i.e. of firms – in future years in the US than in other OECD nations, but this remains a conjecture.

A final possible explanation is accelerating structural change. Some structural trends should have produced a faster rebound in jobs in this recession than in previous times – e.g. the much greater use of the Internet in job search in recent years[2], since faster job finding should have resulted in more employment at any given time. However, the crucial characteristic distinguishing between unemployment due to structural change and "Cyclical" or "Demand Deficient" unemployment, is 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. Is there *any* evidence for a corresponding recent increase in the number of unfilled vacancies in the USA?

As well, appealing to structural change to explain recent job creation trends leads naturally to the question "What's *different* about US structural change?" Other countries also have the Internet, advanced computer technologies, etc. and a defining characteristic of 'globalization' is an acceleration of the rate of international diffusion of innovations. If structural change is the cause of anaemic job growth in the US, one should see signs of similarly slow job creation elsewhere – but one does not. Between December 2000 and December 2004, total non-farm employment in the US barely moved (indeed fell by 0.2% - declining from 133,308,000 to 133,027,000[3]). Canada, arguably the country most institutionally similar to the US, saw an increase in employment of 7.3% over the same period[4].

Job creation in the US now lags that in several other countries. As Figure 1 illustrates, by 2003 the employment / population ratio in the US – particularly for men – was not much different than that in many other OECD nations. There is more variation across countries in female employment than in male and the combination of earlier retirement and higher unemployment 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 US in 2003.

---

[2] see Internet Job Search and Unemployment Durations; By Kuhn, Peter; Skuterud, Mikal; American Economic Review, March 2004, v. 94, iss. 1, pp. 218-32

[3] http://data.bls.gov/cgi-bin/surveymost

[4] Employment rose from 14,974,500 in December 2000 to 16,098,800 in December 2004 – see CANSIM II SERIES V2064890

These other nations also have more social supports – in income transfers, health care provision and public services – available for the jobless than in the US. 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 there will be a cruel choice to be made between better job creation and macro-economic stability in government debt and inflation.

Figure 1
2003 Civilian Employment-Population Ratios by Country
Male and Female