

Jobless Recovery: The New Economy?

The National Bureau of Economic Research (NBER) Business Cycle Dating Committee called the end to our most recent recession in November 2001, marking one of the shortest recessions in our history (March to November 2001). Those folk monitoring employment conditions in the economy have seen few signs of recovery, until the recent October employment release. The October figure and the upward revisions in the August and September numbers may portend employment recovery. Some uncertainty remains, however, since employment grew over the same months in 2002, only to see employment retreat again in future months. Also, employment grew anemically in October, less than 0.1 percent. Nonetheless, the signals seem stronger for employment growth in 2004.

While employment patterns typically lag the business cycle, the current recession and the last recession in the early 1990s both exhibited jobless recoveries. Employment growth after the recession in the early 1990s picked up only 18 months after the recession ended. The August, September, and October rise in employment, if sustained, dates the current pick up after 21 months. So, what changes in the economy have altered the pattern of employment and real GDP movements? What gives rise to jobless recoveries?

Productivity Versus Employment Growth

A recession commonly means two consecutive quarters of falling real GDP. While that definition frequently holds, the NBER Business Cycle Dating Committee uses other variables, including employment, to track the business cycle. How can real GDP and employment move in opposite directions? Labor productivity measures average real GDP per worker. Thus, growth in real GDP can occur as employment grows, as labor productivity improves, or some combination of the two.

In the current economy, resurgent labor productivity growth drives real GDP growth, even though employment fell. In other words, productivity growth more than offsets the decrease in employment. For example, the third quarter recorded productivity growth of 8.1 percent, while the revised employment growth rose only 0.1 percent.

The manufacturing sector has exhibited significant productivity growth while the level of employment in the manufacturing sector continues its decline that began in 1979. Laborsaving technology boosts output in the manufacturing sector and drives labor productivity to new highs. Over time, displaced manufacturing labor must migrate to other sectors. That migration may reflect the actual movement of individual workers or may reflect the retirement of workers in manufacturing and the hiring of new job entrants in other sectors.

Cyclical Versus Structural Unemployment

Economists classify unemployment into three categories – frictional, cyclical, and structural

unemployment – although the precise boundaries between the different types of unemployment remain difficult to identify. Frictional unemployment refers to the job search that new entrants and other reentrants to labor markets conduct. While searching for jobs, they count as unemployed. Such unemployment inevitably exists in competitive labor markets, implying that policy makers need not respond to such unemployment.

Cyclical unemployment reflects the movements of the business cycle. When the economy booms, the labor markets heat up and employers compete through higher wages to attract sufficient labor services. When the economy cools down and dips into recession, employers temporarily reduce the hours worked and/or layoff workers, intending to reverse the adjustments once the economy recovers and demands for the employers' products rise again.

Structural unemployment emerges when changes in technology alter the organization of production, reducing demands for certain labor skills, or when new products alter consumer demands, calling for labor in different sectors with different skills. Such adjustments cause labor to migrate from one sector to another, probably also requiring new and different skills.

Imagine taking an inventory of the economy. On one side of the ledger, all workers line up with different skills to offer. On the other side, the firms line up with different needs for job skills. If the employers' needs match exactly employees' offers, then structural employment problems do not occur. If the skill mix of the employees does not match the needs of employers, then structural unemployment emerges. While some workers with certain skills lose their jobs, shortages of other skills bid up the wages of workers' with those skills. That bidding up of wages provides the market signal for some workers to alter their skill mix and move to the expanding sectors. Such movements, however, do not occur over night, taking information, time, money, and effort to learn about and acquire the new skills needed.

Both cyclical and structural unemployment attract policy makers' attention, especially if the problems persist. But, these two different unemployment illnesses require different policy medicines. Cyclical unemployment, a macroeconomic problem of inadequate overall demand, responds to fiscal and monetary policy. Structural unemployment, a microeconomic problem with a mismatch of labor skills, responds to employment policies such as job information, job training and education programs, and so on that improve mobility between labor markets.

Temporary Versus Permanent Job Losses

Cyclical unemployment reflects temporary job losses, where the employers expect to rehire laid-off workers, if still available, once the recovery gets rolling. Structural unemployment, however, reflects a permanent loss of jobs in one sector and the need to reallocate those thrown out of work into other sectors. That is, new jobs must replace the permanent loss of jobs.

In a recent New York Federal Reserve Bank study, Groshen and Potter report that unemployment during the last two recessions exhibited a larger percentage of permanent job losses and a smaller percentage of temporary job losses. Thus, jobless recoveries display a strong need to reallocate workers from one sector to another and a weaker need to return workers to their old jobs. Such adjustment requires more time to accomplish than recovery from our more-standard recessions, where many more job losses are temporary (cyclical).

Put another way, our recent jobless recoveries reflect considerable restructuring of production and employment. Some of that restructuring emerges as many developing nations chase the American dream and begin to manufacture and export to the United States items that were formerly manufactured at home for domestic consumption. That is, the United States has steadily moved from a manufacturing to a service economy. That process continues.

In sum, jobless recoveries place more burden on microeconomic policies to deal with employment problems rather than the more traditional fiscal and monetary policies.

Last Recovery as a Guide to the Current Recovery

The restructuring that occurred during the recession in the early 1990s was followed by the longest business expansion (10 years) in our recorded history. If the past is any guide to the future, then the additional restructuring of the economy during the most recent recession may set the stage for another long expansionary run. We can hope.

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Edited version appeared in *In Business*, November 14-20, 2003.