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Has the Great American Jobs Machine Ground to a Halt?

The Reasons Why Job Creation Is So Slow

By D. Mark Wilson

Although the National Bureau of Economic Research has not yet determined when the last recession officially ended, baring another downturn next year, the recession was likely over in December 2009.[1] Regardless of the exact end of the last recession, it will go down as the longest and deepest of the post-World War II era. Moreover, the weak performance of the labor market since January 2010, combined with continuing high unemployment and tepid employment projections has raised serious concerns that this will be jobless recovery.

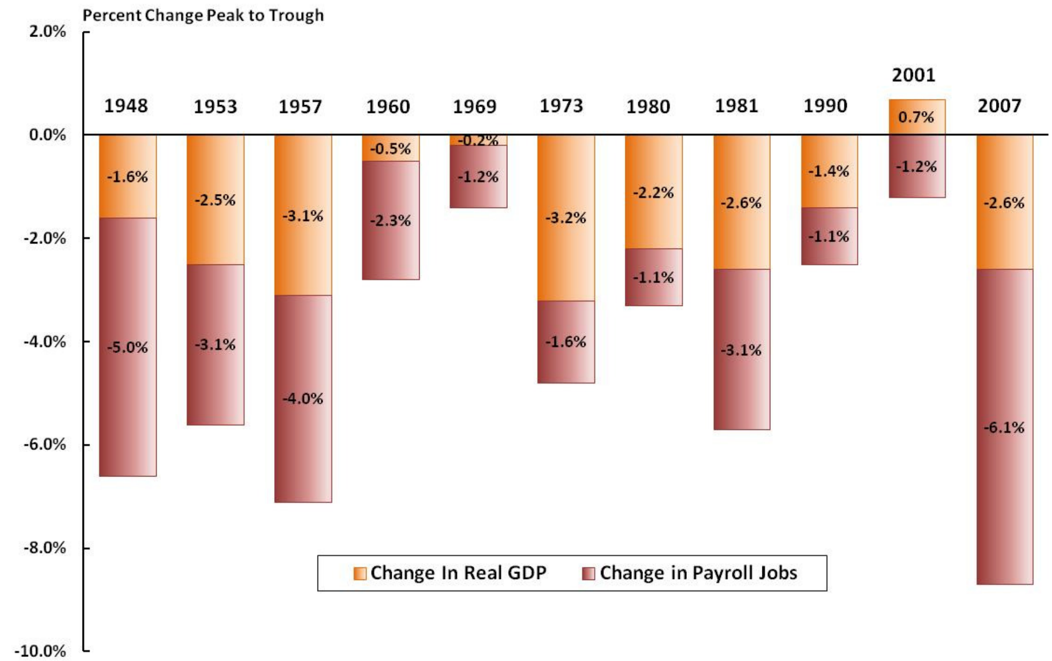
The reasons behind the lack of job growth are varied, but blaming corporations for accumulating cash is not one of them, especially when everyone except the federal government is trying to save money. Tax increases are looming on the horizon, uncertainty reins over future health care costs, and the potential for costly new employer mandates and labor regulations seems to be everywhere. All of these combine with the current economic uncertainty to cast a dark cloud over employers' hiring plans. Frankly speaking, there are simply better business opportunities in other countries right now.

The Great Recession Will Take Time To Recover From

The Great Recession of 2008 likely lasted 24 months, significantly longer than the severe recessions in 1973 and 1981, both of which lasted 16 months, and the post-World War II era average of 10 months. The last recession was also very deep compared to previous downturns; with the Gross Domestic Product dropping by 2.6 percent and the number of payroll jobs falling by 6.1 percent. Only the 1948 and 1957 recessions come close to this severe a decline in combined economic activity (see Chart 1).

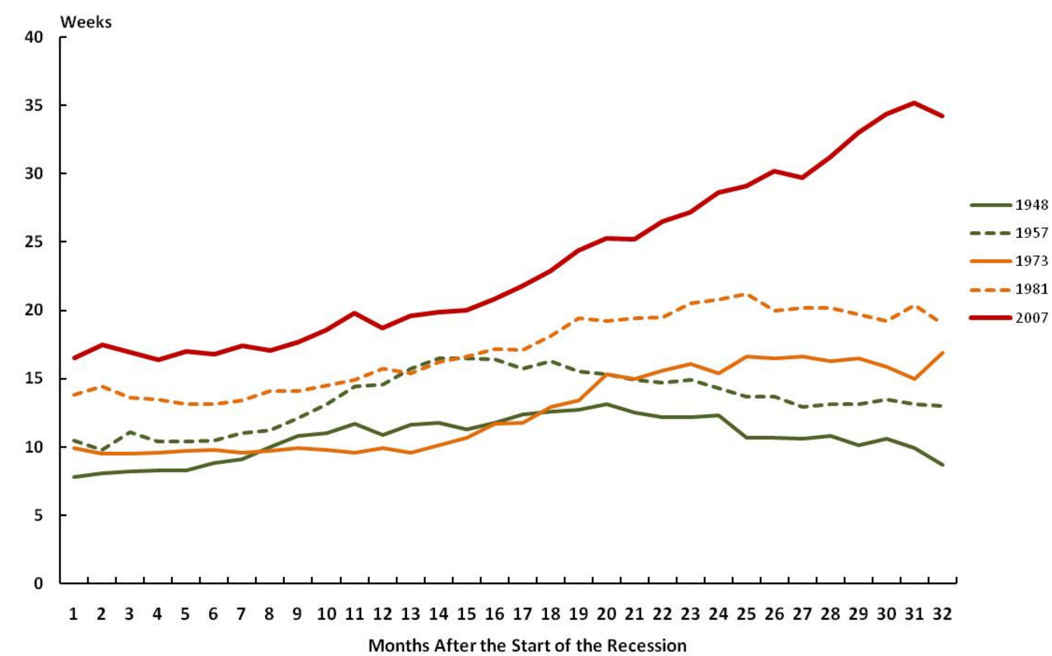
However, it is the duration of unemployment that distinguishes this recession from all other post-World War II downturns. Some 32 months after the beginning of the recession and 7 months into the recovery, the average duration of unemployment is a substantial 34 weeks, and would likely be higher but for 1.2 million unemployed workers who left the labor force from April to July 2010. In previous downturns, the average duration peaked at significantly lower levels and began to decline around 20 months after the beginning of the recession (see Chart 2).

Chart 1: The Combined Severity of Post-World War II Recessions



Source: Applied Economic Strategies analysis of Bureau of Labor Statistics and Bureau of Economic Analysis data.

Chart 2: Average Duration of Unemployment in Post-World War II Recessions

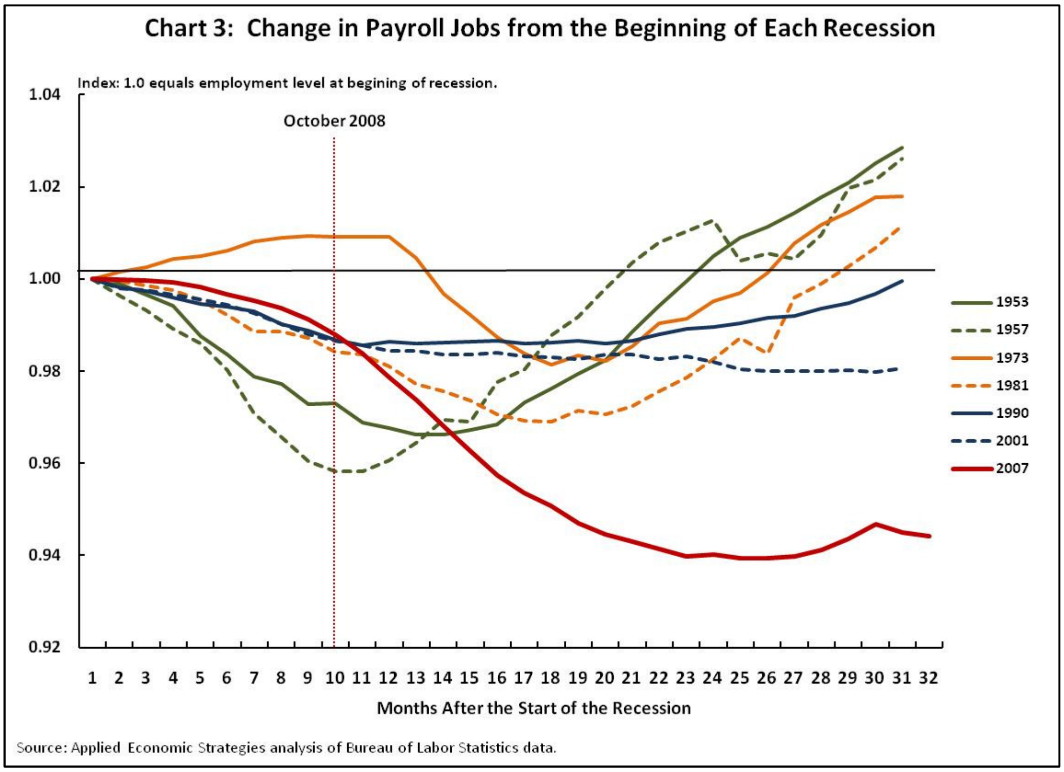


Source: Applied Economic Strategies analysis of Bureau of Labor Statistics data.

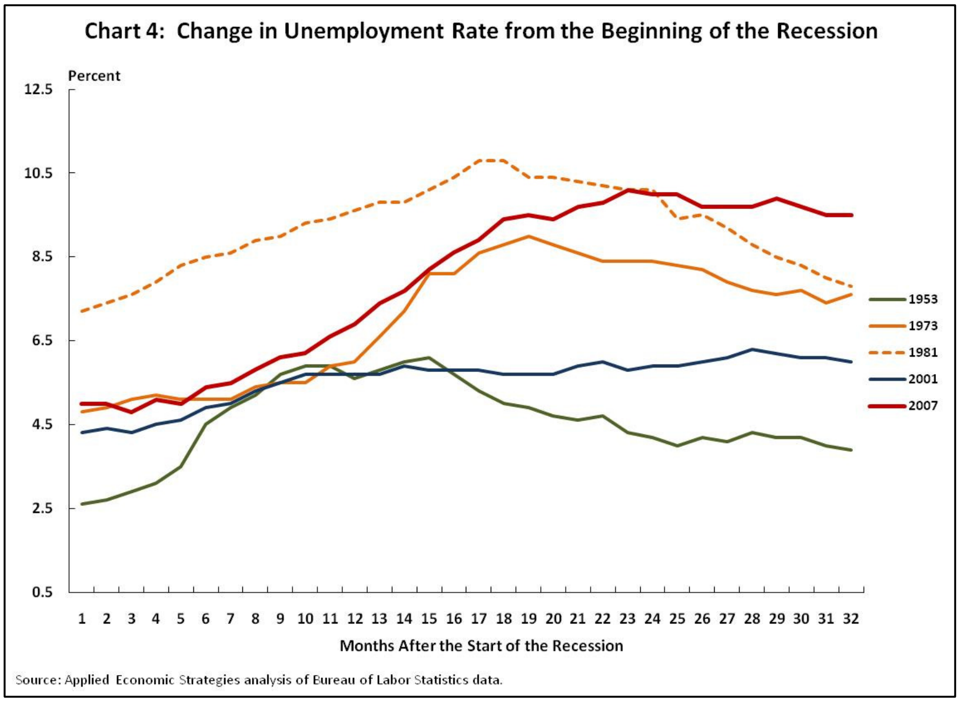
A Jobless Recovery So Far

Unlike the recoveries after 1973 and 1981, this recovery appears to be settling into a prolonged period of slow growth where the level of employment languishes below its pre-recession levels (see Chart 3). To date, the current recovery looks more like the jobless recovery after the 2001, rather than the kind of employment growth that occurred after the bottoms of the 1953, 1957, 1973, and 1981 recessions.

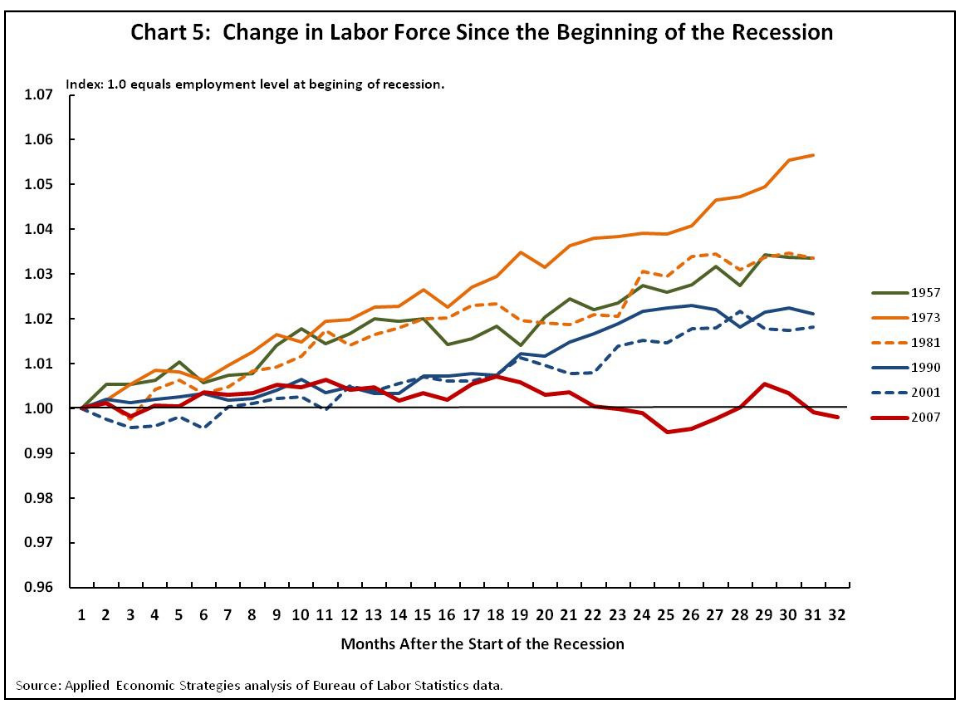
Total payroll employment during the last recession also shows that the percent decline in jobs wasn't much different from previous recessions until October 2008, when it began to deteriorate rapidly, falling outside the historical range within a few months (*see Chart 3*). This coincided with the financial market turmoil, which shook the economy and led to sharp employment declines.



Moreover, 32 months after the beginning of the recession the unemployment rate is now higher than after the severe 1981 recession (see Chart 4). The jobless recoveries that followed the recessions of 1990 and 2001 suggest a bleak medium-term employment picture. Although both of those recessions were rather mild in the short term, with small increases in the unemployment rate over the first year, their effects lingered and kept unemployment above pre-recession levels long afterward.



Perhaps the most distinguishing feature of the current recovery is the lack of any labor force growth (see Chart 5). Although the wave of baby-boomers into the economy in the 1970's and 1980's helped push up labor force growth after the 1973 and 1981 recessions, labor force growth in this recovery is non-existent, and well below the growth that occur during the jobless 1991 and 2001 recoveries. This is especially troubling since labor force growth is an important structural component of overall economic growth. Since the labor market recovery began in December 2009, the total labor force has declined by 160,000 because white women and teens, and black teens have dropped out of the labor force. On the other hand, the labor force of white men, black men and women, and other races has increased since December 2009.

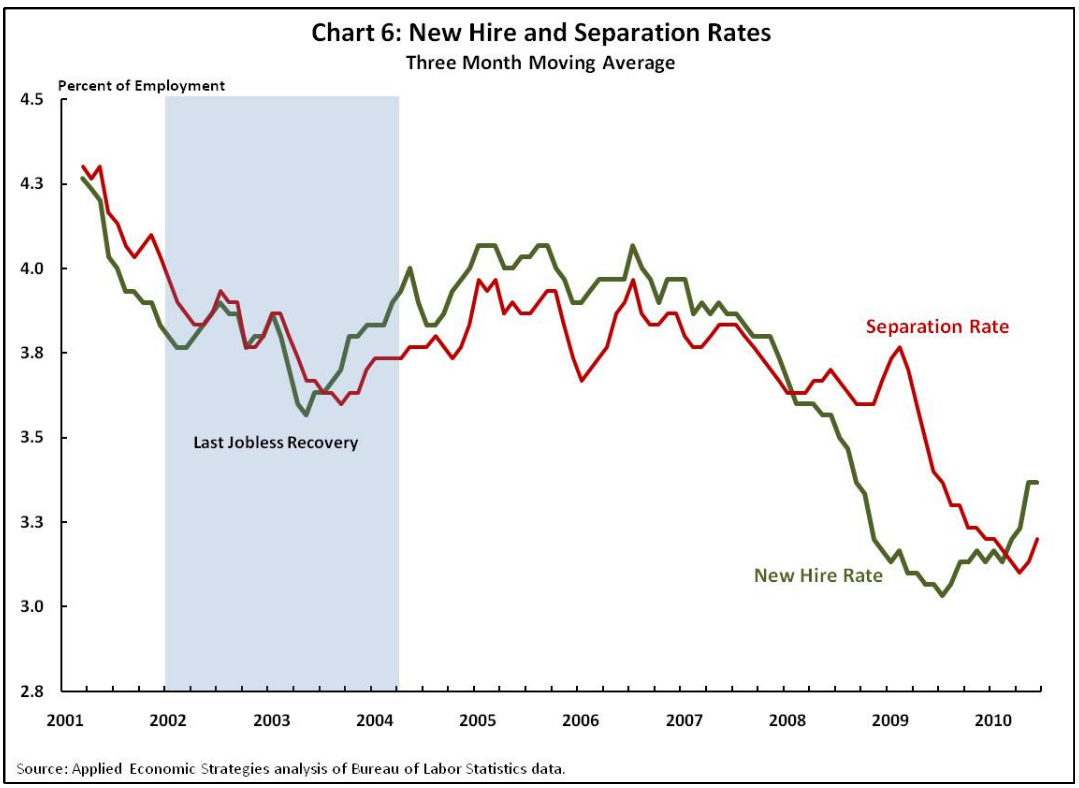


Although given the severity and duration of the last recession it may be premature to officially call this a jobless recovery, the economic headwinds that business, consumers, and government are facing will likely keep the rate of employment growth below its post-World War II average for some time.

The New Hire Rate Has Increased, But Remains Low

During the last recession the drop in business hiring explains far more of the unemployment increase than the increase in layoffs as the new hire rate collapsed in 2008 to historic lows (see Chart 6). In fact, compared to the expansion period from 2004 to 2007, the layoff or separation rate really didn't increase that much. After a small spike at the beginning of 2009, the separation rate has fallen as well.

More problematic is the rate of job creation. Although the new hire rate has recently increased, it remains well below the level it was during the jobless recovery of 2002 and 2003. Moreover, it appears to be leveling off as payroll job growth has weakened.[2] For the first five months of 2010, an average 4.2 million workers began new jobs each month, 14.9 percent less than during the jobless recovery in 2002.



Although the number of on-line help wanted ads reported by the Conference Board has increased significantly since last November 2009, it has not yet translated into robust private-sector employment gains, and the Bureau of Labor Statistics data on the number of job openings for the first five months of 2010 remains 14.3 percent below the 2002 monthly average.[3]

Economic Forecasts Call for Weak Employment Growth

A Bureau of National Affairs survey of 23 well-known economic forecasters is calling for modest real GDP growth of 3.2 percent this year and 3.1 percent in 2011, not strong enough to quickly reduce the unemployment rate.[4] The forecasters predict the unemployment rate will average 9.6 percent in 2010, then slowly fall to 9.0 percent in 2011 as job growth improves. Payroll job growth is expected to increase an average of 224,000 jobs per month in the first half of next year, compared to 124,000 a month for the second half of 2010, and 147,000 per month in the first half of 2010.

A recent survey by Manpower Inc found overall hiring activity in the third quarter of 2010 is expected to be the same level as in the April to June period, relatively weak.[5] In the third quarter, 18 percent of employers plan to add to their payrolls, while 8 percent are expecting to reduce staff. Another 70 percent foresee no change in jobs.

The latest mid-year economic review from the Office of Management and Budget projects the unemployment rate to average 9.7 percent for the rest of 2010, 9.0 percent in 2011, and 8.1 percent in 2012, and to not fall below 6.0 percent until 2015.[6]

In May 2010, the National Association for Business Economics forecast employment growth will average 120,000 jobs per month for the rest of 2010, and 225,000 jobs per month in 2011, relatively weak growth for a recovery.[7]

Why Aren't Businesses Creating More Jobs?

Recently a series of articles have appeared in the media blaming corporate greed for the jobless recovery. According to one opinion writer, "Big business has found a way to make big money without restoring the jobs it cut the past two years, or increasing its investments or even its sales, at least domestically."[8] Another Washington Post article began with: "Corporate America is hoarding a massive pile of cash. It just doesn't want to spend it hiring anyone."[9]

However, the reasons behind the jobless recovery are much more varied and difficult to address, especially in the short-run. Here are just a few reasons why companies are not hiring more employees in the United States:

- Global companies are going to expand where they have access to high-growth markets and will locate their operations where market and supply chain opportunities lie. In manufacturing and a growing group of services that means outside advanced countries. According to the World Bank, in 2011 and 2012, the China and India will grow over twice as fast as the United States, and Brazil will grow 50 percent faster.[10] Frankly speaking, there are simply better business opportunities in other countries.

- As the United States recovers from its 15 year debt-fuelled consumption binge, consumers are going to spend less and save more. This will significantly dampen the ability of small and medium size businesses to expand sales and employment. Uncertainty over the how the upcoming holiday season and how robust economic activity will be next year also has many businesses taking a wait and see attitude towards adding new employees. Moreover, stricter credit standards will further limit the ability of smaller businesses to grow no matter how much money is available to loan out.

- The sheer magnitude of implementing health care reform and the uncertainty surrounding the future costs of this "Grand Experiment" has made companies very cautious about hiring full-time employees in the short-term. The federal government estimates that just one of its recent regulations will increase health care premiums by an average of 1.5 percent per enrollee in non-grandfathered plans next year, and there are many more regulations to come.[11]

- The Bush and Obama tax cuts are also scheduled to expire at the end of the year and taxes will increase by $235 billion in fiscal year 2011, and $377 billion in 2012.[12] This large tax increase would reduce the demand for all kinds of goods and services that companies produce and reduce the need for additional employees, driving the unemployment rate 0.6 percentage points higher than it otherwise would be next year. Just raising taxes on high-income individuals and families would still reduce growth by 0.2 percentage points. One respondent to the Federal Reserve Bank of Dallas's Texas Manufacturing Outlook Survey recently reported that "we are hoarding cash and postponing hiring and capital equipment decisions until the November election."[13]

- Also looming on the horizon are the recommendations of the President's deficit reduction commission and how much payroll taxes will have to be raised to fix Social Security in the future. According to the 2010 Social Security Trustees Report, in order for the Social Security and Disability programs to remain solvent the payroll tax rate would have to be immediately and permanently increased by 1.84 percentage points, or benefits would have to be reduced by 12.0 percent, or some combination of the two.[14]

- The uncertainty surrounding the potential for new employer mandates and labor market regulations combines with the economic uncertainty to cast a dark cloud over employers' hiring plans. The list of legislation with pleasant sounding names but serious costs and unintended consequences is long (the Pay Check Fairness, the Health Families Act, the Employee Free Choice Act, the Employment Non-Discrimination Act, and the Protecting America's Workers Act). Although these bills may be intentioned, they will increase the cost of employment in the United States and thereby reduce the demand for labor. Moreover, each new regulation in the Department of Labor's new "Plan, Protect, and Prevent" regulatory and enforcement strategy may not seem like much by itself, but they all carry some additional cost that is piled on top of the maze of existing federal and state rules. Further, the lack of clarity in many regulations creates significant unintended legal liabilities even for well intentioned employers that discourages employment growth in the United States.

Although these reasons primarily explain why the new hire rate remains so low, there are also structural reasons why businesses are having trouble finding workers even when they are hiring. In almost every recovery a structural mismatch in the labor market occurs due to the need to reallocate labor away from industries whose employment needs are declining towards industries that are growing (i.e., from construction to health care). Other structural mismatches are:

- A geographical friction in the labor market created by the housing market crash that has locked people into homes they cannot sell without taking a large loss they cannot afford. This has significantly reduced labor mobility compared to the rust-belt to sun-belt migration that occurred after the 1981 recession. Incredibly, some 70 percent of Nevada borrowers have negative equity in their homes.[15] As a result mobility out of Nevada is limited. Florida (12.3% unemployment), Michigan (14.1%), and California (12.6%) are other labor markets where large percentages of homeowners have negative equity in their homes.

- Employers cannot find workers with the skills they need. Specifically, there appears to be a skills mismatch between some of the unemployed and the jobs being created. For example, in June the USA Today reported that although the auto industry is poised to add up to 15,000 this year, the new jobs won't necessarily be filled by displaced workers.[16] Automakers need workers with more and different skills than in the past on the factory floor. Among priorities: computer skills and the ability to work with less supervision than their predecessors. The one thing that is very clear is that production workers need a two-year community college degree or the equivalent. The technology is quite sophisticated and changing rapidly. More recently, the New York Times reported that although factory owners have been adding jobs slowly but steadily since the beginning of the year, some of the employers cannot fill their openings because the people who are out of work don't match the types of jobs that are open and growing.[17] Most manufacturers are looking to hire people who can operate sophisticated computerized machinery, follow complex blueprints and demonstrate higher math proficiency than was previously required of the typical assembly line worker.

Finally, corporations are not sitting on massive piles of cash just because they do not want to hire anyone. Although corporate profits are up $460 billion from 2009 to 2010 and employee compensation is down by $219 billion, *this trend is almost exactly the opposite of 2007 to 2008* when corporate profits *fell* $466 billion while employee compensation *rose* by $380 billion. Moreover, from 2007 to 2010, employee compensation is *up* $160 billion, while corporate profits are *down* $5.0 billion.

At the end of 2008 when global capital markets froze and corporations were having serious trouble raising money to meet payroll and finance trade, companies reacted by slashing payrolls and conserving cash to ensure their survival. The accumulation of large cash balances and savings for both businesses and households is a natural reaction to the 2008 financial crisis and the stricter lending standards that have followed. When individuals and companies save cash at near record levels, as they are today, it's a sign they're nervous about the future,[18] and in this economic environment many employers are not going to be in any hurry to hire.

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[1] A number of economists believe the last recession ended in July of 2009 when real GDP growth turned positive. Others believe the recession ended in December 2009 when payroll jobs began to grow on a regular basis.

[2] Most recent data is for June 2010.

[3] A job opening is defined by the Bureau of Labor Statistics as: 1) a specific position exists and there is work available for that position, 2) work could start within 30 days regardless of whether a suitable candidate is found, and 3) the employer is actively recruiting from outside the establishment to fill the position. Included are full-time, part-time, permanent, short-term, and seasonal openings. Active recruiting means that the establishment is taking steps to fill a position by advertising in newspapers or on the Internet, posting help-wanted signs, accepting applications, or using other similar methods.

[4] Bureau of National Affairs, *BNA Panel Sees Recovery Taking Hold, With Growth Steady at Around 3 Percent*, Daily Labor Report, July 1, 2010.

[5] Bureau of National Affairs, *Hiring Outlook for Third Quarter Remains Positive, Manpower Says*, Daily Labor Report, June 8, 2010.

[6] Office of Management and Budget, *Mid-Session Review Budget of the U.S. Government Fiscal Year 2011*, July 23, 2010.

[7] National Association for Business Economics, *NABE Outlook*, May 24, 2010.

[8] Harold Meyerson, *The Job Machine Grinds to a Halt*, Washington Post, July 28, 2010.

[9] Jia Lynn Yang, *Companies Pile Up Cash But Remain Hesitant To Add Jobs*, Washington Post, July 15, 2010.
[10] The World Bank, *Global Economic Prospects*, Summer 2010.
[11] Employee Benefits Security Administration, *Interim Final Rules for Group Health Plans and Health Insurance Issuers Relating to Coverage of Preventive Services Under the Patient Protection and Affordable Care Act,* Federal Register: July 19, 2010, Volume 75, Number 137.
[12] Macroeconomic Advisers, LLC, *The Impact of Sunset of Tax Cuts on GDP, Employment, Inflation & Interest Rates*, August 3, 2010.
[13] Thomas F. Siems, *Government and the Uncertainty Trap,* Wall Street Journal, August 7, 2010.
[14] Social Security Administration, *The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, August 5, 2010.
[15] CalculatedRisk Finance & Economics, *Negative Equity Breakdown,* August 3, 2010, available at: http://www.calculatedriskblog.com/2010/07/negative-equity-breakdown.html.
[16] Sharon Silke Carty, *Auto Industry May See Labor Shortage,* USA Today, June 4, 2010.
[17] Motoko Rich, *Factory Jobs Return, But Employers Find Skills Shortage*, New York Times, July 1, 2010.
[18] Nin-Hai Tseng, *Did the recession actually end?* Fortune, July 31, 2010.