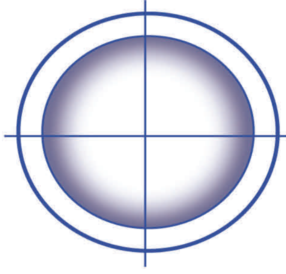

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Employment Redux

A Behind the Numbers Look at Some Reasons for Dismal Job Growth

June 18, 2012 by William L. Pittenger, MAI, SRA

In last week's IN FOCUS Commentary (June 8th) we wrote about the dismal May Employment Situation Report. Only 69,000 payroll jobs were created in May and the two previous months were revised down by a net 49,000 jobs. Over the last three months (March-May), the economy created an average of 96,000 new jobs. That is less than half the 252,000 average each month for December through February and significantly less than the roughly 125,000 jobs needed each month just to keep pace with growth in the working age population available for work. As a point of reference, at least 200,000 jobs per month are typically added in an expansion.

Various thoughts have been advanced about why employment growth seems to have lost traction. Some believe the dismal numbers were simply an aberration. Others advance the notion that it was payback for unseasonably warm temperatures which led to surprisingly robust winter job creation. Indeed, among other factors, the construction sector added 45,000 jobs in three months during the warm winter. Nevertheless, it also lost 48,000 in the following three month period. Our view is that the tepid job creation is driven by both cyclical factors that will eventually change and improve but also by systemic factors which have changed the employment dynamic permanently or at least very long term. The systemic issues constraining employment growth include both shifting demographics and structural changes in employment dynamics that have led to permanent, as opposed to cyclical, job losses. Regardless of what one views as the cause, the recent employment numbers offer a chilling reminder of how painfully anemic economic recovery has been. It also points out how perilously close both our nation and the global economy could be to another recession. The employment sector is undeniably in the grip of the broader economic slowdown where recovery is remarkably weak and just can't gain sustained traction. Consider the following cyclical but powerful issues that are clearly frustrating job creation.

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The global economy is in turmoil. Europe, which includes many U.S. trading partners, is experiencing a debt crisis and is spiraling toward recession. Greece is perhaps the most troublesome, but surely not the only problem. The United Kingdom, Spain, Italy, Ireland, and others are at risk of economic collapse. These countries have already experienced two quarters of GDP decline. Even the more economically powerful Germany showed a one-percent GDP decline in the first quarter while France and Sweden delivered very modest growth of one-percent or less. Even emerging markets such as China, India and Brazil are showing signs of economic stress. With the global economy in turmoil, there is obviously less demand for exported U.S. goods and services.

Both consumer and business confidence, as measured by the Conference Board and the National Federation of Independent Business respectively are low. Consumer confidence is especially low as consumers lack optimism about their economic and employment future. Businesses are concerned about what additional regulation - and its cost - might mean in the form of both health care and financial regulation driven by the Dodd-Frank Act.

The so-called "fiscal cliff" also casts a dark shadow over business and consumers. Tax increases and spending cuts are already set to take effect around December 31st. The negative impact is potentially huge and amounts to about five percent of GDP each year. The date is set and, as of this writing, there is no resolution in sight. Fear and lack of confidence translate into reduced spending which means inventory buildup, less manufacturing and the adverse result lands squarely in the employment sector.

Corporate profits are healthy and productivity has arguably reached its limit. These factors would typically argue for additional short term hiring. Adding employees, however, is a significant investment for most companies and many are just unwilling to make that investment due to uncertainty and lack of confidence in the nation's economic and political future. Instead, many choose to limp along with existing staffs to keep payrolls lean. They substitute lower paid contract workers and often outsource abroad. While such moves keep payroll costs down, innovation, a hallmark of American business, also suffers

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Government spending is also shrinking. That's a double edge sword and certainly a political sore spot. The expectation was that government spending would pick up some slack while the private sector was in recession. Most government stimulus programs have proven to be dreadful failures. Today, government spending is down but the private sector has not yet picked up the slack as anticipated. Government employment is down 1.8% and the workforce has declined for three years in a row cutting around 700,000 workers.

The list of recessionary events buffeting both the labor market and the broader economy are many. They are powerful, intense and there are few leading indicators that point to a self sustaining recovery within the next year or so.

Structural Unemployment. By definition, structural unemployment results from things like skills mismatches; something that cannot be fixed by expansionary policy or improving demand over time. While structural unemployment is not necessarily permanent, it often is.

Technology, for example, has been slicing away at American jobs for decades thus contributing to structural unemployment. As technology improves, low skilled jobs are rapidly replaced and mis-matches occur. Even as 12.7 million Americans remain unemployed with 5.4 million of them unemployed long term, the Organization for Economic Cooperation and Development (OECD) discovered that 50% of employers surveyed had difficulty filling available positions as there was a huge mis-match between employee skills and employer needs. Jobs that were once low skilled are now, or will soon be, automated thereby requiring a vastly different set of worker skills. As the economy recovers, global competition and skill based technological change will certainly push worker skill requirements even higher. If the level of educational achievement does not keep up, and it has not for four decades, the median wage will continue to decline and wage inequality will widen further thus increasing the structural unemployment even more. As an aside, the median wage for men with only a high school education has declined 46% (inflation adjusted) since 1970.

Let's look at some historical job loss and recovery patterns as well as demographic and structural changes driving the nation's employment.

Job Loss, Recovery and Recession History. There have been 11 declared recessions since World War II. None of them, however, was as broad, deep, severe or long lasting as the most recent; aptly referred to as "The Great Recession." Indeed, in many ways, the most recent recession rivals the Great Recession of the 1930's.

Early post-war recessions showed some consistent patterns of employment change. The first eight showed "V" shaped patterns of job loss and recovery. Job loss was usually swift and steep but recovery was too, thus resembling the letter "V" when graphed. That was largely the product of pent up demand during the recession being unleashed after it. Consumers and businesses alike stopped or slowed buying during each recession. That, in turn, led to significant job losses, especially in manufacturing. Post recession, many resumed "business as usual" and jobs recovered relatively rapidly. Not so following the last three recessions and especially the most recent as technology, demographics and employment dynamics changed.

The first post-war recession began in late 1948 and lasted 11 months as the nation adjusted to peace time and military personnel migrated to the private sector. Peak to trough job losses were steep at over five percent (the steepest between World War II and the Great Recession) and it took approximately 20 months to regain full employment.

Similarly, the 10 month recession in 1953 that followed the end of the Korean War had nearly identical characteristics as did the eight month contraction caused by flawed monetary policy beginning in 1957. In both cases, it took roughly 20 months to regain full employment.

More recently, the early 1990's saw both a technology boom and a relatively short eight month recession triggered by the Savings and Loan Crisis. While total job losses were moderate at about 1.5%, it took nearly 32 months to regain full employment. Recovery time was a full one-third longer than previous recessions which, in our view, speaks volumes about the structural changes driven by technological innovation.

The eight month recession that began in early 2001 which was triggered by the internet tech bust and Y2K scare was relatively minor with peak to trough job declines at around 1.5%. Nevertheless, it took over 45 months to recover during which time wages also stagnated.

Much of the job loss during and after the last three recessions was driven by innovation and new technology which fueled productivity and meant that firms could do more with less.

Today we face the aftermath of the Great Recession. Peak to trough job decline was around 6.5%; steeper than any other recession since World War II. It has now been about 52 months since peak employment and the sector has regained less than half of the jobs it lost. About 3.745 million jobs have been created but the bigger story is that another five million jobs need to be added to reach the pre-recession peak. Even if employment growth picks up to, say, 200,000 jobs per month, full recovery would be a 2014 event. At 125,000 new jobs per month, full employment stretches through 2015.

That begs the question of whether employment will ever return to its pre-recession peak. Surely it will over time but not for reasons we've seen historically. The nation's unemployment rate has averaged 5.7% since 1948; some 64 years. Given the structural changes, in employment dynamics, the "new" unemployment rate may be much higher. Nobel Prize winning economist Edmund Phelps and others have done extensive work on the "natural rate of unemployment." They concluded that the new normal may be 6.5% to 7.5%. That change of one to two percent could translate into an additional 1.5 million to 3.0 million persons unemployed after recovery based on the current size of the civilian work force.

These are a few of the headwinds facing labor market recovery. They are, by no means, all of them. The problems facing the labor market are exceedingly complex but their effects are far reaching and critical to recovery of the broader economy.

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