Opinion

The Long View of the Labor Market

BY JOHN WEINBERG

Sometimes a single dramatic event — a natural disaster, say, or a financial crisis — affects our economy in a highly visible way. It's only natural to then focus on that event when trying to make sense of current conditions. But focusing too closely on extreme events can draw our attention away from slower-moving, more persistent forces in the economy.

The Great Recession is a case in point. Although the unemployment rate recently dipped below 6 percent for the first time since 2008, many people have questioned whether this represents a genuine improvement in the health of the labor market. They note that labor force participation has declined dramatically since 2009 and is now at its lowest rate in more than three decades. Certainly, some of the people who quit the labor force in recent years did so because they were discouraged about the likelihood of finding a job. But the decline in labor force participation actually started around 2000, well before the most recent recession, and research by Richmond Fed economists and others suggests it is driven in large part by long-term demographic changes, such as the aging of the baby boomer generation.

Many people also have been concerned about the slowdown in GDP and wage growth compared with pre-recession levels. They view the Great Recession as a wrench in the works of the economy that spurred major deviations from historical trends and has pushed us far below our potential. But it's possible that what we are experiencing now is not an anomaly but rather the result of longer-term changes in how the labor market functions.

The aggregate numbers we use to describe the labor market, such as the number of jobs created or the unemployment rate, mask a tremendous amount of activity beneath the surface. Jobs are constantly being both created and destroyed as firms expand and contract, and workers are constantly moving between jobs and companies. This reallocation of jobs and workers tends to be good for the economy, helping to move resources from less-productive to more-productive businesses and helping workers make better (and higher-paying) matches with employers.

But beginning around 1990, according to research by Steven Davis at the University of Chicago and John Haltiwanger at the University of Maryland, the rates of job and worker reallocation in the United States started to decline significantly. The causes of this decline are varied and in some cases benign. For example, one factor is the shift from "mom-and-pop" stores to big-box retailers, which tend to have much less movement of jobs and employees. That shift has also been accompanied by huge increases in supply-chain efficiency and lower prices for consumers, developments that many would argue are positive.

But there may also be less favorable aspects to these changes. Since 2000, there has been a large decrease in the number of high-tech startups and young firms. Such firms contribute disproportionately to job creation and destruction rates, and they were also an important source of innovation and productivity growth during the 1980s and 1990s. To the extent that the declines in reallocation are driven by changes in the high-tech sector, they may be a factor in the slower productivity growth we are experiencing.

Government policies, such as stricter employment-protection laws or licensing requirements, may also play a role. In the 1950s, about 5 percent of employees had jobs that required a government license; by 2008 the share had increased to 29 percent. And during the 1970s and 1980s, courts made a series of decisions providing exceptions to the employment-at-will doctrine. While these measures may have other beneficial effects, they've likely had a negative effect on the fluidity of the labor market.

As Davis and Haltiwanger note, less job and worker reallocation equals fewer new job opportunities. That means unemployed workers will tend to remain unemployed for longer, and employed workers will probably have a harder time moving up the ladder or changing careers. In aggregate, the result is likely to be lower employment and slower wage growth — exactly what we are seeing today.

The Great Recession was a cataclysmic event in our country's economic history. But not all of our present economic conditions can be attributed to that event. Changes in the labor market appear to have begun well before the recession and have likely played a large role in the disappointing nature of the recovery. That means we may need to reconsider what's "normal" when assessing the economy's current performance.

But it doesn't mean we must remain gloomy. The American economy has demonstrated tremendous resilience in the past, and our workforce has a strong track record of discovering new sources of innovation. And there are signs the economy is gaining momentum: GDP growth was strong in the second and third quarters of 2014, and job growth has averaged nearly 250,000 per month over the past year. These data contributed to the Federal Open Market Committee's decision to end quantitative easing and to move toward more traditional monetary policy. Taking the long view of the labor market suggests that we may need to temper our expectations in the present, but it also suggests we should remain optimistic about the future. **EF**

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