THE Fiscal TIMES

Big Fiscal Dilemma — Economy Grows, But Jobs Don't

By KATHERINE REYNOLDS LEWIS, The Fiscal Times March 24, 2011

Of all the woes of the Great Recession, one anomaly is the most troubling: How can the economy be growing while unemployment remains so high? The breakdown in the historic relationship between GDP growth and jobs has confounded experts ranging from White House Chief Economist Austan Goolsbee to Cato Institute scholar Mark Calabria.

Under the principle known as Okun's law, named for Arthur M. Okun, an economist who worked for Presidents John F. Kennedy and Lyndon Johnson, a 3 percent increase in U.S. gross domestic product should lead to a 1 percent drop in the unemployment rate. Yet as the U.S. economy rebounds from the latest downturn, the jobless rate remains stubbornly high — as much as 2 percentage points higher than economic theory predicted. Possible explanations include overly cautious employers, a lack of worker mobility and simple measurement error.

If the economy departs from historical norms, workers, employers and policymakers will all have to change their assumptions.

There's more at stake than a debate among economists about whether to revise their textbooks. Government policy aimed at creating jobs for more than 13 million unemployed Americans rests on widely held assumptions about the impact of spending and growth on employment. If growth has become untethered from job creation, or if the labor market faces structural problems that cannot be solved by economic recovery, the implications for U.S. workers are serious. If the U.S. economy is entering a new phase that departs from historical norms, workers, employers and policymakers will all have to change their assumptions and behaviors.

"A lot of these things that we used to hold up as rules of thumb no longer apply," said David Cross, president of Market Outlook, a consulting firm in San Diego, Calif. "The unemployment rate has been notoriously deficient in describing the stress for middle-class households and what has been going on in the labor market. Wall Street makes a big deal of how GDP has miraculously recovered from the slump, and we're now at a higher point than in the previous recovery, but that completely ignores the underlying stress in the economy, which has significant long-term implications."

The Two-Track Recovery

The U.S. is experiencing a two-track recovery, in which overall growth has recovered but households continue to struggle with unemployment and devastated assets, like the value of their homes, Cross said. Young people in particular face a very tough road to build a career and save for major life events, when the job market is so unstable and tight.

"There are 900,000 more people with jobs today than a year ago," said Betsey Stevenson, chief economist at the U.S. Labor Department, in an interview with The Fiscal Times. "The problem is that we've added more people than that to the population and they haven't all gone into the labor force."

Some things have changed since Okun was chairman of the Council of Economic Advisers in 1968 and 1969. "In this recession some people have argued that the law is broken," said Christopher Neely, an economist at the St. Louis Federal Reserve Bank, noting that the last two U.S. recoveries also included puzzlingly slow job growth. "Economies change over time, industries change, labor relations change, unions wax and wane in strengthen, the demographics of the labor market change. It's difficult to expect that empirical regularities are going to hold."

Experts offer several possible explanations for the broken law:

Different U.S. demographics: In formulating his law, Okun looked at data from 1945 through the 1960s, when the working population was younger, more male-dominated and often the sole family income, noted Bill Beach, director of the center for data analysis at the Heritage Foundation. The modern workforce includes older baby boomers who have a tough time finding work once they're laid off, as well as a bulge of younger, low-paid workers who tend to have higher unemployment regardless of the business cycle.

"What's happened since 2000 is something positively puzzling, which are these jobless recoveries which seem to be challenging Okun's law," Beach said. "We seem to have these persistent periods of post-recovery high unemployment rates."

Going forward, the labor market may experience unavoidable, prolonged periods of high unemployment. Young people should be financially prepared for intermittent work and more resources should be deployed to help older workers retrain for new jobs, he said.

This recession was unique: As companies returned to healthy output levels without adding too many new workers, productivity increased markedly, noted Kathryn Kobe, a senior economist with Economic Consulting Services. From the first quarter of 2009 to the first quarter of 2010, productivity grew 6.7 percent — the most since 1962. Higher productivity lets employers increase output without having to hire.

Because the recession was the most severe since the Great Depression, and involved the all-important financial sector, employers are more cautious about hiring and investing during the recovery. “We are at a point where they can't expand output too much without adding to their payrolls," Kobe said. "When they become more confident, they will hire, but it's hard to predict what changes a company into being more positive about the economic outlook.”

Structural problems impede hiring: Another strange aspect of the recovery is that unemployment remains high while job openings continue to grow. That suggests that people are unable or unwilling to take positions that are being created, said Mark Calabria, director of financial regulation studies at Cato.

“The people who are losing their jobs aren't necessarily the right skill set for the job openings ... You can't overnight turn a construction worker into a nurse,” Calabria said. “There's an industry component but there's also a geographic component to it.”

With real estate at the epicenter of the recession, many workers are underwater on their mortgages and cannot sell their homes to pursue work in a different part of the country.

The numbers are wrong: Some economists explain the breakdown in Okun's law by disbelieving the data. It may turn out that GDP growth was actually worse than measured in 2009 and 2010, said Mark Zandi, chief economist at Moody's Economy.com.

“Okun's law really holds in hindsight," Zandi said. "It could be the case that the economy got hit even harder than we think. It could be that they'll revise the data and Okun's law will hold.”

Related Links:
The Myth of Jobless Recoveries (Seeking Alpha)
Joblessness Far Higher than 8.9 Percent (Investor's Business Daily)
U.S. Recovery is Slowly Happening Said Fed Officials (Financial Feed)