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Solving the Long-Term Jobs Problem

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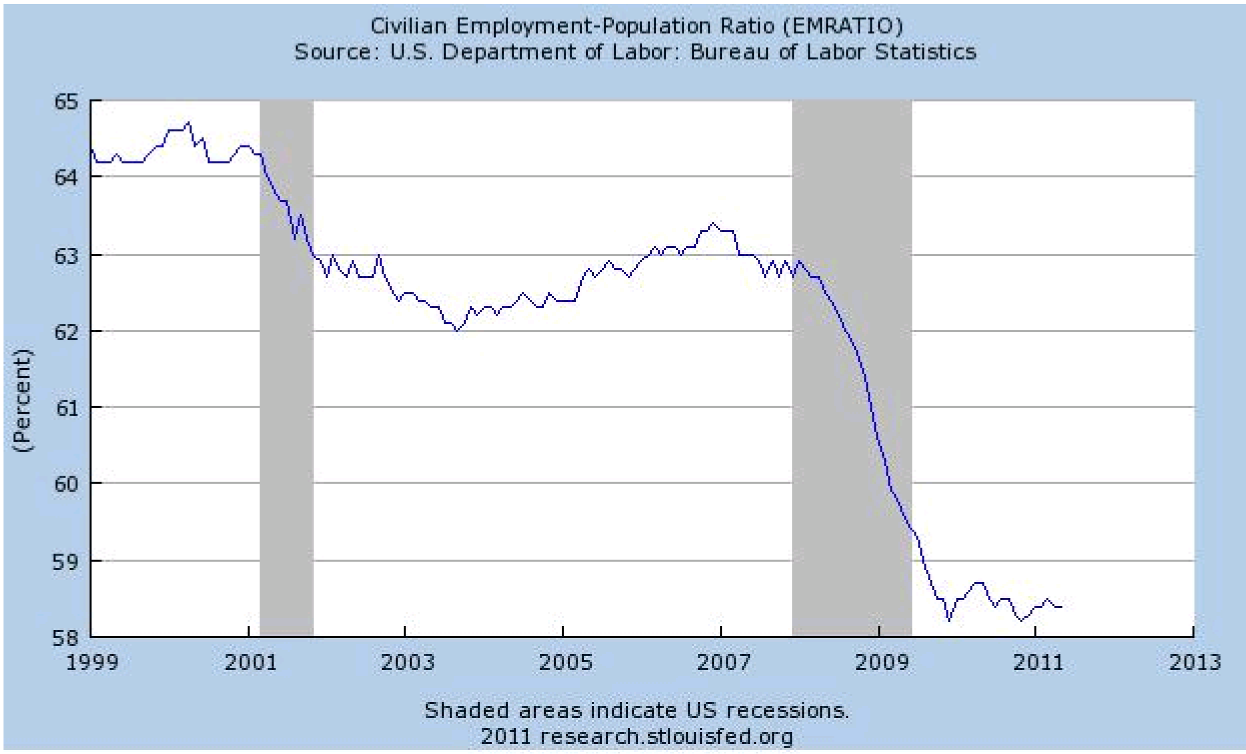
Stimulus has failed. It's time to unleash entrepreneurs in the new commanding heights of the economy: healthcare and education.

As the American Recovery and Reinvestment Act winds down, the unemployment rate remains over 9 percent and the economy is idling. It is increasingly clear that Keynesian stimulus has failed to get the economy where it needs to be.

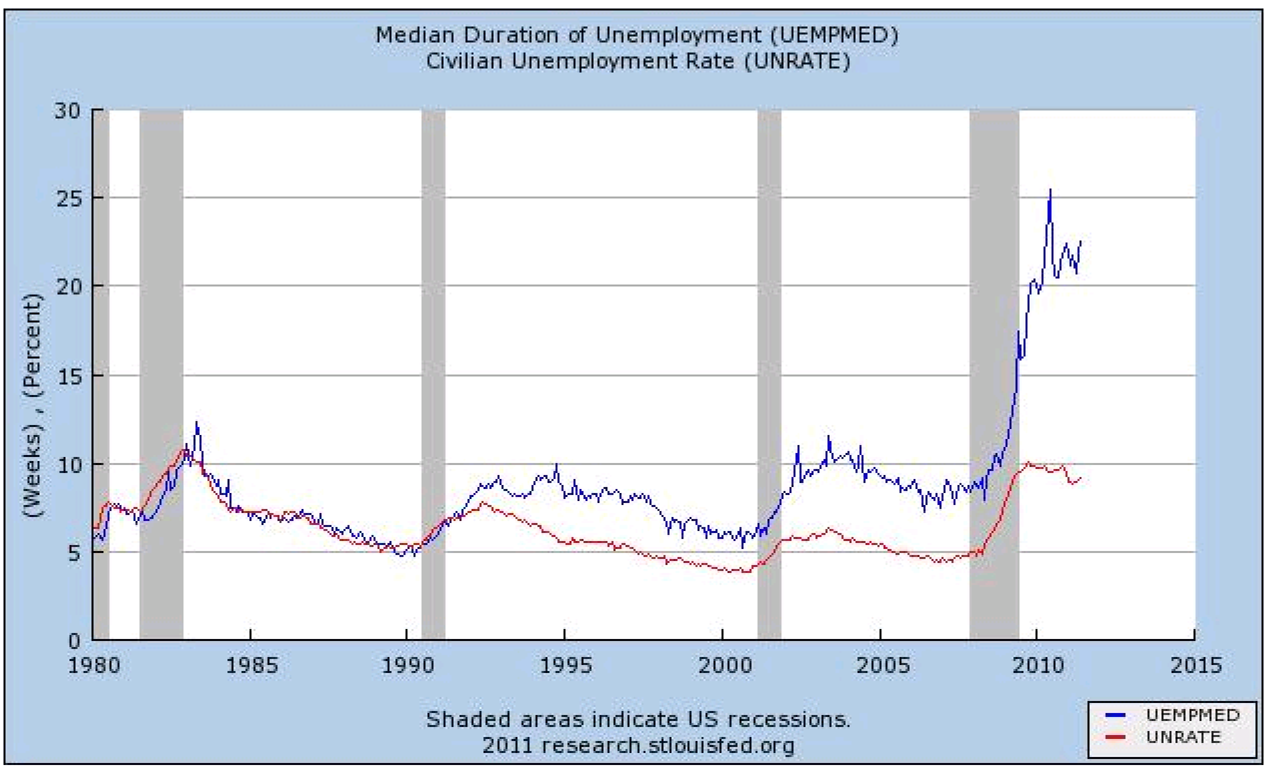
Now what?

The U.S. economy faces problems that are structural and long term, not merely cyclical and short term. This helps explain why Keynesian policies failed to stimulate adequately. More importantly, appreciating the fact that the American economy faces profound structural pressures is the first step on the road to sustained recovery and perhaps the next growth boom.

How do we know the problems are structural? For starters, the downward trend in the proportion of the working-age population with jobs predates the financial crisis and recession. This can be seen in the following chart, courtesy of the website of the Federal Reserve Bank of St. Louis and based on data from the Bureau of Labor Statistics. It shows the percentage of the adult population that is employed.



Unlike with some previous recessions, very few of today's unemployed are on short-term layoff, awaiting recall. Instead, an unusually high proportion are long-term unemployed. As you can see from the graph below, the medium duration of unemployment has skyrocketed relative to earlier economic downturns.

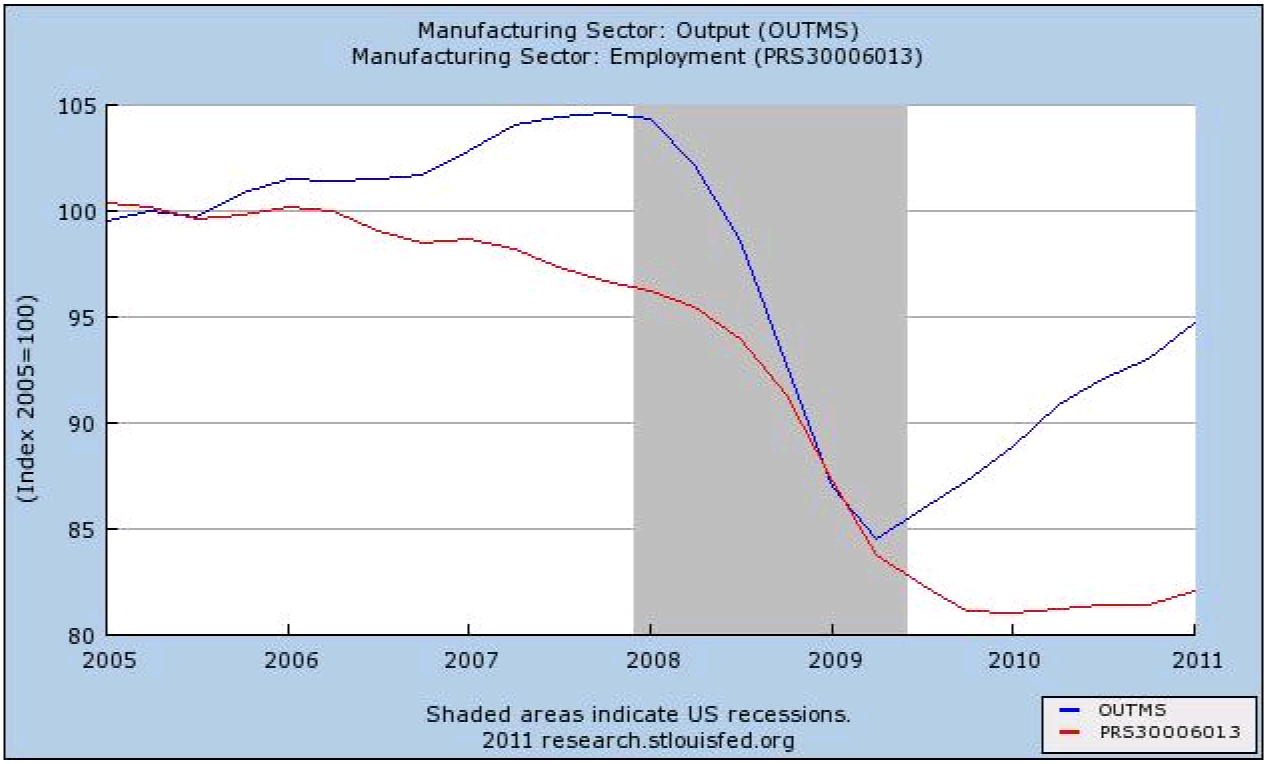


Government stimulus can sometimes be effective at returning people to their old jobs, but the market is telling investors and entrepreneurs that those jobs are not needed anymore. And so the stimulus fails to stimulate very much. It may sound cold to say this, but those old jobs are not coming back.

Consider two of the economy's important sectors: finance and manufacturing. It is increasingly evident that the vast majority of jobs lost since the financial crisis are not coming back. There's no iron law saying America needs more folks working in finance. And given the recent chaos in the sector, perhaps this is not a bad thing.

Meanwhile, manufacturing in the United States over time has become less and less labor intensive. This is clear each time the economy moves out of the bottom of a recession. Today, manufacturing employment is not tracking manufacturing output as output recovers from the recession.

In the following chart from the Federal Reserve Bank of St. Louis, the blue line is manufacturing output, which has rebounded nicely. The red line is employment in the manufacturing sector, which obviously has not.



No matter how aggressively manufacturing output rebounds, and it has done relatively well the past two years, production workers in manufacturing will remain below 10 percent of the labor force. Manufacturing in the United States is so automated that labor input is not really a variable factor of production any more.

It's worth noting that this is a mark of manufacturing's maturation and ascent. It is not, as some would put it, a sign of manufacturing's "decline." American manufacturing is by most measures robust, healthy, and extremely productive. However, with the immense productivity gains over time from new technology and business techniques, fewer employees are needed even as output increases dramatically.

If not in sectors such as finance or manufacturing, where are the jobs that everyone on both ends of Pennsylvania Avenue says they want?

The two sectors of the economy that are increasing most as a share of output and employment are education and healthcare. In a new essay in the journal National Affairs, we call these sectors the New Commanding Heights. When Lenin coined the term "Commanding Heights" early in the 20th century, he was referring to critical industries that dominated economic activity, such as mining, farming, electricity, and transportation. While those sectors are still important, the economy today is very different than it was in Lenin's day, or even 20 years ago.

There are many reasons for the rise of these New Commanding Heights but it's enough to know that wealthy industrialized countries such as America will shift their consumption toward education and healthcare over time relative to other goods and services. Growing as they are, the New Commanding Heights of education and healthcare will increase in importance this century while other sectors undergo a relative decline. These sectors are where demand is rising and where there is potential for jobs to be created.

So what's the problem? The problem today is that government policy is impeding innovation and job creation in these sectors. Both education and healthcare are already heavily influenced or controlled by federal and local government. That means that the evolution of those sectors is driven by top-down command and control, rather than by bottom-up innovation.

To revitalize these sectors and revive the American job market, we must open up these industries to competition and entrepreneurial reform. This will require tolerating a certain degree of messy experimentation. But entrepreneurial growth in these sectors is what will get the American economy back to work.

Pointing out the extensive political control of these sectors is not some partisan point. Both parties have leaders who advocate deeper government involvement in these sectors.

Under President George W. Bush, for example, education reform became synonymous with testing and school performance as evaluated by government officials. This notion of accountability to top-down standards continues to be the dominant theme of education policy today.

But the effect of this top-down school reform agenda has been to entrench and empower education bureaucrats and to create yet another layer of insulation between school officials and their customers, the parents.

There are millions of well-meaning, talented men and women working in education. But American education shows all the hallmarks of a sluggish, backward sector of the economy. There is remarkably little experimentation or trial-and-error, and an absence of radical new methods and models.

The vast majority of students in K-12 are educated in a manner similar to students 100 years ago. Instead, education should be rapidly innovating through new technology.

Imagine what might happen if government involvement in education were restricted to giving school vouchers to households below the median income. Entrepreneurs would be free to redesign education completely. Perhaps the very concept of a school would ultimately be replaced by different educational components with entirely different business models. Some companies might emerge as high-quality math educators and sell their services to individuals or schools or districts. Others might emerge as high-quality developers of social skills and builders of teamwork. Still other enterprises and services would emerge that no one can yet imagine.

Most importantly, as it relates to our current job problems, entrepreneurs would not be limited to a labor force consisting of people with teaching credentials. They could instead design their operations to use the available work force most efficiently. This could even mean taking workers without college diplomas—some of those hardest hit by the economic downturn—and training them to provide services to students. Perhaps less-educated workers could be involved in helping create and deliver rich-media content, based on guidance from experts with deep, specialized knowledge.

Beyond grade 12, entrepreneurship in education is held back by government support for the incumbents in the industry. From accreditation to subsidies, government sends a message that existing colleges and universities are the only legitimate players, while new entrants are suspect.

In the corporate world, over the past century there has been rapid turnover in the companies making up the Dow Jones Industrial Average. Many corporate giants of three decades ago are no longer in business. In contrast, every member of the elite list of colleges of 1980 is still on such a list today.

Consider that many elite universities were founded with industrial fortunes. Think Leland Stanford, James Buchanan Duke, or Cornelius Vanderbilt. The legacy enterprises that created those fortunes have been upended, transformed, or demolished by competition and new technology. But the universities those fortunes founded remain near the top of the heap, shielded from entrepreneurial disruption.

There is a better way. The federal government needs to give room in the college ecosystem for new entrants to grow and thrive. It could do this by reducing the funding that goes to existing institutions. Instead, government funding for students should be in the form of vouchers, and these funds should be allowed to be used in nontraditional colleges and for students to learn in nontraditional ways. Government funding for research should provide less support for institutional overhead and instead should encourage researchers to work outside of the traditional university framework.

The problems of government involvement in the education sector apply to healthcare as well. And here, too, Republicans have been little better than Democrats at promoting robust competition and genuine bottom-up reform. Government involvement, whatever its merits in helping expand consumer access to insurance or meet other goals, serves to entrench industry incumbents. One of the most important ways it does this is by using licensing laws to protect the incomes of doctors, specialists, and allied health professionals. In a sense, government is setting the work rules in healthcare, and these work rules serve the interests of healthcare providers, not consumers.

Instead, imagine if state governments experimented by setting up healthcare enterprise zones. These would be areas where entrepreneurs could set up healthcare delivery systems without any rules concerning what license would be required to engage in any particular activity. Perhaps medical services could be delivered by workers with fewer credentials but more rigorous on-the job training.

Healthcare providers would be accountable for the quality of their work, not for the certificates hanging on their walls. Instead of forcing work rules on the healthcare system, consumers and the government should hold innovative healthcare organizations accountable for results. If their success rates and error rates compare favorably with traditional hospitals and medical practices, then these alternative models should be free to remain in operation and to continue the process of redesigning healthcare.

In a post-stimulus world, the economy needs entrepreneurs to find work for Americans and create enormous numbers of jobs. The fields of education and healthcare hold the greatest potential for job creation. However, entrepreneurs today are stifled by the top-down model through which government approaches these sectors. It is time for radical approaches that reduce government's control over education and healthcare.

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FURTHER READING: **Kling and Schulz have also published "Is Mandated Health Insurance Constitutional?" and "Individual Health Savings Accounts Are Better." Kling has written "Prosperity, Depression, and Progress," "Putting Mr. Market on the Couch," "Not Your Grandfather's (or Keynes's) Economy," and "When Labor Is Capital: The Limits of Keynesian Policy."**

Image by Rob Green/Bergman Group.