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COMMENTARY

There's No Such Thing As a 'Jobless' Recovery

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The recent rise in payroll employment provides hope that the long-awaited sustained growth of jobs has now begun. Although there was never any doubt that higher employment would eventually follow the increases in production and sales that started nearly two years ago, it is good to see it happening.

The current economic recovery has been characterized by a remarkably rapid rise in productivity -- that is, in output per working hour. By using new technologies, firms have been able to produce the output that their customers demanded without hiring as many new workers as they would have at the same stage in a more traditional recovery. A recent study by the Department of Labor showed that the primary reason for the lack of job growth in the past two years has been an unusually low rate of new hiring in expanding businesses rather than an unusual number of layoffs by declining businesses.

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The productivity growth rate jumped to an annual rate of more than 4% in the period since early 2001 after rising at 2.6% a year from 1996 to 2000 and at less than 1.5% a year in the previous quarter-century. That 4% productivity growth rate meant that firms were able to increase output by 10% in the past two-and-a-half years without hiring any new workers or increasing the average hours worked per week. And during the second quarter of this year, productivity rose at an annual rate of nearly 7%, implying that spending would have to increase at that rate just to prevent employment from falling. Only as spending growth catches up to the rise in productivity will firms start to increase employment.

Fortunately, the strong productivity growth will eventually lead to more jobs as higher wages stimulate consumption and higher profits induce more investment in business plant and equipment. But spending responds only with a lag that depends on expectations and confidence. Even with the extra stimulus from the two Bush tax cuts and the low interest rates, households and firms were so cautious that total spending lagged behind productivity gains.

Because confidence is so important for spending decisions, the declining number of jobs until September created the risk of a self-fulfilling prophecy of low demand and weaker employment. That's why the recent upturn in employment is particularly good news.

Although the most recent dramatic productivity surge will not persist beyond the next few quarters, productivity growth is likely to continue at an above-trend pace for years to come. Companies will continue to learn new ways to use the Internet and corporate intranets to reduce the number of employees needed in activities like supply management, sales, accounting, and a wide range of clerical services.

Strong productivity growth in retailing will continue to reflect the expansion of stores like Wal-Mart and Staples with high sales volume per employee as well as the growth of online shopping. Over time, the faster productivity growth will mean a higher standard of living, with most of the productivity gain eventually taking the form of higher real wages. The historical evidence is clear that employee compensation remains at about 70% of national income as the economy grows.

Our labor market is a very dynamic one in which large numbers of people change jobs every month. The recent Department of Labor study showed that the net employment decline of 70,000 in the final quarter of 2002 was the difference between the 7.82 million workers who lost jobs in establishments that downsized or closed and the 7.75 million workers added by establishments that increased employment. It's clear from these figures that very small variations in the rates of layoff and of new hires make the difference between declining and increasing net employment.

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One negative influence on the rate of new hires in every recovery is the distorting effect of unemployment insurance. The increase in the maximum duration of unemployment benefits that Congress enacted last year has delayed the current employment recovery even more than usual.

Unemployment benefits typically equal about half of the pretax wage that the individual earned before becoming unemployed. When taxes are taken into account, net-of-tax unemployment benefits replace about 60% of the previous net-of-tax wage. Because of the combination of taxes and unemployment benefits, an individual whose pretax wage before becoming unemployed was $600 a week loses less than $200 of spendable income by remaining unemployed for an additional week.

While some unemployed individuals try to find a new job as quickly as possible, others respond to the low net cost of remaining unemployed by spending more time searching for a better job or simply using the time for household activities. Statistical studies show a substantial effect of unemployment benefits on the duration of benefits and a significant surge in job finding in the weeks just before benefits run out.

When Congress extended the maximum duration of benefits from the usual 26 weeks to 39 weeks, it slowed the rate at which the unemployed found jobs. While no one should begrudge unemployed workers the protection of unemployment benefits, it is important to recognize that those benefits raise the unemployment rate and delay the rise of employment in every economic recovery.

A continued rapid growth of productivity can mean both higher incomes and more jobs. The strong growth of spending in recent months and the rise of employment in September indicate that the American economy is now on the right track to make that happen.

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