March 4, 2011

Gaining perspective on the employment picture

The **employment report released today** indicated a **moderate increase of 192,000** in nonfarm payrolls and a slight decline in the unemployment rate from 9 percent in January to 8.9 percent. While certainly an improvement over recent months, employment growth still has not reached a level needed to produce significant drops in the unemployment rate.

In a **speech** given yesterday, Atlanta Fed President Dennis Lockhart addressed some of the underlying issues that have potentially been holding back job growth. On the supply side, President Lockhart addressed three structural issues, including skill mismatch, house lock, and extended unemployment insurance.

> "Skill mismatch exists when work skills of job seekers do not match the requirements of jobs that are available. For example, a construction worker is unlikely to have the particular skills needed in the healthcare industry."

This comment is motivated by the research of Federal Reserve economists (**Valetta and Kuang** and **Barnichon and Figura**, among others) that suggests while there is likely some evidence of skill mismatch, it's not materially different than what's been seen during past recessions.

Another possible explanation mentioned by President Lockhart for persistently high unemployment is the existence of what is sometimes referred to as "house lock."

> "Currently many people owe more on their homes than their homes are worth. It's claimed that job seekers don't accept jobs available in other geographic locations because of the difficulty or cost of selling their homes."

Here too, President Lockhart says there is evidence indicating house lock is not a large contributor to the current high level of unemployment (For example, see **Schulhofer-Wohl**, **Kaplan and Schulhofer-Wohl**, and **Molloy et al.**)

More convincing is the argument pointing to the impact of extended unemployment insurance benefits. Research from the most recent recession and recovery—for example, see **Valetta and Kuang** and **Aaronson et al.**—suggests extended benefits have added to the unemployment rates, with estimates ranging from 0.4 percentage points to 1.7 percentage points. If that's the case, then President Lockhart says these extended benefits may be acting "as a disincentive to accept an offered job, especially if the job pays less than the one lost."

As President Lockhart indicates, however, standard skill mismatch, house lock, and unemployment insurance disincentives do not provide the full answer. So, he offers some additional factors:

> "On the demand side, it's been argued that credit constraints affecting small businesses are holding back hiring. Banks are blamed for this situation and so are regulators. Getting credit at an affordable cost was a challenge during the recession. But credit conditions for established small businesses have been steadily improving for some time now. Recent surveys suggest that most small businesses are cautious about hiring more because of slow sales growth rather than lack of access to credit.
>
> "Furthermore, a recent National Bureau of Economic Research study showed that job creation is more correlated to young businesses than the broad class of small businesses. Start-ups and young businesses are often financed in ways other than direct business loans. Difficulties getting home equity loans and other personal credit appear to have reduced formation of new businesses.
>
> "Strong productivity growth is another much-discussed potential impediment to hiring. Stated simply, increases in productivity allow businesses to support a given level of sales with fewer people. In the longer term, rising productivity expands the economy's output, which in turn generates jobs. But in the short run, productivity investment can be the enemy of employment growth.
>
> "Productivity growth was unusually high during the recession and in the early stages of the recovery, limiting the need for additional workers. Recently, however, productivity growth has slowed below the pace of business sales. If this trend continues, the need to hire additional workers will increase.
>
> "Finally, in recent months, reluctance to hire has been attributed to heightened uncertainty, a common theme among my business contacts. A few weeks ago I argued that uncertainty has abated somewhat with the improving economy, the resolution of the November elections, the extension of tax cuts, and the apparent containment of the European sovereign debt crisis. I said that before Tunisia and before the fiscal struggle in Congress gathered steam. The restraining influence of uncertainty persists, to some extent."

Outside of productivity, it is difficult to measure the impact of these issues. (For example, it is difficult to survey people who did not start up a firm to determine if credit was an issue.) However, the theme of uncertainty has been a consistent factor in discussions on employment with our contacts here at the Atlanta Fed. If a simple explanation for persistent weakness in labor markets has proven elusive, there is little argument with President Lockhart's observation that "the recovery has brought little relief to the labor market."

Should today's employment release change any opinions about the strength of the labor market? In my mind, not really. There are still 7.5 million fewer jobs than at the start of the recession. There are also still over 8 million workers employed part time for economic reasons, and almost 6 million of the unemployed have been so for more than 26 weeks.

But the numbers released today did provide some additional evidence that the labor market is moving in the right direction with a level of growth consistent with at least a modest decline in unemployment. Furthermore, as consumer expenditures continue to rise, profitability increases, and the amount of uncertainty diminishes, hiring should increase. However, as President Lockhart alluded to in his speech, it will likely take time before the labor market recovery catches up to the overall economic recovery.

*By **Melinda Pitts***
Research economist and associate policy adviser at the Atlanta Fed

March 4, 2011 in Data Releases, Employment, Labor Markets, Productivity | Permalink