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A Closer Look at Changes in the Labor Market

The Atlanta Fed's Center for Human Capital Studies hosted its annual employment conference on October 1–2, 2015, organized once again by Richard Rogerson (Princeton University), Robert Shimer (University of Chicago), and the Atlanta Fed's Melinda Pitts. This *macroblog* post provides a summary of the papers presented at the conference.

Many measures of labor market performance remain at relatively low levels compared with levels seen before the Great Recession. A key question for policymakers and academic researchers is the extent to which these changes reflect a slow recovery from a large cyclical shock—or do they simply represent the "new normal"? This conference brought together researchers studying several dimensions of these changes in labor-market outcomes. A common theme is that current labor market outcomes largely reflect the ongoing effect of secular trends that predated the Great Recession.

Recent empirical work has highlighted that the U.S. economy, and in particular the labor market, has seen a pronounced downward trend in several measures of "dynamism." Prominent among these measures are decreases in job and worker flows as well as in the entry rate of new establishments. A key challenge is to uncover the driving forces behind these trends and determine whether they reflect a worsening of U.S. economic performance.

Three papers addressed these changes. In "Changing in Business Dynamism: Volatility of vs. Responsiveness to Shocks?," Decker, Haltiwanger, Jarmin, and Miranda pose a key question for assessing whether these declines might reflect positive versus negative forces. Specifically, if lower volatility in firm-level outcomes reflects a change in the volatility in the economic environment in which firms operate, then it might well be a positive development. On the other hand, if the decreased volatility in firm-level measures reflects less responsiveness to changes in the economic environment, then the changes may constitute a negative development. The paper notes that elements of each may be present in different sectors of the economy, but their analysis suggests that lower responsiveness to shocks is an important factor.

In a second paper on the topic, "Dynamism Diminished: The Role of Credit Conditions," Davis and Haltiwanger focus on the decline in the business entry rate and consider one particular driving force: the role of housing wealth in facilitating start-up entrepreneurship. They ask whether cities that had the largest drops in housing wealth also had larger drops in entrepreneurial activity, holding other factors constant. Their analysis finds a strong correlation between the two, suggesting that the loss of housing wealth from the Great Recession has had a significant negative effect on the rate of business startups.

A third paper on the theme of diminished dynamics offered a somewhat different perspective. In their paper "Understanding the Thirty Year Decline in the Start-Up Rate: A General Equilibrium Approach," Karahan, Pugsley, and Sahin offer a more innocuous interpretation of the trend decline in the entry rate. They note that the growth of the U.S. labor force has slowed in the last 30 years, because of the aging of the baby boomers as well as the slowdown in the growth rate of women in the labor force. Standard models of industry equilibrium imply that this will require a slowdown in the rate of growth of firms, achieved through a decrease in the rate of entry. They also note that standard models imply that substantial differences in cohort dynamics in response to such a change will not be evident, and they depict this in the data.

Secular changes in inequality have received much attention in recent years. Two papers examined the nature of these changes. In "Firming Up Inequality," Bloom, Guvenen, Price, Song, and von Wachter use tax return data from the Social Security Administration to examine the underlying sources of increased income inequality since 1978. A key feature of this analysis is that it is based on tax return data for the universe of individuals, making it much more extensive and reliable than estimates based on smaller samples and self-reported measures of income. The authors find that the rise in income inequality is dominated by an increase in income dispersion across firms rather than within firms, which seems to result from an increase in the extent of sorting of workers across firms. The authors suggest that this increase reflects a change in the way firms are organized. The authors also show that executive pay plays essentially no role in the overall rise of inequality.

Lochner and Shin also examine the dynamics of inequality in "Understanding Earnings Dynamics: Identifying and Estimating the Changing Roles of Unobserved Ability, Permanent and Temporary Shocks." This paper focuses on changes in labor earnings among males from 1970 to 2008. Unlike the previous paper that focused on dispersion between and within firms, this paper focuses on permanent versus transitory components of inequality and the extent to which changes in inequality reflect changes in the price of unobserved skill. The paper provides a detailed decomposition of the evolution of these various components over a 40-year period. The decomposition between permanent and transitory components is of central concern since higher transitory variance averages out over time at the individual level. One key finding is that since 1990, the dispersion of permanent shocks has increased, especially for low-income workers.

Hall and Schulhofer-Wohl analyze changes in match efficiency in the U.S. economy since 2001 in their paper "Measuring Job Finding Rates and Matching Efficiency with Heterogeneous Job Seekers." Standard estimates based on an aggregate matching function that treats all workers as identical imply that matching efficiency has deteriorated dramatically during the Great Recession and its aftermath. The authors show that if one takes into account heterogeneity in matching rates for workers with different observable characteristics, a very different picture emerges. In particular, although a decrease is still evident in the aftermath of the

Great Recession, this decrease reflects a continuation of an existing downward trend. The key implication is that lower matching rates currently found in the data reflect a secular trend.

In "The Great Reversal in the Demand for Skill and Cognitive Tasks," Beaudry, Green, and Sand offer a new perspective on secular trends in the labor market. Key to their explanation is that the boom prior to 2000 is associated with investment in the new general-purpose technology associated with information technology. Their theory holds that this technology is put in place during a period of high investment demand and high demand for skilled labor. But once the new technology is in place, it requires much less high-skilled labor to maintain or operate it. In this "de-skilling" phase, high-skilled individuals will move to jobs that are lower in the skill spectrum, thereby displacing individuals with lower skill levels to either move farther down ladder or even out of the labor force. The authors argue that this de-skilling phase began sometime around 2000 and was somewhat obscured prior to the Great Recession. The paper presents a stylized model of this process and presents several pieces of empirical evidence consistent with this dynamic. The key implication is that recent developments in the labor market indicate secular trends.

Autor, Figlio, Karbownik, Roth and Wasserman examine a different trend in U.S. labor market outcomes. In "Family Disadvantage and the Gender Gap in Behavioral and Education Outcomes," the authors examine the growing gap between male and female educational attainment. This gap is particularly large for children from disadvantaged backgrounds. The authors evaluate the hypothesis that the gap reflects differences in the sensitivity of boys and girls to adverse environments. They use data from Florida that allow them to study brother-sister pairs, allowing them to control for family environment. The key finding is that their study supports this hypothesis, though they are unable to identify which specific factors might be at work.

Full papers for most of these presentations are available on the Atlanta Fed's Center for Human Capital Studies website.

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