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The US labour market is still a shambles

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By Joseph Stiglitz

It is understandable, given the number of times green shoots have been seen since the downturn began in December 2007, that there might be some scepticism about claims the recovery is finally under way. To me the question is what does it imply for policy? Does it mean we can be more relaxed about the demands for budget cuts emanating from fiscal conservatives? Or that the US Federal Reserve should start paying more attention to inflation, and begin contemplating raising interest rates? Even if this is not one of the many green shoots that soon turn brown, the economy will almost certainly need more stimulus if it is to return to full employment any time soon.

This is the inevitable conclusion from looking at the state of the labour market today. It is a shambles. In Friday's US employment report, the proportion of working-age American adults in a job moved up only 0.1 percentage points, to a miserable 58.6 per cent – numbers not seen since the downturn of the early 1980s. There are still 23m Americans who would like a full-time job but who cannot get one. The jobs deficit, the number of extra jobs that would have been required to keep up with new entrants to the labour market, is 15m. Employment has yet to return to its level of December 2008. Male employment is still below what it was in February 2007 – meanwhile, the working-age population has grown considerably.

Let's assume that job creation continues at the rate of 225,000 jobs a month. That is only about 100,000 beyond the number required to provide jobs for the average monthly number of new entrants into the labour force. At that pace, it would take 150 months to reach full employment – 13 years, some time around 2025. The independent Congressional Budget Office is more optimistic, forecasting the return of full employment by 2018.

With labour-force growth normally about 1 per cent per year and productivity growth about 2-3 per cent, it takes sustained output growth in excess of 4 per cent to bring unemployment down. No one expects growth at that pace for long enough to return the US economy to full employment any time soon.

We might, once deleveraging is finished, return to "normal" growth rates; but what is required to get unemployment down is an extended period of above normal growth. However, three elements of "missing demand" (missing, that is, compared with 2007) make that unlikely: then, the household savings rate was zero, a result of the top 20 per cent of Americans saving 15 per cent of their income and the bottom 80 per cent spending an abnormal 110 per cent of their income.

Even after deleveraging and after our financial system is fully repaired, saving should not return to anything like the level it was before. Neither should we expect the "return" of American consumers – indeed, we should worry at their reappearance, for what it says about both their rationality and a financial system that facilitates such profligacy.

Before the crisis, 40 per cent of all investment was in property. We had a housing bubble that left a legacy of excess capacity. Continuing weakness in the property sector is reflected in high foreclosure rates and low home prices.

Finally, US states and local governments are constrained, to a large extent, by having to balance their budgets. They depend heavily on property taxes, so both revenues and expenditures have plummeted. This is why there are a million fewer public employees than before the crisis. Government as a whole is being procyclical, not countercyclical.

The pre-crisis bubble masked fundamental problems with the US economy. Low-income households spend a higher fraction of their budgets on consumption than richer households. Therefore, the redistribution towards the top – with the top 1 per cent getting more than a fifth of the nation's income – would have led to weak aggregate demand in the absence of the bubble.

Moreover, just as the Great Depression was part of the transition of the economy from agriculture to manufacturing, the Great Recession is part of the transition from manufacturing to a service-sector economy. Growth in productivity, plus changing comparative advantage, made a decline in manufacturing employment inevitable. Markets on their own do not manage such dramatic economic transformations well.

Unfortunately, little has been done about the underlying structural problems. Indeed, the downturn, during which wages have not kept pace with inflation, has in many ways made US inequality worse.

Today the American economy faces three big risks. First, a steeper European downturn, as a result of the excessive austerity and the euro crisis. Second, complacency that the economy will recover quickly without government support. Though every downturn comes to an end, that should not be of much comfort. Third, that we accept that an unemployment rate above 7 per cent is inevitable.

If my Cassandra forecast turns out to be wrong, stimulus can be cut. But if it turns out to be right, and we do too little, we will live to regret it.

The writer is a recipient of the 2001 Nobel Prize in economics and professor at Columbia University

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