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The Job Market and the Great Recession

TESTIMONY

by

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"The Challenge of Creating Jobs in the Aftermath of 'The Great Recession'"
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He is the author of three books on how markets work. A member of the Mercatus Center's Financial Markets Working Group, he is finishing a monograph on the financial crisis. He is also the host of the weekly award-winning podcast, EconTalk. He holds a Ph. D in economics from the University of Chicago.

Chairwoman Maloney, Vice Chairman Schumer, Ranking Members Brady and Brownback, and Distinguished Members of the Committee:

We are in the middle of what is likely to be the worst economy since the Great Depression. Since the recession began in December of 2007, the economy has lost 7.2 million jobs. We all want to see an expansion of opportunities that would allow people to get back to work. It is easy to create jobs. The challenge is to create genuine opportunity—productive jobs, not make-work jobs.

The American Recovery and Reinvestment Act of 2009 (ARRA) has been in place for more than nine months. While GDP growth is now positive, the job market remains deeply troubled. Unemployment is unacceptably high. And the economy continues to lose jobs.

What went wrong? Why didn't the $787 billion stimulus of ARRA get the job done? What might be done that could improve job opportunities? These are the questions I address here.

The stimulus package has been disappointing. Even proponents concede that the spending side of the stimulus has been very slow to reach the economy—only $235 billion has been spent as of December 1, 2009. More importantly, the structure of the stimulus package was not designed to stimulate. More than a third of what has been spent was in the form of a temporary tax rebate. Just as with the Bush Administration tax rebates in early 2008, most of the money was saved rather than spent.

The direct spending component has been $145 billion. Of that $145 billion, the four government agencies receiving the most money—the Departments of Health and Human Services, Department of Labor, Department of Education, and the Social Security Administration, account for over 80 percent of the spending.

Those agencies don't have many shovels.

The money has gone to increase funding for Alzheimer's Research, to bolster the tax revenues of states so that teachers can continue to be paid, to digitize medical records and to continue paying unemployment benefits. Some of the money went to give raises to workers. Pleasant for them, but not so helpful for job creation.

Roughly one half of the job losses since December of 2007 are in construction and manufacturing. A better understanding of Alzheimers and more efficient medical record-keeping are good things. But they do little or nothing for the bulk of the workers looking for work.

I did manage to find a $1 million program in the Department of Education for re-training laid-off manufacturing workers. But overwhelmingly the money spent by these agencies was not targeted at the problem.

The Department of Transportation has spent only $6.5 billion.

Is it surprising that unemployment remains in double digits?

Some argue that it doesn't matter what we spend the money on. The main thing is to get the money in circulation. People will then spend it, creating demand for products, which creates jobs and puts more money in people's hands and so on. Ironically, this Keynesian story works best when the economy is healthy.

But consumer spending is down because people are rightfully worried about the future. The future of the economy is highly uncertain. Prudence is a good idea. But when people are scared of the future, they are going to save more and spend less compared to when they are optimistic about the future. So fiscal policy that counts on the multiplier doesn't work any better than monetary policy in that famous liquidity trap. This is particularly true of temporary increases in income. So both fiscal and monetary policies are constrained by the anxiety people have about the future.

Unfortunately, policymakers aren't very good at dispelling anxiety or creating confidence. Politicians like to show how active they are. That very activity creates uncertainty about the future. So spending an extra $235 billion in the face of a $1.4 trillion deficit or an additional proposal to spend $200 billion may actually make things worse.

There is no reliable way of knowing whether the stimulus package has averted a worse situation or whether it's part of the problem. There is no consensus in the economics profession on this question and no empirical evidence that can settle the dispute.

People know that tax increases are coming but they do not know how big their share will be. There is also the once-unthinkable possibility of a default by the United States on its fiduciary obligations. These possibilities do not encourage confidence.

While politicians may not be good at creating confidence, they can be very good at creating increased uncertainty. Right now, the government is either intervening in numerous parts of the economy or considering expanded intervention in major ways. These sectors include the auto industry, the financial sector, health care, carbon dioxide emissions, and the role of unions. In the areas where the government has already intervened, the timing and nature of the exit strategy is up in the air. In the areas where the government is considering major intervention, the timing and entrance strategy are equally uncertain.

This uncertainty discourages the risk-taking needed to get the economy going. We need new businesses to start and old businesses to expand. But if their owners can't be sure of what the rules of the game are going to be—the tax rates they might face, the interest rates they might face, the inflation rate they might face, the health care mandates they might face, the emissions requirements they might face—then it's not surprising that business (and investors and consumers) are likely to sit on the sidelines to see how things will turn out.

In a recent survey of employers released this week by Manpower, Inc., 73 percent said they plan no change in staffing for the first quarter of 2010. That is the highest level of "no change" since 1962. Employers are sitting on the sidelines waiting to see what the rules of the game are going to be.

And some changes in the incentives facing employers go in the wrong direction and have reduced the incentive for job creation. The recent increase in the minimum wage has made low-skill workers more expensive to employers and by creating a shortage of opportunities, reduced the bargaining power of employees in the employer-employee relationship.

The recent CBO study of the effects of the stimulus seems to contradict these claims about the impact of the stimulus. That study found that the stimulus had saved or created between 600,000 and 1.6 million jobs. That estimate is embarrassingly imprecise. And it's not really an estimate of jobs saved or created. It's a mechanical application of past estimates of the fiscal multiplier. It is actually the same estimate the CBO made before the stimulus was passed. It remains nothing more than that—a guess of what might be the impact.

Here is the delicate way the CBO explains it:

> Estimating the law's overall effects on employment requires a more comprehensive analysis than the recipients' reports provide. Therefore, looking at the actual amounts spent so far (where identifiable) and estimates of the other effects of ARRA on spending and revenues, CBO has estimated the law's impact on employment and economic output using evidence about how previous similar policies have affected the economy and various mathematical models that represent the workings of the economy.

Those mathematical models don't reach a consensus. Nor is there any reason to think that the relationships embedded in those models remain applicable in the current set of circumstances.

So what is to be done?

Most people presume that there is something that can be done, something to get people back to work faster. That may not be possible. Government policy induced an unnatural expansion of the housing sector. We built way too many houses. That naturally drew a lot of people into construction. Fully 25 percent of the job losses have been in construction. The workers who no longer hold those jobs need to find other things to do. They will want to take time deciding what they should do instead. Unfortunately, it is natural that unemployment lingers.

The current trend suggests it may take another two years or more before employment returns to its old level. That time period is guaranteed to get the attention of every member of the House and at least a third of the Senate. Is there anything that might speed things up?

Given the lack of success so far and the role uncertainty plays in the decision-making of entrepreneurs, investors and consumers, doing less might, paradoxically, be more successful than doing more, especially if the "more" that is done works in the wrong direction.

So if you must do something, the goal would be to get the most bang for your buck (or

actually our buck, since we, the people, are paying for it). Stop giving away money to states with no strings attached. Don't treat the unspent TARP funds of $200 billion of our money, as if it were free money. It isn't. Don't waste it the way the stimulus money was wasted.

If you must spend it, spend it in ways that encourage employers to create jobs. The obvious way to do that is to cut the payroll tax. Cut it by 25 percent for the next five years. That will reduce revenue by about $250 billion per year, but at least it has a chance to create jobs.

It doesn't solve the uncertainty problem. To do that, you need to stop fiddling with every aspect of the economy.

- Leave something, anything, alone and admit that not every problem has a solution.

- Start acting responsibly. Stop selling free lunches. Stop pretending you can add to the demand for health care and cut costs at the same time.

- Stop issuing short-term debt. The government is playing with fire. That's what got Wall Street in trouble. The government rescued Wall Street. There is no one to rescue us.

- Reduce some aspect of government spending to show that the grown-ups are in charge and that someone can practice tough love with the American people. Say no to some special interest. Get rid of corporate welfare. Cut tariffs and quotas which are a silent tax on the consumer.

- Stop ad hoc interventions and get us back to the rule of law.

- Stop propping up losers. Let people who were reckless go out of business.

- Let the economy heal.

F. A. Hayek said that "the curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." It would be good to recognize our limits about what we imagine we can design. We cannot steer the economy. Or the labor market. Recognizing our limitations is a step in the right direction.