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When Will the Labor Market Recover?

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Although it has been nearly two years since the Great Recession of 2007 was officially declared over, we are still waiting for jobs to recover. More than 9.0 million people joined the ranks of the unemployed during the 18-month recession—the worst since the Great Depression, bringing the total number of unemployed to nearly 16 million. While real GDP is currently within one percent of its prerecession peak, total private employment is still nearly 6 percent below the employment peak of December 2007.

Productivity gains drove the early stages of the recovery, which did little to increase employment and reduce unemployment. Productivity gains have slowed recently, and have even turned negative, so it could be that the rest of the expansion may be driven by increases in hours and hiring. If so, the relative strength of the employment recovery is determined by two factors: the number of new job openings created and how quickly the unemployed can move into these new positions. During the first 16 months of the recovery, job openings increased 39 percent, which is nearly double the increase in job openings during the previous expansion after the 2001 recession. Job openings increased from 2.3 million per month to 3.3 million per month. However, hiring has remained flat, increasing by only 3.6 percent. (See Figure 1.)

How can job openings be increasing so much faster than new hires? Obviously, new openings are going unfilled, but why? First, workers may not qualify for the new positions because their skills don't match the job requirements. This is referred to as an increase in structural unemployment. Workers displaced from a declining industry may have to search in another industry that has job opportunities yet their skills may not easily transfer to that industry. This view is somewhat controversial, however, with several studies pointing to less structural and

more cyclical change. The restructuring and downsizing of the auto industry and the real estate slump and its effect on construction are two examples of regionally concentrated restructuring. Typically, workers would respond to these conditions by moving to areas with better job prospects, but decline in housing values, leading to negative home equity and foreclosures for many households, reduces their ability to do so. An additional factor is the increasing duration of unemployment, with studies showing that the longer duration of unemployment the harder it is to get a job.

Several organizations offer various scenarios for the recovery of the labor market. For instance, the Congressional Budget Office expects the unemployment rate to decline to 7.96 percent in 2012 and the participation rate to increase to 64.8 percent. This requires an average job growth of 227,000 per month over the next two years—about twice the current rate and slightly under the 2006 average rate 268,000 per month. Using the Federal Reserve Bank of Philadelphia's recent forecast of employment growth in 2011 of 170,000 jobs per month and extending

that rate forward paints a bleaker picture. The Upjohn Institute calculates that at that pace the unemployment rate would not come down to 8 percent until the end of 2015. In order to return to the prerecession average unemployment rate of 4.8 percent by 2014, the economy would have to generate 338,000 jobs each month. It's not impossible, but monthly growth rates of this magnitude have occurred only in short spurts, and these estimates require sustained growth rates at this level.

Some economists believe that returning to the days of unemployment rates below 5 percent may not be in our future, at least not in the short run. They believe that the recession has caused the long-run natural unemployment rate to be higher than in the past, for the reasons just discussed.

The recession has left the United States with a weak employment situation. Job openings are picking up, but hires are flat, and the labor market is less dynamic than before, with fewer job openings and separations—a measure of labor market churning and flexibility. If job openings continue to increase and the structural changes are minimal, then the rest of 2011 may see a more substantial rebound in employment than many expected a few months ago, when the unemployment was hovering above 10 percent. Yet, it may take at least several more years beyond 2011 before the labor market situation resembles what it was before the recession.

Randall W. Eberts is president of the Upjohn Institute.

Figure 1 Job Openings, New Hires, Separations, and Unemployed (in 000s)

