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The Problem with Structural Unemployment in the U.S.

BY DEAN BAKER*

It took centuries worth of research and evidence for astronomers to convince the world, including their fellow astronomers, that the earth does in fact go around the sun rather than the other way around. Unfortunately it may take as long to disabuse policymakers of the myth that unemployment in the United States is in any important sense structural, as opposed to being the result of insufficient aggregate demand.

This distinction is crucial since it implies very different policies. Structural unemployment, often referred to as a jobs or skills mismatch, results from workers either being in the wrong place for the jobs that are available or having the wrong skills. If this is the case, then policies should be designed to move people from the wrong places to the right places and to get workers to train for the skills that are in demand.

By contrast, if unemployment is due to lack of demand, the answer is to simply create more demand. Ideally demand would be generated through spending that actually has real benefits in the present or future, but any spending can employ workers even if it is wasteful. The obvious policies to promote spending are through larger government deficits, either by direct spending or tax cuts, Federal Reserve Board actions that lower interest rates, and reducing the value of the dollar which will increase the country's net exports.

It is important to recognize some commonly cited facts that do not imply structural unemployment. First, it has been widely noted that the unemployment rate for more highly-educated workers is lower than for less-highly educated workers. This is always true and it tells us nothing about whether or not the economy is suffering from a problem of structural unemployment. Unemployment is only structural if the economy is actually rubbing up against supply constraints for certain types of workers so that if demand increased, there would not be sufficient workers to fill the demand.

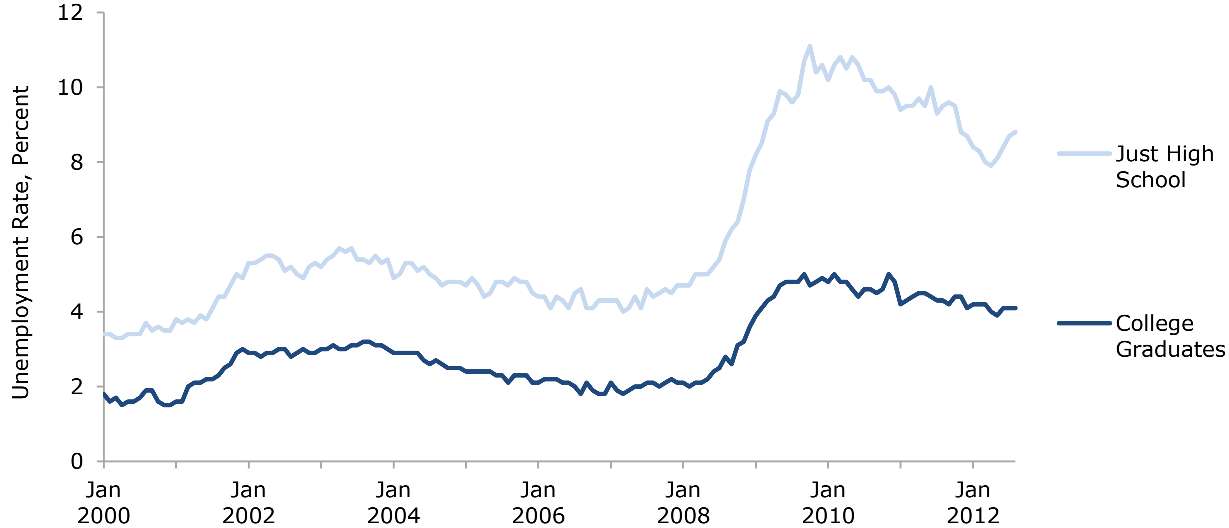
This does not appear to be the case with any substantial segment of the workforce. Most immediately, while the unemployment rate for college-educated workers is far below the unemployment rate for less-educated workers, it is still more than twice as high as it was before the recession

Center for Economic and Policy Research
1611 Connecticut Ave, NW
Suite 400
Washington, DC 20009
tel: 202-293-5380
fax: 202-588-1356
www.cepr.net

* Dean Baker is an economist and the Co-Director of the Center for Economic and Policy Research, in Washington, D.C.

began at the end of 2007. The 4.1 percent unemployment rate for college-educated workers in the summer of 2012 is more than 2.5 times the lows it hit in 2000 as shown in **Figure 1**. It does not appear as though the economy is running up against any limits in the supply of college-educated workers.

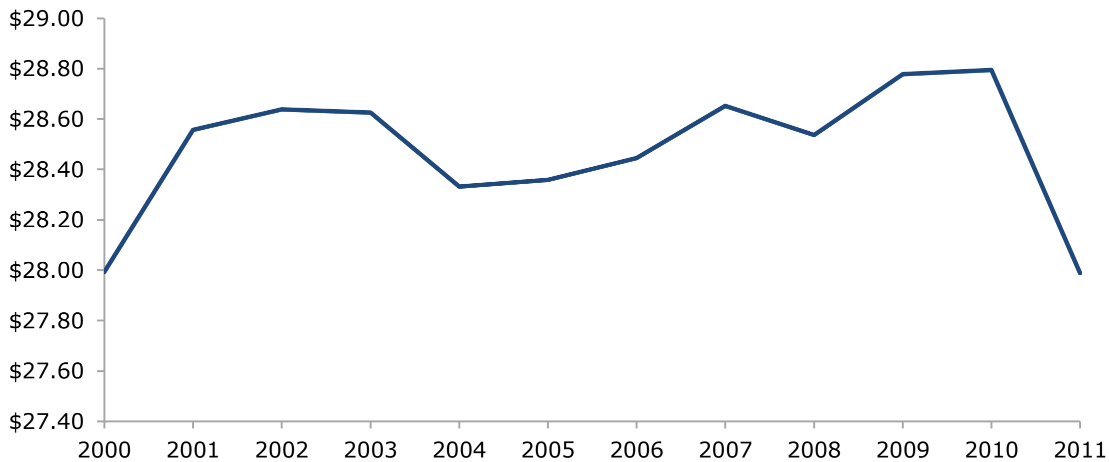
FIGURE 1
Unemployment Rates for College-Educated Workers and Workers with Just High School Degrees



Source: Bureau of Labor Statistics, Current Population Survey.

We can see the same story if we look at wage growth for college-educated workers. **Figure 2** shows the average real wage for a college educated worker, without an advanced degree since 2000. While wages for college-educated workers were rising at a healthy pace at the start of the last decade, they have stagnated ever since the 2001 recession. Again, this is certainly not consistent with the notion of college-educated workers being in short supply. If that were the case, then employers should be bidding up wages to pull needed workers away from competitors.

FIGURE 2
Real Hourly Wages for Workers with College Degree, in 2011 dollars



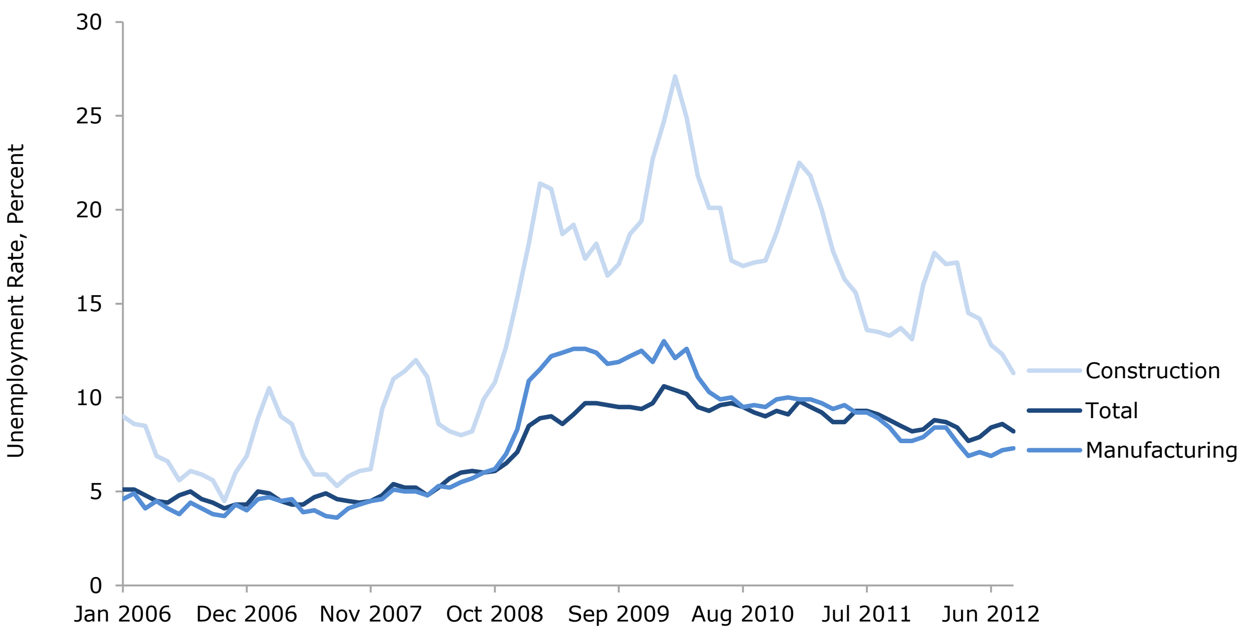
Source: Economic Policy Institute, *The State of Working America 12th edition*, Table 4.16.
http://www.epi.org/files/2012/data-swa/wage-data/Wages%20by%20education.xlsx

Alternatively, instead of considering the issue of supply and demand by education overall, it can be viewed by specific industries. The argument here would be that there may be excess workers in some industries (manufacturing and construction are usually the main ones cited), but other industries are actually struggling with labor shortages. If this were true, then it should be possible to identify industries that demonstrate evidence of a labor shortage, such as rapidly rising wages, a high ratio of job openings to unemployed workers, and a lengthening of average work weeks. There is no major sector of the economy where this evidence of a labor shortage exists.

First, it is important to note that workers who have lost their job in manufacturing or construction appear to have been reasonably successful in finding new employment. **Figure 3** shows the unemployment rates for workers from the manufacturing and construction sectors since 2006 and the overall unemployment rate. As can been, the unemployment rate for construction workers has fallen sharply so that it is now only 3.1 percentage points higher than the overall unemployment rate. With construction accounting for 3 percent of the workforce, this means that the higher-than-average unemployment in the construction industry is adding just 0.1 percentage points to the overall unemployment rate. (It is worth noting that the gap between the unemployment rate for construction workers and the overall unemployment rate was actually larger before the recession.)

The unemployment rate for workers from the manufacturing sector has fallen slightly below the overall unemployment rate. This means that workers from manufacturing have actually been relatively successful in finding employment in other sectors of the economy.

FIGURE 3
Unemployment Rate for Select Sectors



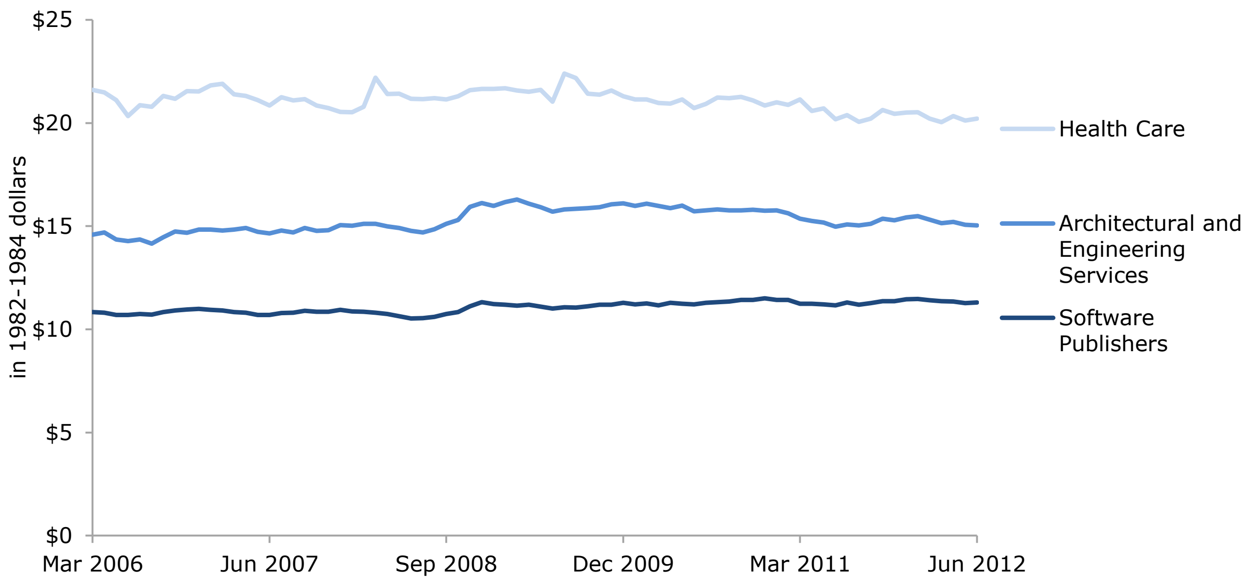
Source: Bureau of Labor Statistics, Current Population Survey.

Of course, the decline in unemployment in these two sectors should not mean that the displaced workers have not experienced serious hardship. Many have been forced to accept jobs with sharply reduced pay. Some have left the labor force altogether believing that their employment prospects were so bleak that there is little point in continuing to look for work. However, in both cases, these workers are not contributing to the persistence of an unusually high unemployment rate.

Turning to the other side – the possibility that rapidly growing sectors are experiencing shortfalls in labor supply – the evidence for this argument does not seem to exist.

Figure 4 shows real wage growth in the health care sector, the architecture and engineering services sector and the software publishing sectors from 2006 to the present. These are sectors that are seeing rising employment or where we might expect that skills command a premium. In none of these sectors are real wages even keeping pace with inflation. While there might be some more narrowly drawn sectors where real wages are rising, it would be difficult to make an argument that the economy is at full employment just because a few narrowly drawn sectors of the labor market might be experiencing labor shortages.

FIGURE 4
Average Hourly Earnings of Employees in Select Sectors, in 1982-1984 Dollars

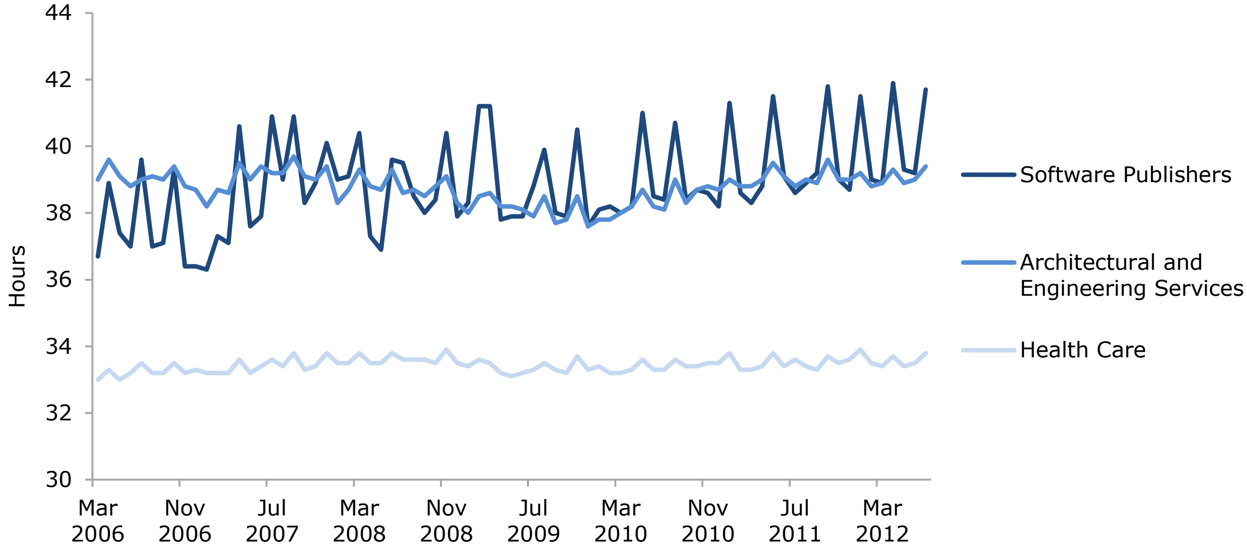


Source: Bureau of Labor Statistics, Current Employment Statistics.

It is also important to remember that productivity growth has been rising at the rate of 2.0 percent annually. This means that if we expect wage shares to remain constant then real wages in the economy as a whole should be increasing by between 1.0-1.5 percent annually.[1] If a sector was experiencing a labor shortage that was impeding growth, then real wages would have to be rising even more rapidly.

Figure 5 shows average weekly hours in these sectors. Again, if there were labor market shortages we should expect to see a rise in average weekly hours. Employers who are unable to find additional workers would be trying to work their existing work force additional hours. While there is a modest increase above pre-recession levels in the software publishing industry, average weekly hours are at or below their pre-recession levels in the other two sectors.

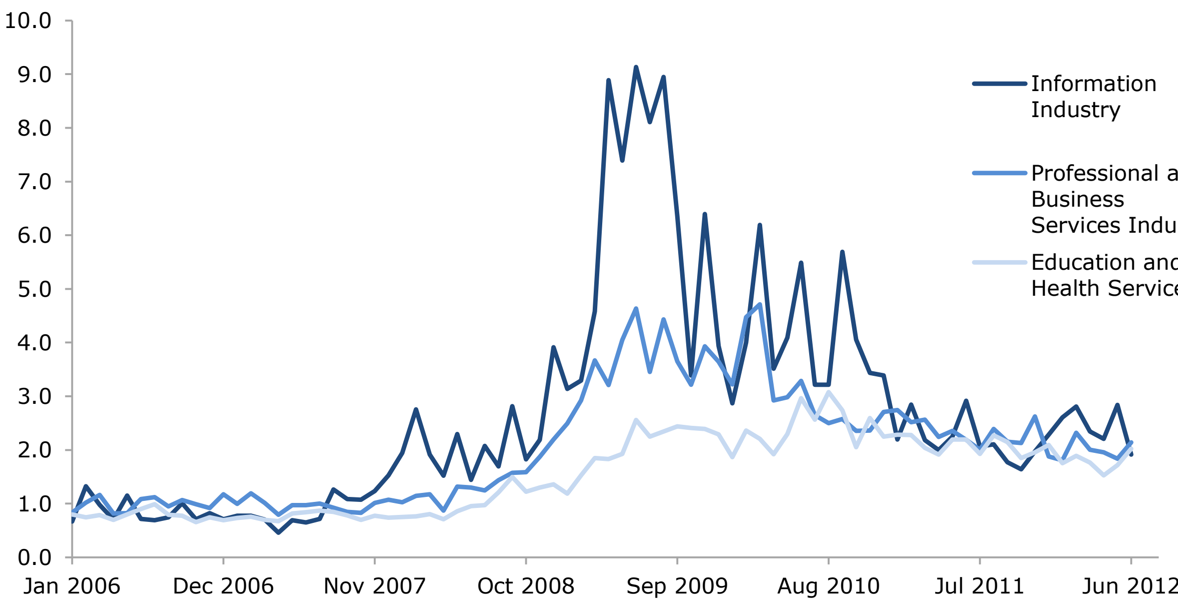
FIGURE 5
Average Weekly Hours of Employees in Select Sectors



Source: Bureau of Labor Statistics, Current Employment Statistics.

Figure 6 shows trends in job opening and the number of unemployed workers in the somewhat larger health care and education sector, professional and business services sector, and information sectors. These sectors are larger than the more narrowly drawn sectors above (the data on job openings and unemployed workers are not readily available at the more detailed level), however if there is a serious problem of structural unemployment then there should be some evidence of it in larger sectors, not just narrowly defined sectors of the economy.

FIGURE 6
Ratio of Unemployed to Job Openings in Select Industries



Sources: Bureau of Labor Statistics, Job Openings and Labor Turnover Survey and Current Population Survey.

While the data do show a decline in the ratio of unemployed workers to job openings, in none of these industries are the ratios close to their pre-recession level, in fact in each case the ratio of unemployed workers to job openings is still above 2.0. It would be difficult to contend that these sectors are suffering from a shortage of qualified workers.

There is one final issue in the structural unemployment argument that is worth noting. Some analysts contend that the workers who are unemployed suffer from being in the wrong locations. While there may be few jobs in places like Nevada or central California, which were hard hit by the collapse of the housing bubble, there are labor shortages in other areas of the country. In this view, people just need to move from the areas of high unemployment to areas of low unemployment.

The problem with this argument is that there are relatively few areas of low unemployment and they are small relative to the areas of high unemployment. For example, it can be argued that the energy boom has in fact led to a labor shortage in North Dakota, where the unemployment rate is just 3.0 percent. However, the labor force in North Dakota fewer than 400,000 workers. If the state's labor market could absorb another 50,000 workers, this would reduce the national unemployment rate by less than 0.04 percentage points. While there are other pockets where labor is arguably in short supply, they are also small relative to the national labor market. Even if workers could be quickly transferred from the areas of high unemployment to the areas of low unemployment it would have little overall impact on the national unemployment rate.

Conclusion

The argument that unemployment is due to a skills mismatch leads to very different conclusions about economic policy than the view that the main cause of unemployment is insufficient demand. The former sees the problem as being with workers while the latter view focuses on the need for economic policy to increase demand.

As mentioned earlier, larger deficits, Federal Reserve action, or lowering the value of the dollar are all policies that can be pursued to increase demand and thereby increase employment. It is also possible to increase employment by encouraging employers to reduce hours to keep people working. This policy, known as work sharing, is the main reason that Germany's unemployment rate has fallen by more than two full percentage points -- to 5.4 percent -- since the start of its downturn. By contrast, the unemployment rate in the United States has risen by more than 3.5 percentage points even though economic growth in the two countries has been virtually identical. There are many good reasons to prefer that reductions in labor demand be met with a reduction in the number of hours per worker rather than laying off workers and possibly leaving them unemployed for long periods of time.

While many people in national policy debates have been anxious to put forward the skills mismatch argument, it is difficult to find evidence that supports this position. The evidence is overwhelmingly consistent with the simple view that the collapse of the housing bubble has led to a large shortfall in demand. In this context, measures that focus on improving skills will have little effect on overall employment.

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1 Real wage growth would be somewhat lower than productivity growth due to some measurement issues and the expectation that an increasing share of compensation will go to non-wage compensation, most importantly health care.