

A jobs miracle that has baffled the experts

ANDREW LEIGH and JUSTIN WOLFERS look how the sustained boom in the American economy has led to a jobless rate that no economist thought possible.

ONE OF the most striking features of the recent US Presidential campaign was the absence of any meaningful debate about unemployment. By contrast, joblessness has been a major issue in every Australian election campaign since the mid-1980s. While this comparison partly reflects different political cultures, the primary reason must be the seemingly miraculous performance of the US labour market over the past decade.

Economists who had long argued that unemployment could not go lower than 6 per cent without sparking inflation were embarrassed to see unemployment sink past that level in September 1994, and since fall below 4 per cent, with inflationary pressures barely evident. The "natural rate" of unemployment, it seems, is not so natural.

What can Australian policymakers learn from this extraordinary experience? It depends on whom you ask. Some on the left tend to deny this unemployment miracle, pointing to high incarceration rates and demographic shifts

as evidence that the numbers are being distorted. Many on the right argue that these developments are a vindication of *laissez-faire* policies. An intriguing study by Professors Larry Katz (Harvard) and Alan Krueger (Princeton) evaluates these claims.

The High Pressure US Labor Market of the 1990s, published by the Brookings Institution, starts by examining demographic trends. The highest unemployment rates, Katz and Krueger point out, are amongst teenagers and young adults.

This meant that in the late-1960s and '70s, when the baby boomers entered the labour market, the unemployment rate rose. But by the '90s, the boomers had become mature-age workers, bringing unemployment down again. They estimate that these demographic shifts have reduced unemployment by 0.2 percentage points since the 1980s.

Secondly, Katz and Krueger identify the effects of increasing casualisation of

the labour market, and particularly the development of the temporary help industry.

Earlier research, they point out, has shown that such agencies are playing an increasingly important role in screening potential employees and providing computer training. By comparing unemployment rates in those states that have a well-developed temporary help industry with those that do not, Katz and Krueger conclude that the industry has helped reduce unemployment by up to 0.4 points.

Next, what role was played by efforts to improve "matching" between the long-term unemployed and work opportunities? Initiatives put in place in the 1990s required the long-term unemployed to make use of re-employment services in order to continue claiming benefits.

However, with long-term unemployment barely evident in the US, these programs were too small to have a no-

ticeable impact on the unemployment rate.

The fourth factor is increased incarceration rates. As a result of "tough on crime" policies, 0.9 per cent of American adults are now in prison — twice the proportion in custody in 1985. Assuming that only about one-third of those behind bars would otherwise be employed, Katz and Krueger estimate that the jail boom has shaved another 0.1-0.2 points from the unemployment rate.

Finally, the two economists assess the combination of weaker unions and worker insecurity. With less than one in ten private-sector workers in a union, and lower trade barriers placing firms under more competitive pressure than ever before, they contend, workers have been unable to press for wage gains as forcefully as they might have done in the past. However, while the "weak backbone" thesis has often been cited by Federal Reserve Board chairman Alan

Greenspan and media pundits, Katz and Krueger find little quantitative evidence of such heightened insecurity.

So what are the implications of all this? Whilst these five factors explain at best half of the decline in unemployment, they clearly show that the US unemployment miracle is neither a figment of distorted data, nor a reflection of fundamental structural change. Yet although the exact causes of the low jobless rate remain something of a mystery, there is reason to believe that a sustained economic boom can substantially lower the natural level of unemployment.

The dismal science may be uncomfortable with miracles, but this is one that we should do our best to understand. Getting Australian joblessness down to US levels would be a substantial achievement indeed.

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