Euler Hermes Economic Research

Economic Insight

United States: Structural Unemployment as a Long-Term Impediment to Growth

25 June 2013

Dan North (Economist for North America)
✉ dan.north@eulerhermes.com

Executive summary

- **Painfully slow labor market recovery caused by structural unemployment**
- **Sources of structural unemployment include skills mis-match, age demographics, and harmful incentives**
- **Possible solutions include vocational training, removal of incentives, legal immigration**

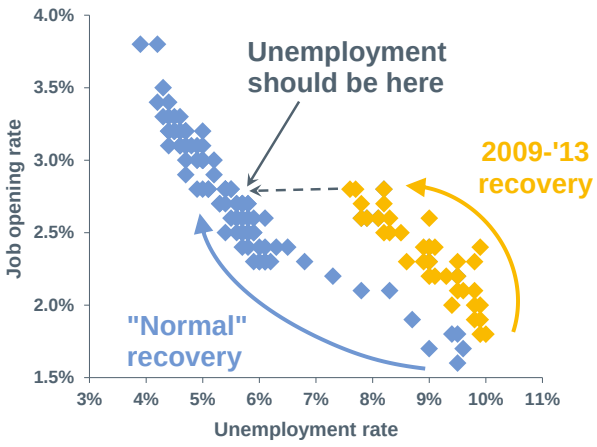
Slow Labor Market Recovery

The U.S. labor market has recovered from the "great recession" at the slowest pace of any in the post-World War II era. Five and one-half years after the recession started in January 2008, the economy still has 2.5 million fewer jobs than before. The next slowest recovery was from the 2001 recession when all the jobs were recovered in four years. All other recessions have recovered much faster.

Structural unemployment has been a significant culprit in this painfully slow recovery, and it will likely be an impediment for some time. Structural unemployment arises from three sources: a skills mismatch, harmful age demographics, and incentives not to work.

The skills mis-match is illustrated in Chart 1 which shows the historical inverse relationship between the job openings rate and the unemployment rate. During a recession when unemployment is high, businesses have very few job openings, and vice versa. In a "normal" recovery as shown by the blue dots, job openings become more plentiful and the unemployment rate falls. However in the 2009-2013 recovery as shown by the yellow dots, job openings rose, yet the unemployment remained stubbornly high. Given the current level of job openings, the unemployment rate should be closer to 5.5%, not 7.5%. The data suggest that even though employers have job openings, people don't have the skills required for the job and thus remain unemployed – a skills mis-match.

Chart 1: Job Opening Rate vs. Unemployment Rate



Source: Bureau of Labor Statistics (BLS)

Sources of Structural Unemployment

The skills mis-match in turn is caused by several factors. These include the fact that technology progresses while the unemployed do not, workers have been much more immobile due to "underwater" mortgages which make it impossible to sell their homes, young people entering the workforce have neither the skills nor experience necessary to succeed in a very tight labor market, and social safety nets have provided strong incentives to stay unemployed.

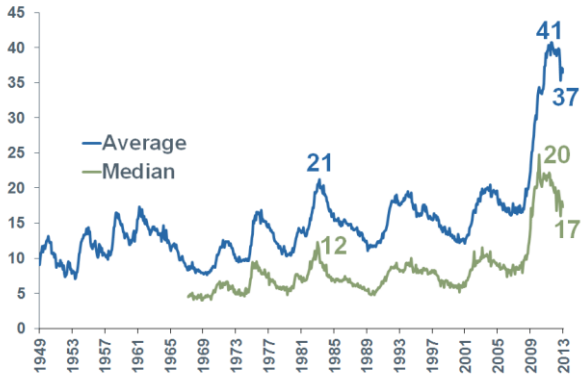
Further evidence is given in Chart 2 which shows the duration of unemployment in weeks. Note that the highest average duration before this recession was 21 weeks. In 2011 it soared to a record high of 41 weeks and remains at 37 weeks today, and the median duration tells the same story. The huge gap between the two suggests that there is a segment of the unemployed who have been unemployed for a very long time, and as a result have probably become unemployable.

Labor Force Deterioration

Chart 3 shows the labor force participation rate which is the number of people who are employed plus those that are currently looking for a job, as a percentage of the population. Clearly this rate has plunged during the recession, primarily because people have become discouraged and left the labor force.

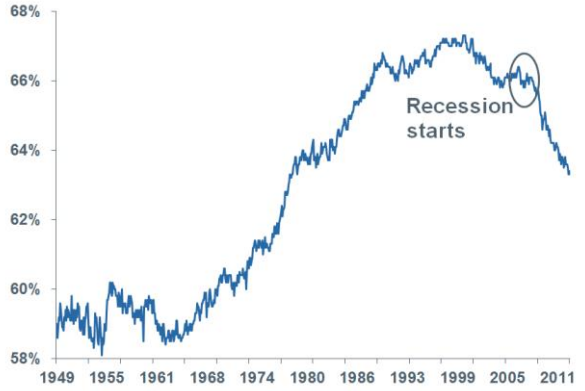
Chart 4 breaks down the participation rate and related data by two age groups, showing marked differences. First note the Change in the % of Labor Force Since January 2008 (the start of the recession). The size of the labor force increased 2.3% in the 25+ age group, but it actually fell 6.6% in the 16-24 group, implying that young people have given up and have left the work force. In addition, the 16-24 group has actually lost 3.324 million jobs since January 2008, while the 25+ group has instead gained 844,000 jobs over that period. The unemployment rate for the 16-24 group is a very high 18.6% compared to 5.8% for the other group. And the labor force participation rate is significantly smaller and has fallen more rapidly since the start of the recession for the 16-24 group. Clearly younger people not only have fewer jobs than before, but they have also given up looking for jobs and have left the labor force. The data show a skills mis-match in the form of an age mis-match, suggesting employers can not find high school or college graduates who have the required skills and some degree of experience. This problem further damages the labor market since the dearth of skilled young workers can not replace the retiring Baby Boomers fast enough.

Chart 2 : Average Duration of Unemployment, weeks



Sources: BLS

Chart 3: Labor Force Participation Rate



Sources: BLS, Euler Hermes

Chart 4: Labor Force Participation Measures by Age

Age	16-24	25+	Total
% of Population	16%	84%	100%
% of Labor Force	14%	86%	100%
Δ in % of Population Since 1/08	4.1%	5.8%	5.5%
Δ in % of Labor Force Since 1/08	-6.6%	2.3%	1.0%
Δ in Employment Since 1/08 (000s)	-3 324	844	-2 480
Unemployment Rate	18.6%	5.8%	7.6%
Δ in Unemployment Rate Since 1/08	9.4%	1.6%	2.6%
Participation Rate	54.3%	65.2%	63.4%
Δ in Participation Since 1/08	-6.2%	-2.2%	-2.8%

Sources: BLS, Euler Hermes

Harmful Incentives

Finally there is considerable evidence that extended social safety nets contribute to high unemployment. During the recession, jobless benefits were extended to 99 weeks, while 33 states still have benefits which extend over one year. The Brookings Institution estimated that extended jobless benefits contributed between 0.7% and 1.8% to the unemployment rate. The Cato Institute estimated the effect to be 2%. Even some members of the Obama administration's economic team espouse the same views. Other safety net programs include food stamps whose use has grown 39% since 2009, and Social Security's disability program which has grown 13% over the same periods.

These structural impediments to employment – skills mismatch, age demographics, and perverse incentives, can not be quickly resolved, suggesting weak economic growth for some time. The Federal Reserve's quantitative easing (QE) programs can do nothing to address these issues, and fiscal spending could have only limited effectiveness as well. Instead QE and fiscal imbalance cause serious risks to the economy without helping the labor market.

Possible Solutions

There are possible solutions. As the economy continues to grow and produce net job creation, the need for perverse incentives drops – overly generous jobless benefits should be tapered back. Clearly the lack of skills among young people calls for profound reforms in the education system, putting a stronger emphasis on vocational and technical training. Finally, dramatically increased immigration of highly skilled workers must be encouraged. Currently the government sends foreign students of science, technology, engineering and math (STEM) (and other subjects) back home as soon as they receive their university degrees, thus allowing them to compete against the U.S. A better policy would be to welcome students to come to U.S. universities on the condition that they stay in the U.S. for some period afterwards. Then these graduates could help the country compete, create jobs, pay taxes, and contribute to the Social Security and Medicare programs which need more income. Currently the U.S. lets in only 65,000 skilled foreign workers per year on temporary H1-B visas. Immigration reform should include provisions to allow a much greater influx of skilled workers for longer periods of time.