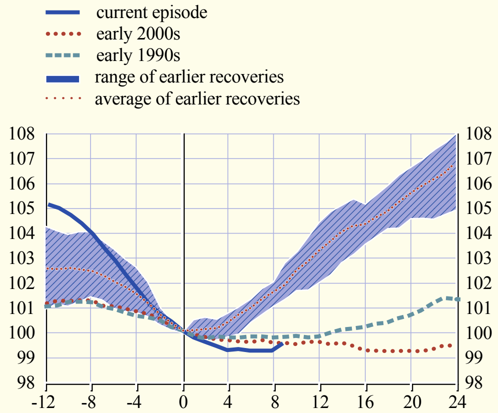
Box 1

PROSPECTS FOR THE LABOUR MARKET RECOVERY IN THE UNITED STATES

The recession that started in December 2007 has been associated with an exceptionally sharp adjustment in the US labour market. In the non-farm sector, a total of 8.4 million jobs had been lost by February 2010. While US employment data showed some improvement in March, concerns remain that the current economic upturn could turn out to be another so-called "jobless" recovery. A recovery is generally termed "jobless" in the United States when employment continues to contract for at least a year into the recovery, as witnessed in the episodes of the early 1990s and 2000s.[1] In fact, recent developments in US employment have been even weaker than in those jobless recoveries (see Chart A). This box explores the main factors that could possibly slow down the upturn in the US labour market in the near term.

Chart A Non-farm employment during US recoveries

(y-axis: indices, end of recession = 100; x-axis: months from trough)



Sources: Bureau of Labor Statistics, NBER and ECB staff.
Note: On the x-axis, t=0 refers to the trough. Both the average and min-max range are based on all US recoveries since 1954, except the jobless recoveries of the early 1990s and 2000s as well as the first part of the 1980 recovery. The most recent recovery is assumed to have started in June 2009. The last observation refers to March 2010.

Economic activity and the labour market

The strength of the labour market upturn strongly depends on the vigour of the recovery in GDP. On average, the jobless recoveries of the early 1990s and 2000s were associated with more sluggish upturns (and shallower recessions) than the other post-war episodes in the United States (see the table below). There may be a risk that the current upturn in GDP – which follows the most severe recession in post-war history – could be comparatively modest, owing to tight credit conditions, high uncertainty regarding economic prospects, a large amount of spare capacity holding back investment, and the need for households to increase their savings. A sluggish recovery in output would be consistent with historical evidence in other countries that have experienced financial crises and could restrain US employment prospects.

Structural changes and unemployment persistence

Recessions typically trigger structural changes in the economy or accelerate ongoing transformation processes. A strong associated reallocation of workers and capital between industries can lead to a weaker and delayed recovery in employment, since it takes time for

1 See, for instance, S. Schreft, A. Singh and A. Hodgson, "Jobless recoveries and the wait-and-see hypothesis", *Federal Reserve Bank of Kansas City Economic Review*, fourth quarter 2005.

GDP and labour market developments during US recoveries

(percentages, unless otherwise noted)

	GDP decline during recession	GDP growth in first year of recovery	Employment growth during quarters 3-6 of recovery	Quarters until first sustained decline in unemployment[1)]
Average jobless recovery (early 1990s and 2000s)	-0.3	2.3	0.3	8
Average of earlier recoveries[2)]	-2.0	7.2	3.7	2
Current recovery[3)]	*-3.7*	*3.5*		

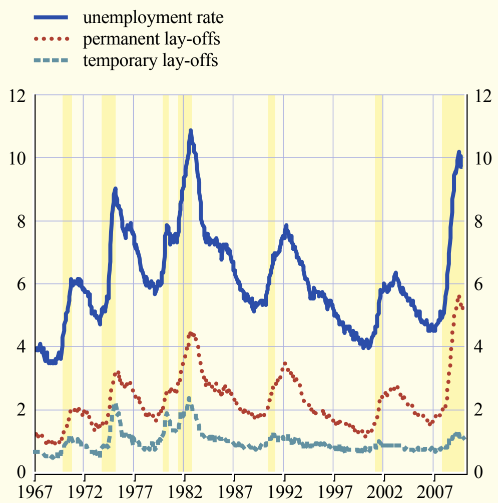
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics and ECB staff.
1) The first sustained decline in unemployment is defined as the quarter when unemployment fell for the first time after the trough in GDP and was not reversed in subsequent quarters.
2) This average includes all US recoveries since 1954, except those of the early 1990s and 2000s and the first part of the 1980 recovery.
3) The most recent recession is assumed to have ended in the second quarter of 2009 and the GDP growth rate in the first year of the recovery is based on the Consensus forecast.

workers to be retrained and hired in other industries. Some workers may leave the labour force altogether. During the most recent recession, some sectors in the United States – most notably, the construction and car sectors – have been particularly strongly affected and could be downsized permanently.[2]

Structural economic changes that require a reallocation of labour across sectors may increase the persistence of unemployment. This would imply that the unemployment rate may remain high for a prolonged period of time. Several indicators are indeed suggestive of higher unemployment persistence.[3] First, permanent lay-offs – as opposed to temporary ones – have increased sharply during this recession, much more so than in the earlier recessions of the 1970s and 1980s which were followed by strong job growth during the recovery phase (see Chart B). Second, the average duration of unemployment reached 31.2 weeks in March – a historical high since records began in 1948. High unemployment duration could lead to a loss of skills, thus causing hysteresis effects, although historically hysteresis has not been very important for US unemployment, in particular in comparison with European countries.[4]

Chart B US unemployment rate and lay-offs

(percentage of labour force)



Sources: Bureau of Labor Statistics and NBER.
Note: "Temporary lay-offs" refers to individuals who have lost their job, but been given a date to return to work or expect to return within six months. "Permanent lay-offs" refers to those whose employment ended involuntarily and who began looking for work. The difference between total unemployment and temporary/non-temporary lay-offs is explained by job leavers, re-entrants and new entrants. The shaded areas refer to recessions.

The role of "just-in-time" employment practices

Past jobless recoveries were also characterised by a high recourse by employers to temporary and part-time workers as well as overtime work – during and after the recession – to increase the flexibility in their workforce. This option of just-in-time employment reduces the need to hire workers in anticipation of stronger future demand, as firms can wait until demand actually materialises and quickly adjust labour hours.

Just-in-time employment practices also seem to have played a role in this episode. First, in the early stages of the recovery, part-time employment for economic reasons (i.e. the number of individuals working part-time because full-time work was not available) rose significantly. Second, overtime hours declined sharply during the recent downturn and have only recently begun to rebound. Both developments reveal an increasing use of the adjustment of hours, rather than employment, at least in the early stages of the recovery. While these practices do not imply

2 For an analysis of the structural factors that have contributed to the jobless recovery of the early 2000s, see E. Groshen and S. Potter, "Has structural change contributed to a jobless recovery?", *Current Issues in Economics and Finance*, Vol. 9 (8), Federal Reserve Bank of New York, 2003.

3 Other factors, however, may also explain increased unemployment persistence, including the length of the downturn, the policy measures that have extended the duration of unemployment benefits during the crisis and a possible reduction in labour mobility within the United States (arising from the fact that the housing downturn has left many US homeowners with negative equity).

4 See J. Roberts and N. Morin, "Is hysteresis important for US unemployment?", *The Federal Reserve Board Finance and Economics Discussion Series*, No 1999-56, 1999.

that the recovery in employment will, overall, be weaker than usual, they tend to delay the upturn in full-time employment.

Conclusion

To summarise, the recovery in the US labour market could possibly resemble the recoveries of the early 1990s or 2000s in that it could occur later and be more subdued than in the other US post-war episodes. Important characteristics of past jobless recoveries – a weak upturn in activity as well as structural changes and the use of just-in-time employment practices – appear to also be present in the current episode.