The Alarming State of the Job Market

Interview with James Medoff

This Harvard labor economist sees no quick turnaround in the economy. Animal spirits will not be revived under President Bush, he says. And the sagging jobs market is the best indication of how weak the economy really is. He thinks current policies are exactly the wrong prescription for what ails us.

Q This has been an unusual economic recovery. Only recently did the National Bureau of Economic Research finally state that the recovery ended in 2001, because we have continued to lose so many jobs. What do you make of the current state of the economy?

A. The current state of the economy is quite poor, and I use the word "quite" in front of poor because of my focus on the labor market more than on any other aspect of the economy.

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Challenge, vol. 46, no. 5, September/October 2003, pp. 5–14.

ISSN 0577–5132 / 2003 $9.50 + 0.00.

Q. How bad is the labor market, given that the gross domestic product [GDP] has been rising, if modestly?

A. The labor market is in a disastrous condition if you focus on indicators other than the unemployment rate. Keep in mind that the unemployment rate is a bad measure of the true state of the labor market. That is because the numerator—the number of people without jobs who are actively looking for jobs—is divided by the labor force—the number of people in the labor force who would like to work or are working. And that number, the bottom number, is in fact a cyclically sensitive variable. That number goes up when the economy improves. More people start looking for jobs. That number goes down when the number of people looking for work goes down because more and more people are what we call "discouraged workers." So the worst thing you could have is a metric that is itself conditioned by the state of the economy, particularly by the business cycle, and that is what we do have.

Q On what would you prefer to focus?

A. The employment report that comes out monthly also includes the change in payroll employment. So we should focus on two numbers. One is the unemployment rate, which I do not like because it is derived from what is called the household survey—that is, a survey of a sample of families, in which one person (husband or wife who is not working and is at home) answers all the questions for everyone in the family. I prefer the payroll survey, as do many economists. I like it because it is a survey of establishments. They know how many people they have hired, and how many people they currently employ. I am comfortable looking at what is happening to the payroll employment. In fact, I take the change in payroll employment as the most important monthly statistic of any kind that comes out in this country.

Q And what is it telling us these days?

A. What it is telling us is quite bad. It has been declining. It shows 2 to 3 million fewer jobs than in 2001. And further, as an index I have computed shows, not only have we been losing jobs, but we also have a lower quality of jobs. My prep school football coach told us at the halftime of a game in which we were getting our butts kicked, "Remember, you guys may be small, but you're slow." That is true of the current economy. We are losing not just jobs, but the very ones we most need to recover.

Q. So the situation is not good in terms of wages and benefits?

A. If you talk to those who have lost jobs, they say that they have real problems in getting back the pension and health-care benefits they had in their previous job. They are much more likely to come close to their old wage than to their former level of benefits. Now, all of this is occurring in a period where we have a diminishment of unionization, and we have an administration that is, one way or another, doing everything it can do to encourage the disappearance of unions. Everyone talks about the union-wage effect, but ultimately the most important influence of unions was on fringe benefits. If you look historically at what unions did, they affected wages less than fringe benefits. The fact that we have such good fringe benefits in the United States was greatly determined by the power of trade unions in the 1930s, 1940s, and 1950s.

Q That is being reversed now?

A. It is definitely being reversed.

Q. And you attribute that to the weakness—the reduced power—of labor unions now?

A. Labor unions have much less power now than they did before. That reflects a number of factors. First, management opposition is extremely high in both a legal and an illegal form. The National Labor Relations Act includes certain rules on how management is supposed to conduct itself during an organizing drive and a unionization effort in its workplace. If you look at the statistics, management does not even come close to abiding by these rules.

The second point is that unions are less popular with the public than they once were, for a number of reasons. That has come about because there is a lot of effort by management and groups like the National Federation of Independent Businesses, the lobbyists of various small business groups primarily, to denigrate labor unions. The other thing is that if unions lose political prowess, they appear less necessary in the eyes of the working class, which believes government already serves the needs of the workers. Because of unions, we have laws like ERISA [Employee Retirement Income Security Act], dealing with pensions, and OSHA [Occupational Safety and Health Administration], dealing with safety and health at the workplace. It appears as if the government is taking care of things. But this is true only because unions were once so powerful. It is amazing to me, and some day the story will be written, how George W. Bush has emasculated the labor movement. He does it in subtle ways—for instance, homeland security. We were going to have more well-trained people at the airports, and so on. What the Bush administration did was to say that, yes, we want more of those people, but they cannot be unionized. Can you imagine that?

Q Is all this causing the current lack of job growth?

A. No. The lack of job growth in the current economy is being caused to a great extent by not having the investment necessary to spur job growth. Now, remember, an administration that is doing its job will not just give money back to its rich friends but will try to increase aggregate demand. The two main vehicles for doing that are investment and government spending. That is what any good liberal economist—and I think any good economist, no matter what his or her politics—would advise. The easiest source for an increase in aggregate demand is government. So think about this: Where do you think you get more bang for the buck? A buck that is used to do more in state and local expenditure or, even more, federal expenditure, or a buck due to a cut in the capital gains tax? The buck from capital gains cuts gets lost there. Our research has found that in terms of both the quantity and quality of jobs, the bang for the buck is much bigger from government expenditures.

Q What do you mean by "bang for the buck," more explicitly? How do you define quality?

A. Quality is compensation per year on a job, including wages and fringe benefits. So it is a monetary bang for the buck, not who goes to a great place to work. The area with the lowest bang for the buck in relative terms is personal consumption. And that would come from your cutting taxes. You get much higher bang for the buck if you stimulate investment or government expenditures, be they state and local, or even federal, even defense, because defense expenditures do not create a lot of new jobs, but do create high-quality jobs.

Q Your data also show, according to that score you developed of quantity times quality of work, that education and health expenditures by the government have a still higher score than defense. Why is that?

A. These expenditures produce a lot of jobs and, on average, compared to other areas, the jobs are pretty good. Capital spending produces still better jobs but not as many of them. When you combine the two factors, numbers and quality, government expenditures in many areas are conducive to job growth. The federal government can influence the economy through monetary policy or fiscal policy. But the Federal Reserve can only go so far. There have been quite a few cover stories about Alan Greenspan and what he has done for the economy, and I personally like Alan very much, but I do not think monetary policy can do a lot to make things better in the economy right now. I am much more confident in fiscal policy, meaning I am much more into government expenditures and government tax policy. And which are the best expenditures? Investment is incredible—good compared to consumption. Now how do you get people to invest? That comes about when people have animal spirits. So when they think they are going to get their money back, they invest. If they do not think they are going to get it back, they do not invest.

How do you get people to invest? That comes about when people have animal spirits.

A government can play some role in the cultivation of animal spirits. Despite what is going on with President Bush, no one I know of on Wall Street thinks animal spirits are to be seen anywhere. People do not have confidence in Bush's keeping this economy afloat, and they do not want to invest in something that is going to pay off in the next thirty years. The other thing that a government can do is enact policies that will stimulate capital investment directly. Think about it for a minute. These policies do not include cutting the capital gains tax rate because that merely means that people who own property are going to get a windfall. It is not an efficient way to inspire them to invest more. An investment tax credit would be much more effective. I would prefer to reward people who will invest in plant and equipment. As for dividend tax cuts, to me they are the same thing as rewarding people for the money they had in the past. That is not going to stimulate investment now.

If you go into the debate about what causes more investment, I would side less with those who think it is the interest rate and more with those who think it is demand for goods and services.

Q. Would they not argue that because of the reduced taxes on rewards—on returns—people will invest more? You are saying that is low bang for the buck. There are better ways to encourage investment.

A. Yes. When you are using tax dollars, you should go as directly to the expenditure as you possibly can.

Q. What about the Keynesian argument that it is demand for goods and services that induces investment? Demand for a company's product?

A. I agree with that. However, as I said earlier, I do not believe that monetary policy is as important as fiscal policy. So I am saying that if you go into the debate about what causes more investment, I would side less with those who think it is the interest rate and more with those who think it is demand for goods and services. I would prefer to have more consumption than less, absolutely. So I am not against consumption. But let us not have that be the only thing that we get more of. That is why I got involved in researching how jobs are best created. Not only do I want to know about aggregate demand, I also want to know how to do it in the way that will best create jobs.

Q. Let us get back to the smart stimulus idea. What kind of stimulus package would you propose now if we could wipe the slate clean?

A. I want to favor new investment on plant and equipment, and I will reward that—however you want to do it. An investment tax credit is good.

Q. And what about government spending?

A. I would want to make sure ultimately that the state and local government have the money that they need to spend and that the federal government has the money it needs to spend. And the alternative to both of those expenditures is cutting taxes, so I am being Keynesian. I am saying you can either increase government expenditures at the state and local and federal level, or you can cut taxes. But cutting taxes is not as good. And it is all about politics. But if you were cutting taxes, the job scores we compute would be much higher if they were directed at the poor. If you are making expenditures that help the poor—in areas like health care—those I would favor. So I am not saying anything profound, and I am sure you would vote the same way. But when we are talking about job creation, the quantity and quality of jobs, that is a whole different story. What brought me to the story was the need to think about a bit more than just the direct effects of government programs. Everyone knew that state and local health expenditures were probably good for the poor. But you also need policies to make sure the benefits get to them. Sometimes the states do not come through on that.

Q. Does low-income spending usually create more jobs? We started with the idea: How do we create jobs in this economy? In the end, is it capital investment that is best?

A. The answer is that if you want to create more jobs, you do best by having investment. The most important fact for your story is that even though investment represents only 15 percent of GDP, it represents two-thirds of a percentage change. That is important. If you really want to reverse this downturn, you have to have investment, and that means you have to have animal spirits, you have to make people feel that they want to invest. Cutting the capital gains tax will not rekindle these spirits.

Q You did some work to update this analysis of the number and quality of jobs. How have these indicators fared under the Bush administration?

A. They are both the worst during the Bush "II" years. They declined on an annual basis somewhat on both indicators during the first Bush administration ten years ago. The better numbers were under Clinton. It is not a big headline story to say that the labor market was much better under Clinton than it was under either of the Bushes, but that is what the facts show. There were improvements in the quantity and quality of jobs.

Q. The labor market was not that great under Clinton either, over eight full years.

A. That is right. That is why ultimately I am a Keynesian. I come back to your view on aggregate demand—aggregate demand was really higher in the 1960s, and that helped jobs. The job market was strong then, hotter in the sense that most jobs were high quality. The tightest labor market that we had in this country was under Jimmy Carter in 1978, when there was incredibly strong aggregate demand. So, is demand important? Yes, I am saying the strongest labor market was when the aggregate demand was strongest.

Q. The reason you are bringing up that example is you are saying aggregate demand works?

A. That is right.

Q. What is your outlook for the economy? Do you have an outlook, at least in general terms?

A. What I would say to my Wall Street friends is I am still a secular bear, which means I think the economy is in bad shape. I also think that it is going to be like this not for a number of weeks, but for a number of years.

Q. Is that because we did too much capital investment in the late 1990s?

A. As I said before, the only way that we are going to get out of this is if, in fact, there is some investment, and I just do not see any animal spirits. I also think it is difficult to know what would rekindle animal spirits.

Q. Under the Bush administration, you do not seem to think that is likely?

A. No way.

Q. He is just not inspiring the confidence?

A. What we need in our economy is not a movement along a demand curve for loanable funds, which comes from a reduction in real interest rates. What we need is an outward shift in this and other final demand curves (representing investment or government spending or durables consumption). These shifts are most unlikely when "animal spirits" are not to be found and less likely if we choose tax cuts as opposed to "smart" government expenditures.