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THE ECONOMIC RESEARCH ORGANIZATION
AT THE UNIVERSITY OF HAWAI'I

UHERO BRIEF

The Lag in Employment Recovery

JUNE 2, 2011

While US real GDP bottomed out in the second quarter of 2009 and is now back at its pre-recession level, non-farm payrolls only started picking up at the beginning of 2010, and they remain far below their previous peak. What explains the existence of this lag?

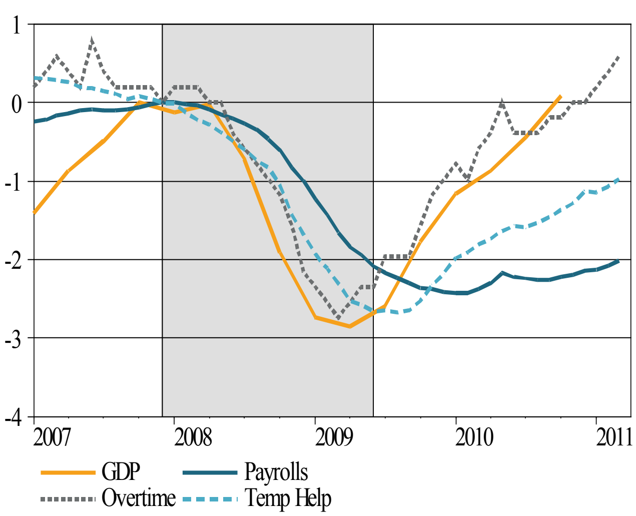
During downturns it is natural for employers to strive for higher productivity. Firms typically reorganize their job assignments after layoffs and discover that the same work can be performed with fewer workers. With increased productivity, the demand for labor coming out of a recession will be smaller than the amount of labor lost going in, which will delay the recovery of employment relative to output.

If there are substantial training costs, firms may retain most of their skilled workers during a downturn to avoid the cost of training new hires once the recession is over. Therefore, hiring for specialized jobs will not begin until the existing employees are fully utilized. In contrast, the demand for unskilled positions tends to exhibit a much stronger cyclical behavior. Frequently these positions are filled by temporary workers, which enables firms to quickly and cheaply adjust to fluctuations in demand. Before committing to hiring new people, firms usually want to make sure that any observed improvement in business conditions is not a false signal. To bridge the period of uncertain recovery, firms take advantage of overtime of existing workers and hiring temporary labor. Such just-in-time employment practices let firms fill orders and at the same time delay hiring permanent employees.

At the beginning of an upturn, employment recovery is mainly limited by the lack of labor demand, but it may also be impeded by factors affecting labor supply. Some of the sectors that were hit hardest in the current recession, such as construction, have still not recovered. This introduces a skill mismatch—a situation when skills of job seekers do not match the requirements of available jobs, such as in healthcare. In addition, many people now owe more on their homes than their homes are worth. Because of the difficulty or cost of selling their homes, job seekers may be unwilling to accept employment available in other locations. Finally, extended unemployment insurance benefits may act as a disincentive to accept a job, especially if the prospective job pays less than the one lost.

The US economy is generally a great job creator, although the depth and length of the recent recession pose particular challenges. We need continued employment growth in the 200,000-per-month range in order to bring down the national unemployment rate appreciably. We expect an improvement in Hawaii labor market conditions to begin once the local recovery picks up steam.

-Peter Fuleky



RELATIVE MOVEMENT IN KEY US INDICATORS (DEC. 2007=0)

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