The Economist

FLUID DYNAMICS

America's famously flexible labour market is becoming less so

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At first glance, the labour markets in America and Europe could not be more different: in the former unemployment has fallen steadily since 2010, while in the euro zone, it is still close to an all-time high. Not surprisingly, Janet Yellen, the chairman of the Federal Reserve, and Mario Draghi, the president of the European Central Bank, struck very different notes at an annual economic conference held in Jackson Hole, Wyoming, in late August. Ms Yellen made it clear the Fed is debating how close the economy is to full employment and thus how soon rates, currently near zero, should rise. Mr Draghi, in contrast, hinted that more measures to stimulate the European economy are in the offing.

Yet Ms Yellen, Mr Draghi and many other central bankers at the conference share a common concern: their labour markets are bifurcating into secure, predominantly skilled jobs on the one hand and insecure, mostly unskilled work on the other. The fear is that the split is due to inflexible labour markets that make it hard to climb up the job ladder.

Historically, Europe and Japan have suffered more from inflexible labour markets. In Spain, for example, centralised wage bargaining and other protections for workers made it difficult for employers to sack permanent employees or cut their wages (these rules were recently eased). Instead, firms hired armies of temporary workers, who bore the brunt of the massive job losses that began in 2007. Similarly, the prevailing system of "lifetime" employment made it hard to reduce labour costs when deflation ate into Japanese firms' profits. They have responded by making ever greater use of part-time workers with few protections.

America, by contrast, is a model of flexibility as millions of workers quit, or are sacked, each month and millions more are hired in a continuous process of job creation and destruction. But that picture may be incomplete. As Steven Davis of the University of Chicago and John Haltiwanger of the University of Maryland showed in a paper presented in Jackson Hole, American job markets have become less dynamic.*

The paper refers to workers' movement in and out of jobs as "fluidity". It has two sources. One is "job reallocation" which occurs when a shrinking or bankrupt firm sheds workers, or a new or expanding firm hires them. Job reallocation has steadily shrunk since the early 1980s. The other is "churn", the normal business of hiring, quitting, retiring and firing, unrelated to whether a firm is growing or shrinking. Churn is much more cyclical: it fell sharply during the recession, and has barely recovered. The overall turnover of workers, including reallocation and churn, declined from 33.5% of the workforce each quarter in 1999 to 24.1% in 2010, and has since recovered only slightly (see chart).

Some of this may be down to structural changes in the economy. Fewer new businesses, a big source of newly created jobs, are being born. In some industries, big companies such as Walmart, where people tend to work longer, are taking market share from mom-and-pop operations. On-the-job training has also expanded, which requires a more lasting commitment between employee and employer.

Grounded by background checks

But less benign forces are also at work. The spread of occupational licensing, for everything from horse massage to hair braiding, has raised barriers to entry for occupations that once required little or no training. American employers used to be free to sack workers more or less as they pleased, but that "employment at will" doctrine has been eroded somewhat by court decisions that have established an implicit contract between employee and employer. That makes firms less likely to fire people, and therefore to hire them. The authors also finger the information revolution: a job applicant these days could be undone by a criminal record, a poor credit history or even an impolitic Facebook posting, all of which are easy to find online. This, they speculate, has led to more exacting hiring and "less use of trial employment arrangements".

Mr Davis and Mr Haltiwanger find that fluidity has fallen most for the young and least educated. This, they reckon, makes it harder for them to move to better jobs, change careers or win pay rises. For the unemployed, job opportunities come along less often, so jobless spells lengthen and human capital depreciates.

All this, they hypothesise, could explain why the employment rate (the share of the population with jobs) has fallen so much for less educated men in recent decades. They use a variety of statistical tests to conclude that a percentage-point drop in the turnover of workers reduces the proportion of men under 25 without a high school diploma in work by 1.4 percentage points.

Some economists at Jackson Hole found the statistical tests unconvincing. Richard Rogerson of Princeton University noted that the period over which turnover fell, from the early 1980s to the mid-2000s, coincided with a rise in the share of the population that worked. He also noted that higher turnover should lead to increased productivity as workers find better matches; but as turnover fell during the late 1990s, productivity jumped.

Given these uncertainties, policymakers should not try to increase turnover for its own sake, but rather remove artificial barriers that trap workers in poorly paid, insecure jobs. In 2012 Spain overhauled its labour laws so that permanent employees could more easily be fired. A preliminary analysis by the OECD, a club of mostly rich countries, suggests this has led to more hiring of permanent workers. In America, Obamacare could improve fluidity by making it easier for employees to change jobs without losing health insurance. But it could also expand the ranks of part-time workers by requiring employers to provide insurance only for full-time ones. That is something America's bifurcating job market could do without.

* "Labor Market Fluidity and Economic Performance," conference draft, August 2014.