Labor Policy and the Great Recession: An Economist's Perspective

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I begin with a disclaimer: I am not a lawyer. I am an economist—one who specializes in economic history and labor economics. I have been assured that an economist is what is wanted in this particular discussant slot. Still, as an outsider, I apologize in advance for my innocence of legal scholarship and perhaps also for my innocence of the folkways and etiquette of your tribe.

I also begin with a thank you. I am grateful to be included in a conference where I have an opportunity to learn so much. When I was an undergraduate, my career goal was to be a lawyer—a lawyer who specialized in labor law. My ambition came in part from my background—I am the child of the industrial working class. My father worked in a steel mill, my mother worked in a meat-packing plant, my uncles all worked in coal mines or steel mills, and I grew up in the union hall. In college I found economics and took a turn away from the law. I replaced a passion for labor law with a passion for labor economics. This conference gives me a chance to see a bit of what I missed along the road not taken.

I am struck by the question mark at the end of the title of the conference, *A Time for Hope and Change?*, and at the end of the title of this session, *Can Obama Bail Out Workers?* Indeed, those question marks are substantially more profound after the recent elections. As I understand the purpose of this first session, we are to focus on the economic landscape within which the possible (or hoped-for) change in labor conditions or employment law or both might take place under the Obama administration.

Professor Flanagan gives us a primer on the economic analysis relevant to the labor market, organized sensibly around two issues: (1) the level of aggregate employment; and (2) the distribution of welfare—earnings and employment.[1] To use the hackneyed metaphor, Flanagan looks at the size of the pie and how it is sliced up. Like any good primer, Flanagan's is clear, concise, and teacherly. And like any good *economics* primer, the focus is on trade-offs. The simple insight at the center of all economic analysis is opportunity cost—in order to get something of value it is necessary to give up something else of value. That is, you can't have it all. Economists are called dismal scientists for a good reason.

Flanagan begins with the great macroeconomic trade-off at the center of the Keynesian model: policies that reduce unemployment put upward pressure on the price level—that is, they lead to inflation.[2] He even introduces us to the nonaccelerating inflation rate of unemployment (NAIRU).[3] Clearly the overwhelming problem in the American economy now is the stubbornly high rate of unemployment, which was stuck in October 2010 at 9.7% of the labor force—

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1. Robert J. Flanagan, *Labor Policy in the Great Recession*, 87 IND. L.J. 43 (2012).

2. *Id.* at 46.

3. *Id.* at 45 (citing ANDREW B. ABEL, BEN S. BERNANKE & DEAN CROUSHORE, MACROECONOMICS 445–77 (6th ed. 2009)).

not much reduced from its high of 10.1% in October 2009.[4] In the United States, we are well above NAIRU, and most (but not all) economists and bankers have stopped worrying about inflation.[5]

Economists commonly divide unemployment into three types:

(1) frictional unemployment: some degree of which is always present because it takes time for people to be matched to jobs. NAIRU reflects frictional unemployment;[6]

(2) structural unemployment: comes from a disconnect between the characteristics of workers (e.g., their skills and location) and the characteristics that employers demand;[7]

(3) cyclical unemployment: comes from weak aggregate demand associated with a downswing in the business cycle. The Great Recession is mostly about cyclical unemployment, though you can get arguments from people who see structural problems in the current situation.[8]

Policies to combat cyclical unemployment come in two flavors: (1) deficit-financed fiscal policy (increased government spending and lower government revenues) which necessarily leads to higher government deficits (Flanagan's second trade-off); and (2) monetary policy (adjusting the quantity of money to lower interest rates).[9]

That fiscal policy must necessarily lead to larger government deficits was stressed by John Maynard Keynes in an open letter to President Franklin Delano Roosevelt on December 31, 1933:

> Thus, as the prime mover in the first stage of the technique of recovery, I lay overwhelming emphasis on the increase of national purchasing power resulting from governmental expenditure which is financed by loans and is not merely a transfer through taxation, from existing incomes. Nothing else counts in comparison with this.[10]

Standard monetary policy focuses on short-term interest rates, but in the current Great Recession, aggressive monetary policy, operated by the Federal Reserve, lowered short-term interest rates to essentially zero by the end of 2008 without

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4. *Labor Force Statistics from the Current Population Survey*, BUREAU OF LABOR STATISTICS, http://data.bls.gov/timeseries/LNS14000000.

5. For example, in his June 22, 2011 press conference, Federal Reserve Chairman Ben Bernanke referred to a "subdued outlook for inflation in the medium run" and projected longer-run inflation of at or below 2%, which is well within the Fed's target range for inflation. Ben Bernanke, Chairman, U.S. Fed. Reserve, Press Conference (June 22, 2011) (transcript available at www.federalreserve.gov/mediacenter/files/FOMCpresconf2011 0622.pdf).

6. RONALD G. EHRENBERG & ROBERT S. SMITH, MODERN LABOR ECONOMICS: THEORY AND PUBLIC POLICY 503–04 (10th ed. 2009).

7. *Id.* at 510.

8. *Id.* at 516–17.

9. ANDREW B. ABEL, BEN S. BERNANKE & DEAN CROUSHORE, MACROECONOMICS 412–19 (6th ed. 2009).

10. John Maynard Keynes, *From Keynes to Roosevelt: Our Recovery Plan Assayed*, N.Y. TIMES, Dec. 31, 1933, at 2.

producing much recovery. With the recent rejection of fiscal policy by the American electorate and the fact that the Fed has exhausted its options on short-term rates, the Fed is now valiantly (or maybe foolishly) trying to reduce long-term rates through bond purchases (confusingly called quantitative easing).

As Flanagan points out, the Obama administration has focused its attention on trying to increase aggregate output and employment through macroeconomic policy, and has not much pursued an active program of labor-market regulation or legal reform.[11] Under the dire economic conditions we currently face, this emphasis on trying to goose the aggregate economy is understandable. It would not, however, be accurate to conclude that the Obama administration has been unconcerned with distributional issues. Health care reform, how much of the Bush tax cuts to keep, what to do about estate taxes, credit card reforms, consumer protection, mortgage market policies, and even financial sector regulation are all deeply distributional—though they are not labor and employment law. In Professor Golden's paper we also learn about distributional proposals coming out of the White House Task Force on Middle Class Working Families chaired by Vice President Biden.[12]

Let's look at three questions raised by Flanagan that focus directly on labor market policies.

Question 1: Do specific labor market policies reduce aggregate unemployment?

After introducing us to the NAIRU, which mostly reflects frictions in labor markets, Flanagan provides a useful discussion of whether active labor market programs (ALMPs) can lower the NAIRU.[13] Sweden has led the way in policies designed to provide information and training and to subsidize mobility, arguing that such policies would reduce NAIRU.[14] By contrast, the United States does very little of this. I learned from the Flanagan paper that a recent meta-analysis led by the well-regarded economist David Card finds mixed results from such policies, with job-search-assistance programs having the biggest impact.[15] We might all hope for the day when the United States is close enough to the NAIRU to want to engage in policies designed to lower it.

Question 2: Where does the power lie in the labor market?

Flanagan reminds us that the outcome of the wage and working conditions bargain depends on the relative power of the suppliers and the demanders of labor.[16] Workers will do better if there are lots of employers clamoring for their services, and employers will do better if there are lots of workers clamoring for their jobs. Anything that reduces competition among employers for workers' services increases their power (called monopsony power[17]). Flanagan reports that last September, an antitrust settlement by the Justice Department reduced

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11. Flanagan, *supra* note 1, at 44, 57.

12. Lonnie Golden, *Becoming Too Small to Bail? Prospects for Workers in the 2011 Economy and 112th Congress*, 87 IND. L.J. 11 (2012).

13. Flanagan, *supra* note 1, at 47–48.

14. *Id.* at 46–47.

15. *Id.* at 47–48 (citing David Card, Jochen Kluve & Andrea Weber, *Active Labour Market Policy Evaluations: A Meta-Analysis*, 120 ECON. J. F452, F453 (2010)).

16. *Id.* at 51.

17. JOHN BLACK, A DICTIONARY OF ECONOMICS 308 (1997).

monopsony power of Silicon Valley firms that had agreed not to recruit workers from other firms in the industry.[18] Score one for greater competition!

Question 3: What explains the stunning rise in productivity we have seen in the midst of the Great Recession?

According to the National Bureau of Economic Research, the trough of the Great Recession occurred in June of 2009, and, even though the economy has now been heading up for sixteen months, unemployment has fallen very little. That total output (gross domestic product) has been growing without much increase in labor input usage (employment) means that output per unit of labor has increased. In general, we cheer for productivity growth, but in this case we worry because we are not getting the decline in unemployment we desire.

Thinking about these last two issues, the relative bargaining power on the two sides of the labor market and the recent rise in productivity, leads me to some questions about interactions between the Great Recession and labor policies. These are questions that arose from thinking about both Professor Flanagan's paper and Professor Golden's paper.

The higher productivity we see suggests that workers who do have jobs are working harder (and longer) in the high unemployment economy. It makes sense that under conditions of high unemployment (abundant labor supply), the balance of power in the labor market shifts in favor of employers. The effect on the wage is straightforward. Even if the nominal wage per hour does not fall, the implicit piece wage does fall because labor cost per unit of output declines. However, there are likely to be impacts beyond the wage. In the midst of a high unemployment economy, workers who still have jobs are more worried about losing them, and unemployed workers are more anxious to find jobs. Under such conditions of heightened anxiety I expect that workers are less vigilant about possible deterioration of working conditions (e.g., safety, pace of work, hours, and perks) and that employers may be more likely to violate rules (e.g., safety or overtime). We might also see that the higher relative power on the demand side of the labor market increases employers' ability to choose workers they prefer on non-productivity grounds—that is, there may be a rise in favoritism and discrimination. All this suggests to me that enforcement of labor law and regulations may be even more important during periods of high unemployment and that a conference like this one is particularly valuable now.

Professor Golden has written a *big* paper. In the first half of his paper, he too provides a useful primer—focused on the empirical side and a nice complement to Professor Flanagan's review of theory.[19] Golden pulls together the facts and presents them in a series of graphs and tables that show us details of the unemployment situation in the Great Recession and what has happened to compensation and the distribution of income.[20] He shows the long-term downward trend in labor's share of total compensation and the recent spike in productivity.[21] It is a bounty of data, and I suspect that all of us will be grateful to print out this paper

18. *See generally* Competitive Impact Statement, United States. v. Adobe Systems, Inc., No. 1:10-cv-01629 (D.D.C. Sept. 24, 2010).

19. Golden, *supra* note 12.

20. *Id.* at 14–26.

21. *Id.*

and have these facts nicely pulled together in one place. He then goes on to consider a dizzying variety of policies (taxes, education, regulation, health insurance, family-flexibility, gender equity, and work sharing) and finishes with a list of proposed legislation.[22]

I'm going to pick out just one from his list to focus on—education, and I want to recommend to you a wonderful book that looks deeply at the question of what determines the size and distribution of the pie: *The Race Between Education and Technology* by Claudia Goldin and Lawrence F. Katz.[23] Underlying long-run economic growth is education—no surprise there. But you might be surprised at the link between education and changes in distribution. Goldin and Katz show that *greater equality* in the mid-twentieth century was associated with rapid increases in the supply of educated workers, which lowered their relative wage.[24] The widening income distribution since the 1970s is associated with *attenuated growth* in education so that the supply of educated workers has risen more slowly than the demand for educated workers, which increases their relative scarcity and therefore their compensation.[25] I leave you with an assertion. If the Obama administration is to deliver hope and change to bail out workers, the most important thing it can do is invest in education.

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22. *Id.* at 26–42.
23. CLAUDIA GOLDIN & LAWRENCE F. KATZ, THE RACE BETWEEN EDUCATION AND TECHNOLOGY 320–323 (2008).
24. *Id.*
25. *Id.*