

Internationale Arbeitsmarktkonferenz

## **Wege zu mehr Beschäftigung**

International labour market conference

## **Ways and means of increasing employment**

5. September 2000  
Hannover (Expo 2000)

Richard B. Freeman

### **Gold or Porzellan?**

### **The American Alchemists' Formula for Full Employment**



Institut für Arbeitsmarkt- und Berufsforschung

Richard B. Freeman  
(Harvard University and NBER, Cambridge/Mass.,  
London School of Economics)

## **Gold or Porzellan? The American Alchemists' Formula for Full Employment**

„If Germany and Japan can grow as fast as America even when their incentives are blunted by an inflexible model, imagine what they might do were their economies to be set free“ (Economist, 10 April, 1999, p 10).

Full employment has become the measuring rod for economic success among advanced capitalist countries. In 2000 the unemployment rate in the US fell below 4 percent – lower than in Japan or Germany or other European Union countries, making the American economy the envy of the world. Full employment has been accompanied by other economic successes: a huge federal budget surplus, declines in crime, a booming stock market, healthy growth of productivity, the integration of welfare mothers into work. The late 1990s full employment boom has led many to believe that the US has found the magic formula for economic success in the new Millennium, achieving what I have elsewhere called „peak economy status“ (Freeman, 2000).

The claim that the US has become the peak advanced economy, whose institutions and policies merit emulation by others, is relatively recent. In the 1960s some analysts saw French indicative planning as the best way to steer a capitalist economy. In the 1970s, many looked at corporatism, Scandinavian-style, as offering the best system for responding to the oil shocks, with Austria and Germany also seen as successful corporatist models. In the 1980s Japanese economic performance made it „number 1“ to some; while Germany's successes led analysts to extol the virtues of Rhineland capitalism, with its purportedly longer time investment horizons. The early Clinton Administration sought to bring a national health care system to the US and looked enviously at German apprenticeships. In the „war of the models“ observers extolled whichever country was doing better in a given period as having the right economic institutions and policies – the alchemists' formula of the title – and called upon other countries to emulate them, vide the Economist quote above.

In this paper I consider critically the claim that the top-performing economy in a given period has indeed found the magic formula for economic success. Then I examine the factors that underlie the full employment record of the 1990s top performing economy, the US. I dismiss five widely held beliefs about job creation in the US as myths and lay out what in fact has helped the US attain full employment and develop a New Economy for the 21<sup>st</sup> century.

### **1 Interpreting Economic Success**

That the US is doing things right in the 1990s seems self-evident, much as it was self-evident that Japan or Germany were doing things right a decade or so ago, or that Sweden and other corporatist economies had found a successful „third way“ two decades or so ago.

How should one interpret the economic success of particular countries in different time periods?

There are three possible ways to read the evidence.

First, it may be that the country with superior economic performance has indeed found the magic formula for success, much as capitalism has proven superior to centralized planning. Perhaps a particular set of capitalist institutions and policies – flexible deregulated markets, independent central banks, anti-inflationary policies, whatever – yield better outcomes in all economic situations. If US institutions and policies had produced lower unemployment than in other advanced countries over long periods of time, we might all agree that the US was the peak capitalist economy. But the US's superior employment record is largely a phenomenon of the 1990s, particularly the late 1990s, and as noted, the economy/economies that seem deserving of the peak label changes from decade to decade. The evidence does not support a „one model fits all economic environments“ view of capitalist institutions or economic policies.

Second, it may be that particular institutions are better adapted to some economic environments than others. Perhaps indicative planning and corporatist arrangements work best in an era of mass factory production but are ill-suited for an information-based economy; whereas high mobility and flexibility work better in that environment than in others. The notion that some economic institutions are better-suited for the New Economy of the 1990s-2000s than others while they were more poorly suited to the economy of the 1950s-1980s is a more subtle and demanding interpretation of economic history than the universal „X works best“ claim. It requires that we understand how different institutions function under different environments and how they adapt to changing circumstances, or learn from the changing world. If we are to draw policy lessons from current successes, this view also requires that the current environment maintain itself for some period of time. The evidence is consistent with an adaptationist interpretation, in part because this perspective affords us an additional degree of freedom with which to interpret events.

Third, we must allow for the possibility there is no real difference in the performance of capitalist institutions, and that observed variation in economic outcomes is largely a matter of luck, possibly coupled with some auto-correlated persistence. Runs of good performance occur by chance per random walk coin-flipping or Brownian motion, where there can be long periods in which the number of heads (or tails) will exceed zero. Many macro-economists believe that the US is doing well on employment because it enjoyed two positive economic shocks – reductions in health care costs and overvaluation of the dollar – that lowered the inflation associated with full employment, and that a reversal of these shocks will bring US unemployment back to „the natural“ rate, of 5-6 percent or so. The evidence does not rule out the „lucky break“ interpretation, but luck cannot be the whole story, for institutions and policies must allow a country to benefit from positive economic shocks. The experience of the oil countries proves that a positive shock can have adverse effects absent efficient open markets and policies.

In any case, let us accept the notion that some institutions and policies can contribute to full employment and economic success, at least in some economic environments. Accept also that the current economic environment will continue into the foreseeable future, so that there is policy value in understanding why the leading US economy has managed its greatest run of prosperity and low unemployment in decades. The question then becomes, which institutions or policies have contributed to this performance? Does the US economic success come from mixing in a cauldron venture capitalism, weak unions, high inequality, an influx of poorly educated immigrants, essence of Alan Greenspan, a few billionaires, filet of a fenny snake, Bill and Hillary, tax increases? Or does success come from some other combination of elements – divided government, an influx of highly educated immigrants, junk bonds, eye of newt and toe of frog, Bill and Monica, tax cuts, higher education?

The alchemy problem is that there are lots of possible factors that might enter the formula and not much pseudo-experimental variation to uncover which factors are critical. That the economy closest to the US in its institutions and policies, Canada, was the worst performer among advanced economies in the 1990s should caution us all that there is much mystery in the formula. Indeed, it is easier to debunk the role of some alleged factors in producing US economic success than to determine the right mix of factors, so I will begin with a debunking exercise.

## **2 What's Not in the Formula: four myths about US job creation**

*Myth 1. US job growth consists largely of low level fast-food type jobs, of which McDonald's is the archetype.*

Looking at the industrial composition of US jobs growth from the 1980s through the 1990s American job creation has been concentrated in services, particularly retail trade, which pays less than, say, manufacturing. And in the 1990s, when the US attained full employment, the retail trade share of employment has fallen. In 1990 17.9 percent of nonagricultural employment was in retail trade; in 1999, 17.7 percent of employment was in retail trade. Employment grew rapidly in the broad service sector, but services include many high-paying and skilled industries as well as low-paying and less skilled industries. Average hourly earnings for production workers in services was 48% higher than in retail trade in March 2000 and 1.5% above the national average (Monthly Labor Review, May 2000).

Looking at the occupational composition of US jobs growth, the McJobs story has never been true. In 1999 30 percent of the US work force was in managerial and professional specialties compared to 23 percent in 1983. While the growth of employment was bifurcated with fast growth at both the top and bottom of the skill and wage distributions, on net US employment was more skilled in 2000 than in 1990 or 1980.

*Myth 2. US job growth has come at the cost of falling real wages and productivity.*

From the 1970s through the mid 1990s, the real wages of American production workers fell while the real wages of workers in most OECD countries rose, suggesting that declining

wages accounts for US job growth relative to other countries. But examined closely, the trade-off claim loses its appeal. The wages of low skilled men fell absolutely and relative to the wages of more skilled men, but so too did the employment and hours worked of the low-skilled. Women, whose wages rose relative to men, increased employment. The 1980s reductions in the real minimum wage did not improve employment of low skilled youth, while the 1990s increases in the minimum did not reduce it. Comparisons of employment growth in Canada, France, and the US (Card, Lemieux, and Kramarz) or between Germany and the US (Freeman and Schettkat) also shows no clear relation across countries in the growth of employment among groups and in the pattern of wage changes. Finally, the move to full employment in the 1990s was associated with rising real wages for the low skilled.

The link between productivity growth and job growth is more complicated. Productivity grew less rapidly in the US than in other advanced OECD countries in the 1980s through mid-1990s, suggesting that the US paid for its employment expansion through slower productivity advance. But output per hour rose rapidly in the US during the late 1990s period of expanding employment, reducing inflationary pressures, and thus helping maintain the boom.

### *Myth 3. US job growth benefits from an unregulated labor market*

The view that the U.S. job market is largely unregulated is fallacious. The US has a considerable corpus of labor laws covering everything from hours worked to occupational health and safety to protection of minorities and women. In the 1990s Congress enacted new laws enhancing individual employee rights -- the Americans with Disabilities Act of 1990; Civil Rights Act of 1991; Family and Medical Leave Act of 1993. Most states adopted rules on wrongful dismissals that allow employees to sue for wrongful dismissal in court. Congress twice increased the minimum wage and rejected business efforts to modify the Fair Labor Standards Act that requires time and a half overtime and to ease „company union“ restrictions on employee involvement committees. Because the federal government has few regulators to monitor these laws, the main mode of enforcement has been through courts or by workers bringing complaints to agencies. Most large firms in the US face some court suit about employment practices every year. Firms have found the burden of employment law sufficiently large to lead many to seek private dispute resolution alternatives.

### *Myth 4 Virtual or short term temporary jobs have replaced permanent jobs in the US*

In the mid 1990s Fortune Magazine heralded the „end of the job“. The US was, the story ran, moving from permanent jobs to temporary work, in which firms put together teams for short periods to accomplish specific tasks much like Hollywood producers produce a movie. Employment in temporary help agencies has, in fact, risen greatly, and there is a growing internet-based industry of „e-working“, where employers contact employees over the web to undertake specific tasks. But the notion that this is not the world of work. Job tenure -- the number of years a worker is with an employer -- has been steady or risen modestly because women have more permanent attachments to work than in the past. Tenure has fallen for less skilled men, due to the decline in their job market opportunities, not a movement toward „on-line“ or virtual work. Indeed, the pattern among America's best firms is in the opposite

direction: toward employee stock options and other forms of financial revenue sharing and team-based decision-making that link workers to firms more tightly than in the past.

### **3. What's in the Formula: five facts about US job creation**

„Double, double toil and trouble, fire burn and cauldron bubble“

#### *Fact 1 Growth of Jobs for Women*

Perhaps the most important fact about US employment growth is that growth has been most pronounced among women. Had the employment to population ratio of US women increased from 1973 to 1997 by the same percentage points as did the employment-population ratio of EU women, the aggregate US employment to population rate would have been virtually constant at 65%. The biggest increase in female employment was among married women with young children. In 1996 the proportion of married women with children less than 6 who were working was 63.6 percent – which exceeds the proportion of all European women, including those without children, working. This occurred without national day-care facilities or with the state hiring a majority of women, as in some Nordic countries, or with labor laws that give parents paid leave or other benefits to ease the burden of child care. In addition, the position of women in the occupational hierarchy improved. In 1983 women were less likely to be in the high wage executive and professional occupations than men (22% of women versus 25% of men). In 1997 they were more likely to be in those occupations (28% for women versus 25% for men) (US Statistical Abstract 1998, table 672). In sum, *cherchez la femme* if you want the real lesson of US employment growth.

#### *Fact 2 Shared Capitalist Modes of Compensation*

During the 1980s and 1990s the US greatly increased the extent to which workers were paid through some form of financial sharing of company rewards. Dube and I (2000) estimate that by the mid-1990s about one-half of the US work force received compensation related to company performance. Approximately 25 percent of the private sector work force had a stake in their firm through some form of ownership – 8% had employee stock ownership plans; another 8% had an all-employee stock option plan, about 10% had a substantial proportion of their retirement funds invested in company stocks. while another 8% or so buy shares at a discount from the firm. A quarter of the work force was covered by profit or gain-sharing. In 1998 55 million workers were covered by a defined contribution private pension plan, giving them a stake in the performance of the economy outside their own firm. In principle, by making pay more variable, these modes of compensation should reduce the variability of employment. Perhaps more important, the shared modes of pay have been accompanied by increased worker decision-making through employee involvement programs and teams that should improve productivity.

#### *Fact 3 - Influx of immigrants*

The 1990s was a period of substantial immigration to the US. Of the 7.3 additional

million persons who obtained jobs from 1990 to 1997, nearly half (3.5 million or 48%) were immigrants who entered the country from 1990 to 1997 (comparable to the early 1900s). The immigrants have a bifurcated distribution of skills. Some, largely from Mexico and Latin America, tend to have levels of education far below those of Americans, and fill unskilled jobs at relatively low US wages, but at wages far above what they could make in their native country. Others, largely from Asia, Europe, and Canada, are highly skilled and contribute to the US higher education and high-tech sectors. Industry has pushed for special visas for some of these immigrants to alleviate alleged skill shortages. As immigrants have become increasingly important in science and engineering, the „best and brightest“ young Americans have moved into business careers. While we do not know the extent, if any, to which the influx of immigrants spurred US economic success in the 1990s, the influx has been a major part of the employment growth story.

#### *Fact 4. New Ventures and Bankruptcies*

Unlike in most EU countries, in the US it is relatively easy to form new ventures (even if they are not dot.coms) and it is relatively easy to go bankrupt and suffer no major stigma: if you are energetic and have a good idea, you can start up again. In the 1990s there were over 150,000 new business starts per year, and about half as many business failures (US Statistical Abstract, 1999, table 885). Between 1990 and 1998 the number of business bankruptcy cases averaged over 50,000 a year while the number of personal bankruptcies more than doubled to over 1.3 million. But perhaps the most important statistic is that venture capital commitments increased from 4 billion dollars in 1993 to 47 billion dollars in 1997. There was a veritable gold rush mentality in exploiting the new Internet and related IT and bio-technological advances.

#### *Fact 5 But the Boom Has Shaky Macro-Foundations.*

Who is the world's greatest debtor nation, with a massive trade deficit and huge level of personal debt to income among its citizenry? The US. In the midst of a great boom, it is easy to forget that fueling the US expansion is an increase in private domestic debt that cannot continue ad finitum accompanied by a trade deficit that also cannot continue ad finitum. Private net savings as a percent of disposable income in the US has fallen to negative 7% while borrowing has risen to 15% or so. The trade deficit reached 3% of GDP in 1999. The danger of a large and sudden devaluation of the U.S. dollar, leading to domestic inflation, higher interest rates and a slowing of the economy's growth rate is real. The danger of a deep recession and debt meltdown is real. If the US jobs boom depends ultimately on consumer spending in excess of income, it is not sustainable, and if the economy has a „hard landing“ in the next 2,3 or 4 years, we will all be comparing the 2000s fall of the US as the new economy wonder to the 1990s fall of Japan as numero uno in the economic world. The search will be on for a new peak economy.

#### **4. The 21<sup>st</sup> century Labor Market**

There is more to the 1990s US job market than full employment. Even if the US model proves frailer in sustaining full employment than many currently believe, there is still much to learn from how the US had adapted to the new world of technology and global capitalism.

Higher education is more closely linked to industry in the US than in most countries, and this has helped the US regain its leadership role in applying advanced technology to the economy, with consequences for employment and earnings. As the business opportunities have blossomed, top American students have chosen business careers in place of academic work.

The link between job seekers and firms has changed, with the Internet becoming a main link between demand and supply. Millions of employees have resumes on-line and employers list jobs at internet job sites and on their own web pages. Information about work and economic opportunities available on line is staggering, and promises to transform the labor market.

The US has also positioned itself to allocate labor to other important areas of scientific and technological progress. Bio-technology, including genetically modified food, which many in the EU deplore, and nano-technology have the potential to be the technological breakthroughs of the 21<sup>st</sup> century, with impacts on employment, productivity, and wages. The federal government has allocated half a billion dollars to research and development in this area. (National Science and Technology Council, 2000)

Finally, whatever institutions and policies produce full employment, the US experience in the late 1990s-2000 shows that full employment helps resolve all sorts of seemingly intractable social problems. Crime falls. Welfare mothers find jobs. The real wages of the low skilled rise. Teenage births fall. While full employment is not the sole factor that has turned US society around, it has contributed impressively to ameliorating many social problems.

Full employment – try it. You’ll like it.

## REFERENCES

Card, David, Tom Lemieux, and Francis Kramarz 1966 „Changes in the Relative Structure of Wages and Employment: A Comparison of the United States, Canada, and France“ NBER WP 5487, Cambridge Mass

Dube, Arindrajit Richard B. Freeman „Shared Compensation Systems and Decision-Making in the US Job Market“ [www.naalc.org/english/publications/seminar2000\\_main.htm](http://www.naalc.org/english/publications/seminar2000_main.htm)

The Economist

Freeman (2000) „Single Peaked Vs. Diversified Capitalism: The Relation Between Economic Institutions and Outcomes“ W7474 Feb 2000, Cambridge Mass

Freeman, R and Ronald Schettkat „Skill Compression, Wage Differentials and Employment: Germany vs. the US“ W7556 March 2000

Godley, W. 1999 „Seven Unsustainable Processes“ Special Report, Annandale-on-Hudson, Levy Institute



Monthly Labor Review, May 2000

National Science and Technology Council, National Nano-Technology Initiative  
<http://frederick.itri.loyola.edu/nano/IWGN.Implementation.Plan/nni.implementation.plan.pdf>

US Statistical Abstract 1998

US Statistical Abstract, 1999