



Puzzling through the Jobless Recovery -- Or Is It a Fundamental Shift?

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On March 5, the U.S. Labor Department announced that the U.S. economy had created only 21,000 new jobs in February. Not only was this far below the 150,000 that economists had predicted, it wasn't even enough to keep pace with the country's population growth. The unemployment rate held steady at 5.6%, but only because many people have given up on finding jobs.

The U.S. economy has been growing since the fourth quarter of 2001, yet few employers are hiring. In fact, the country has lost 2.2 million jobs since 2001. As an article in *The New York Times* recently noted, "At no other point since World War II has the economy grown for such a long period without adding jobs at a healthy pace."



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Economists and other employment experts are stumped. They offer a host of possible explanations – ranging from productivity gains and uncertainty surrounding the Iraq war to fundamental changes in how companies are run – but almost without exception they caution that their hypotheses are, at best, educated guesses. Ben S. Bernanke, a member of the Board of Governors of the Federal Reserve System, noted in a speech last November at Carnegie Mellon that he was somewhat stumped by what has come to be known as the “jobless recovery.”

One thing experts at Wharton agree on is that the phenomenon known as ‘offshoring’ – replacing U.S. jobs with those in lower-wage countries such as India and China – accounts for a far smaller percentage than some politicians and pundits claim. “The fears are far greater than the facts,” says [Ravi Aron](#), Wharton professor of operations and information management, who has studied the phenomenon for five years. “You hear all these fantastic projections, but the real numbers are puny compared with the normal churn in the economy.”

A key driver of that normal churn is worker productivity. As the economy emerges from a recession, companies push employees harder – leaning on them to work more efficiently and longer – and that manifests itself as more output per worker. Greater productivity lets employers postpone hiring until they are confident that consumers will buy what the additional workers produce.

“Companies will always wait to see that the demand is there because the fixed cost of hiring isn't trivial,” says [Peter Cappelli](#), Wharton management professor and director of the school's [Center for Human Resources](#). And firms are, perhaps, better situated to do that than ever because of the now widespread use of contract and temporary workers and staffing firms such as Manpower. These sorts of workers let companies hedge their bets on hiring, rather than committing to paying wages and benefits to permanent, full-time workers.

In this post-recession rebound, productivity gains have been larger than normal, rising at an annual average of about 4.5%, compared with the still-healthy 2.5% gains in the late 1990s. In his speech at Carnegie Mellon, Bernanke called the recent productivity performance remarkable and attributed it, partly, to the hefty investments in technology that many companies made during the late 1990s. “Only over time have managers learned how to reorganize their production and distribution so as to take full advantage of these new technologies and thus enhance the productivity of capital and workers,” he explained.

Mark Zandi, chief economist at economy.com in West Chester, Pa., believes that companies are continuing to invest heavily in technology and to wring productivity gains out of it. “The peak in corporate hardware and software spending was the third quarter of 2000. In the fourth quarter of 2003, we rose above that level.”

A few days ago, he notes, Rohm & Haas, a Philadelphia-based chemical maker, said that it may cut workers this year due to a new \$300 million software system that links its worldwide operations. In 2003, the company cut 550 positions after deploying software to coordinate orders and shipping. Economic indicators suggest that announcements such as the one from Rohm & Haas will keep coming, says Zandi. “Labor costs are falling, but capital costs are falling faster, and that makes it more advantageous to invest rather than to hire.”

Offshoring has contributed to increased productivity, too, he adds. “Before, it was just manufacturing that got sent abroad, but now it’s call centers, customer-service operations and computer programming.” Radiology, financial analysis and architectural and engineering design jobs have moved offshore as well.

Still, offshoring can only take U.S. companies so far. Aron says his research shows that it has risks and thus limits. And that means U.S. employers can’t just keep moving operations abroad. Eventually, they will have to start hiring, assuming the economy continues to grow. “If American Express outsources 3,000 jobs, you might think, ‘Where will it stop?’ But AmEx can’t outsource 300,000 jobs because of the risks.”

According to Aron, “There is operational risk – the likelihood that a process will break down when you move it abroad. There is strategic risk – when you transfer a process to a third party, it can behave in ways that are opportunistic. It might cut costs at your expense, for example. And then there is what I call composite risk – if you outsource too many jobs, you erode the capabilities within your firm.” For these reasons, Aron has found that companies typically will limit their outsourcing to about 8% to 10% of their total positions.

Even so, Wharton management professor [Steffanie Wilk](#) wonders about the long-term implications of the trend. Initially, low-skill jobs were the ones sent to foreign firms. “But now we are seeing better jobs, even high-tech jobs, going overseas.” That creates an obstacle for less-skilled American workers. Before, they could take call-center jobs, for example, prove themselves, acquire more skills and advance to better-paying positions. But with call-center jobs leaving the country, “there’s not the ladder that you can climb up,” she says. “We lose the chain of jobs that allowed less-skilled workers to get better skills.”

In other words, the U.S. economy may be undergoing some sort of deeper change – the tectonic plates of the economy may be shifting, permanently altering the employment landscape. These sorts of shifts,

often hastened by technology, happen in economies, and when they do, they can cause dislocation.

“Maybe what we are seeing is fundamental transformation, but so what?” asks Paul Tiffany, a business historian and Wharton adjunct professor. “In the late 19th century, we saw the same kind of change when the U.S. textile industry migrated from the Northeast to the South. Southern workers got lower wages and were non-union and that was perceived as more conducive to business.” Former textile centers such as Lowell, Mass., were hollowed out, as textile makers moved their operations to places such as Greensboro and Burlington, N.C. Over time, though, other industries developed in the Northeast to fill the void.

The difference today is that the job shifts are across national, rather than state borders, Tiffany says. But the underlying process of capital finding the lowest costs is the same and in the long run, he suggests, benefits everyone.

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