Unedited Rush Transcript

Conference: Labor Market Slack: Assessing and Addressing in Real Time

What structural reform does the US labor market need?

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Karen Dynan: Okay, we're going to get started with the last panel. As we've heard in a previous panel, or so I've heard, the growth in output and employment in the United States has seen… or the growth in the output and employment that the United States has seen over the past couple of years has reduced the amount of slack in labor markets, and in the economy more broadly.

Measuring the remaining slack is complicated, but I think the evidence is consistent with the view that a significant amount of slack remains. So we still need to pursue economic policies that are aimed at supporting the recovery, so as to put more people back to work and raise incomes. At the same time it's critical for the United States to undertake structural reforms to ensure that strong growth can be sustained over time and also to ensure that the increase in our standard of living that results from this growth is widely shared.

There are a lot of areas in which structural reform would be beneficial for our economy, but today we're going to focus on the labor market. That means policies that increase growth in the number of people able and willing to work, as well as policies that increase the productivity of our workers. I'll briefly mention a few of the policies that the administration is working on.

First, the Immigration Reform would increase the size of our working age population and provide a significant boost to potential output. Second, expanding the earned income tax credit for workers without children and non-custodial parents would likely draw more people into the labor force from groups that have low labor force participation rates. Third, there are many ways in which the workplace could be made more inclusive and more friendly to families. We have a number of proposals and initiatives designed to increase participation by allowing workers to better balance the needs of their families with the responsibilities of their jobs. Fourth, in order to increase the productivity of workers we have proposed investments in reforms that would increase worker skills via our education system, starting with Pre-K and going through Higher Ed, as well as through our job training system.

So I'm hoping our panelists are going to be digging into these and other issues. We have a great group here: Jared Bernstein, who's at the Center for Budget and Policy Priorities running their Full Employment Project. Jenny Hunt, currently my colleague at the Treasury Department, but more permanently, Professor of Economics at Rutgers. The Peterson Institute's own Jacob Kirkegaard, who is a Senior Fellow here, and Michael Strain, who's a resident scholar at the American Enterprise Institute.

So each panelist is going to have about eight to ten minutes to offer their remarks, and then we're going to have a period for discussion. So with that, we're going to start-off with Jared.

Jared Bernstein: Well, thank you very much. Thanks to Adam for inviting me. And before I start, I want to say what a great day this has been. I don't really have the attention span I used to have, but I've been just enjoying every panel. And Paul Krugman who I deeply, deeply respect, often goes on about just the terrible state of macroeconomics and he knows of what he speaks, but I think if he were here today he'd have to very much revise this, because I've seen a lot of great real-world macro from some folks who I rip off. I mean, plus some folks whose work I enjoy very much.

So let me begin. So in assessing, as I just mentioned, in assessing labor market slack I borrow relentlessly from everyone here. And with one minor exception, I don't feel at all compelled to try out anything new in terms of the facts of the case. I think the work that we've seen from Jan and Bill and Andy, Adam and Danny, just make a very strong case.

One minor exception, in terms of my own contribution, if you have my little deck there, is hardly an exception since it really just slaps together two different pieces of work which you've actually both already seen and that's Adam and Danny's work and something by Jan Hatzius. Jan had that, what he called a Paleo Wage Phillips Curve, where he showed that, in fact, just the unemployment rate kind of explains recent wage trends and how flat they've been. But in fact, if you look towards the end of … and Jan and I have talked about this, this is not something for which he's unaware at all. But if you look towards the end of his series the unemployment rate over-predicts wage growth, borrowing from Danny and Adam in not merely as adequate a form, because I'm just using

National data and they have a panel, but they have more research assistants than I do.

If you actually run a rolling regression of wage growth on the left-hand side and unemployment and LFPR, Labor Force Participation Rate on the right-hand side, and you start at 1995, by quarters, I'm using the same principal component wage series as a similar one and you start letting the regression add observations at 2009Q1, two things happen. First of all, you see the labor force coefficient grow in magnitude and grow in statistical significance. It actually increasingly explains the flatness in the wage trend. And if you plug the LFPR and this is beyond reduced form. I mean, this is a paleo, as Jan said. If you actually plug the LFPR into Jan's regression there what you'll see and I actually have a little note outside that shows this, is that in fact, you do a much better job of predicting the flatness in the wage trend.

That tells me, as Danny and Adam have concluded, that there is certainly a cyclical component still left in the labor force participation rate, but I'd go a step further, at least according to the wage correlations, that component is growing. It kind of flattens at the very end, but it's growing. So I think that kind of stands in a pretty direct contrast to other analysis that suggest the cyclical component is dying. I guess you'd kind of expect it to in the structural component of the labor force gap is growing.

Okay, that's the only slide I wanted to talk about in terms of sort of more empirical evidence. But I do think, coming off of that observation, that wages are critical here, to both understanding amounts of slack, the path for the Fed. I very much appreciate some of the wage targeting notions that have been introduced. And I've tried to argue in my own work that there is considerable room for non-inflationary wage growth. President Evans, in his extremely, I thought thoughtful and eloquent speech, talked about productivity plus inflation. So that gets you from its current 2% nominal to 3.5. But as I mentioned, re-balancing the factor shares also provide room for non-inflationary wage growth.

The Phillips Curve is flat, as we heard from the last panel. I was talking about worker bargaining power just like Adam. And you can see that in my next bullet, low union density. All very much occurring, and I think it was Bill who made this point, but look at all of these facilitators, all of these kind of technical facilitators of non-inflationary wage growth, are complemented by a Federal Reserve with very strong anchoring instincts and a huge pile of ordinance in the form of the Zero Lower Bound and in the 4-trillion-dollar balance sheet, which that can be unwound.

So with both a little more empirics on the slack side and hopefully a convincing set of bullets on room for non-inflationary wage growth, let me turn to policy for my last few minutes.

So the recovery is relatively stronger than that in many EU countries and in Japan, but the extent to which demand remains constrained is extremely problematic. So if by structural reforms and the theme of this panel, we mean the search for micro-flexibilities that would add jobs by moving down the demand curve, reducing the minimum wage or deregulating or repealing Obamacare, or blocking it, the sort of thing you tend to hear more about in this town than I've heard about in this room today. Yeah, I'm glad you're here.

I think we'll be very disappointed with the results if that's our approach. I think that those kinds of interventions will be more likely to exacerbate already high levels of inequality than they would be to boost jobs or address the macro demand deficiency.

I have a bunch of … in the interest of time, I'm going to skip a bunch of statistics that emphasize the width of the gap now. I very much agree with Karen that things are improving. But just the GDP output gap, using CBO numbers and I'm talking about the gap relative to CBO's new potential, which is lower than their old potential because of, if not hysteresis, whatever you want to call it. The GDP output gap, using CBO numbers, now stands at 700 billion in the most recent quarter. And that's 2,300 bucks per capita, so there is room to move here and important resources left on the table if we don't.

The fundamental problem we face is one of insufficient job quantity and job quality. And that problem must be addressed, in my view, by not just a monetary policy, which has been the focus of today, but fiscal policy and legislative action through which I understand we can't expect much, given our current gridlocked Congress. So the fact that fiscal and legislative actions are needed and probably won't be taken, given politics, isn't going to keep me from talking about them and building a project around them, as I've mentioned at the Center on Budget. This is huge problem for the political economy and I don't think garner much attention at all in DC. In fact, the first person to even mention Congressional restraints was Steve on the last panel and it was kind of late in the day, I think they're serious.

I consider myself a pretty hard-boiled veteran of this sort of thing around this town. I mean, there's not that much I see that leaves me aghast. But the fact that in 2013, we had one and a half percentage points of GDP taken out of the economy by fiscal drag strikes me as not trivial bad policy that Michael and I might argue about on CNBC someday, but deep, deep political economy malpractice.

Most estimates would argue that fiscal drag right now is about zero and that's an improvement. It's better to do no harm than to make things much worse. And perhaps while it's too much to ask our policy makers to help the economy, maybe it's not too much to ask them to do no harm. So be it. What do I think we should do? And let me just finish up because I'm sure I'm at the edge of my time.

Karen Dynan: Two more minutes.

Jared Bernstein: Oh, two more minutes, okay. So what do I think we should do? As you can see from my slides- Just skip that next graph and just go to where it says "Demand-side interventions," I'm very much worried about the kind of structural deficiencies that I think Adam was referring to. I think maybe Sommers has them in mind when he talks about—what's it? Secular stagna--this idea that we are in a bad equilibrium. And clearly, I believe that the solution to the equilibrium is on the demand side more than the supply side. If anything, the world seems awash in loanable funds, yet froth with weak demand, pretty unimpressive investment, generating, if not … I actually thought the hysteresis argument back and forth between Adam and Larry was kind of where I am, which is I don't know if hysteresis exists, but if it does I believe in reverse hysteresis. So at that point you're kind of into nomenclature, as the two of them agreed. So I very much agree with Janet Yellen that a tight labor market could reverse some of the damage, pulling some people in. And I take some confirmation of that view from Adam and Danny's paper, what I thought very strong results, which I've tried to echo a little bit in my reduced form.

I have a set of ideas here, but I think in some ways, the first is most important. We've talked about monetary policy all day and fiscal policy has barely been discussed at all. Now, that maybe because it's off the table because of dysfunction, but in fact, it's very clear to me that fiscal and monetary policy are complements and not substitutes. The Fed can't do it all by themselves. And if you don't believe me look back at Ben Bernanke, more so than Chair Yellen, but practically every time he went up to Congress he was begging them for fiscal policy to complement what he was doing on the monetary side. He was setting the table, borrowing costs were very low. The cost of capital was and remains low, but there has got to be something on the demand side and there the absence of fiscal policy has been a huge problem. Infrastructure investment in public goods strikes me as pretty much a no-brainer, even at this stage in the game.

But let me say something here that may sound a little bit more radical, which is the idea of the government as employer of last resort. In my work on full employment it's become pretty clear that there are groups in this economy who probably won't find work, even if the job market were to tighten up, vis-à-vis the overall average kinds of numbers we've been talking about today, the fives or six percents of overall unemployment. So I'm a big believer that a subsidized employment program is an essential component of a full employment agenda. Yep, I'll wrap up in a minute.

And believe it or not, folks may not be aware of this, but we actually had a pretty robust subsidized employment program in the Recovery Act. It was called TANF Emergency Funds, that's just an acronym. But in my view, it was quite a successful program with a big bang for the buck and I would scale that up.

My broader point here is that if we accept the Federal Reserve as a lender of last resort when the credit market fails I think we ought to think of the government as an employer of last resort when the private market fails to generate adequate quantity of employment.

I'll stop on my last bullet/ I'll leave those two at the bottom off. But let me just stop at my last bullet because I get to plug some great work from PIIE, which is on reducing the trade deficit. I mean, it seems very much- it seems very clear to me and I can probably cite a paper by Dean Baker who wrote a paper for a full employment project. Which by the way, they're all at *pathtofullemployment.org* if you want to see them. But Dean wrote a paper called something like, "*The Trade Deficit: The Largest Barrier to Full Employment*." And I tried to sort of muscle him a little bit and say, "Come on Dean, there's like seven other offers. Do you really want to say your paper is the most important one in terms of that?" But he said, "No, no, I really believe this," and I actually found his paper convincing. So the idea that the extent to which the trade deficit has been a drag on growth and ideas that I see coming out of PIIE, particularly the work of Fred Bergstein and Joe Gagnon, I believe point us strongly in the right direction in that regard.

Karen Dynan: Thank you. Jenny Hunt.

Jennifer Hunt: Thanks very much. It's a pleasure to be here. And I'm going to focus just on a little slice of the structure of the economy and I'm actually going to mix discussion of cyclical and structural things. And I'm going to tell you about what's been happening with female labor force participation and where I expect it to go.

So if you go onto the second page I'll start here with a graph, just showing you, going back actually to 1948, what has happened to female labor force participation. So it rose from being 33% in 1948 to a peak of 60% in about 1999. And you can see since then it's been on what looks like a downward trend, a little recovery in the movement just before the recession and then getting worse in the recession.

If you go onto the next page I've put this into international context. So here, the United States is plotted along with some countries that happen to have- or whose statistics have been made more comparable than other countries. And you see that the other countries female labor force participation rates are still rising, whereas you can see that because the US is falling it's now, for example, actually crossed down just below that of the UK. And I'm actually going to say a little bit more above the UK in a few slides. So just notice that UK starts below the US and has really just been keeping on rising gradually, whereas the US after rising went on to a plateau and has now fallen so that it's crossed the UK.

Now, there are a few things that we do know about this decline from 1999 and those are actually not female specific. So there are a couple of things going on affecting men and women. One of them is the decline in the youth labor force participation rate, so up to age 24, falling for both men and women. Principally because participation rate is falling among the enrolled, and then enrollment is increasing and those both trends that predate the recession. And then, as was just discussed, of course the Baby Boomers in 2008, the first Baby Boomers reached age 62 and began retiring.

So one could talk about structural things to do in that regard, but because they're not actually gender specific I won't do that. So let's instead look at what the female labor force participation rate is on the next page for women aged 25 to 54.

So here the X-axis is the age and the Y-axis is the participation rate and then each line is for a different year. So you can see—I was going to say the blue line, but you can't see the blue line. Well anyway, the line at the bottom is 1980 and you can see that the middle-aged years, the prime-aged shifted up to 1990, up a little bit further to 2000 and then have actually slipped back a little bit at the ages, except the upper ages in 2013. And notice here also what I was saying about the decline in the youth participation rate there. And for knowing what happens in the future it turns out to be critical whether you think that's an age effect or a cohort effect. Are those young people going to work less for the rest of their lives or are they going to pop up to the higher levels that we see here when they reach those older ages?

If you go up to the next page, I put this prime-aged female labor force participation rate in international context. And here the US looks very low, so it's quite a different story as you can see. So compared, for example to the UK, as soon as the US got to that plateau before it even declined it was overtaken by the UK. But it's important not to think—I read an article in *The Financial Times* that seemed to actually be implying that Americans had become lazy.

If you look over just focusing on the women here on the next page and you're thinking just about the total amount of work in the economy, I don't actually have those exact numbers, but what I'm showing you, I'm on slide seven now, is the percent of female workers who are part-time. And you can see the US [inaudible 00:20:50] down at about 12 and the

UK is at about 35%. So you shouldn’t think from those earlier numbers where the US participation rate looks a bit low, that the overall supply is so low compared to other countries.

So if you go onto page eight, I’m just making some comments here, comparing the UK with the US. So thinking about the overall rate, remember it’s just happened that the UK caught up with the US and that’s because the UK has been steadily rising and the US had a sharpened fall since 2008. And we know that the sharpened fall in the US in this broad 16+ group is partly due to the recession, but especially due to the Baby Boomers starting to retire. In the UK, the baby boom is both smaller and a little bit later, so that hasn’t hit the UK yet. So that’s one reason for the difference amongst the older ages that they’re not aging as much in the UK. And then it’s actually considered a bit of a puzzle in the UK why the labor force participation rate did not fall in the recession. There’s lots of puzzles going on in the UK in this recession recovery and so if later you can look back and see those in any downturn for the UK in the recession.

But that’s only explaining sort of the older age categories and we saw that the prime-age labor force participation rates have been diverging since the US reached its plateau in 1999-2000. And that’s in part because the, as I showed you, the participation rates for US women in their 30s and 40s have actually been falling. And this is really putting it at a slightly different way, successive US cohorts are now no longer working more at the same ages than previous ones. And in the UK participation rates in 30s and 40s have been rising and as you can see actually, on the next page, slide nine. And successive cohorts are still working more at given ages than the previous cohorts.

So in slide nine, you can see that I just compared 2000 with 2000 and—it’s actually 2014 for the UK. Unfortunately their age categories are a little bit big, but you can see it increasing a little bit in 25 to 34, 35 to 49 and then I suspect the increase in 50 to 64 is probably more concentrated to the slightly younger ages, since nothing much is happening at age 65+.

Then on slide 10, I’m just comparing the most recent year. It doesn’t say the year, but it’s 2014 for the UK and 2013 for the US. You can see here that- Actually I meant to mention also on the UK slide that they’ve also had that drop in the youth participation rate, which is very interesting just like the US, which means that although the numbers are a little bit higher for the UK youth on slide 10 it’s not as different as it would be if both countries had not experienced this fall in youth participation. And so you can see that until we get to the 50 to 64 age then the UK has higher participation rates in each of the age categories.

So let’s turn to the thinking about explaining these things a little bit then on slide eleven. So I’m not going to go through why there was such growth for US women in the 70s and 80s, but let’s just think a little bit more about why there was an increase in participation rates for prime-aged women in the 90s. So it was surely partly to do with the extraordinarily strong growth in the economy in the 1990s, combined with an expansion of EITC and in 1996 the tying of welfare to work. So the abolition of AFDC, which didn’t require work to TANF, which required work to get benefits.

The EITC expansion and the TANF reduced disincentive to work are still there, but it may only be with growth of 1990s style that will actually be able to return, I think, to the peak participation rate that we saw in 1999. Although again, this really hinges the question as to what’s going to happen with these young people? But if I come to that slightly pessimistic conclusion then how can it be that other countries have this high labor force participation rate?

Well, if you go on to slide 12, and I’m still talking here about people in their 30s and 40s, especially prime-aged, there’s good evidence—actually I’d, yes [inaudible 00:25:52] the papers are cited actually at the back. But there’s good evidence that countries that offer paid parental leave, subsidized child care and more generally family-friendly policies, if the leaves in question are not too long do have higher labor force participation rates. Women are more likely to come back to work after having a child.

And another policy that differs quite substantially from the US and the rest of the world is that the taxation in most of the OECD is done at the individual level and does not have a disincentive for a secondary earner to enter the labor market. So that’s another big difference.

And it seems that all of these policies, drawing in women to work part-time in the other countries. And so some of the increased participation rate actually may stem in fact, from those much higher rates of part-time participation.

So coming back to what’s going to happen in the future to female labor force participation. I think there is a few actually—I don't know if I’ve repeated on slide 13, the prime-aged participation rate just for the US. So you can sort of see the recent trend. If you sort of eyeball, which is making an assumption that the young are not really going to spring about back into participation when they’re older. If you sort of eyeballed it looks like there’s a downward trend, but that it has been steeper during the recession and was likely to recover some. But I think the real slack, so I do believe there’s slack in the economy, but I think the real slack is actually coming from the people who are part-time for economic reasons. I think it’s not so much because of the participation margin for women in general, but some of it is.

So finally, the administration does have objectives, in terms of making workplaces family-friendly. And the aims here or the objectives, are to remove obstacles, so that those who want to work can. So most obviously, of course unemployment, but also allowing people who might have other obstacles than labor demands in the way to working, allowing them to work as well and then allowing work to be combined with family. And an important element of crafting these policies is to not only think of women. In fact, although my talk has been about women, but to design these policies to include men as well as women. That's very important for their success.

So a few examples, I gave some on the previous page already, naming what Europe does already. The one that the administration has put the most emphasis on so far is in the FY-15 budget. We've proposed 65 billion for high-quality preschool education. And then in the current budget there's $100 million to help states set up paid parental leave. And there are some other things that would fit into this general rubric that I had already listed on the previous page. So this is the direction to head, even if it's not the case that workplaces have becoming less family-friendly, making them more family-friendly would remove obstacles to women's participation would be likely to increase the rate.

Karen Dynan: Thank you. Jacob?

Jacob Kirkegaard: Thank you very much Karen. Well Adam asked me to talk about some international perspectives on structural reform, particularly from Europe. But I guess I just in response to some of the things that were said in the beginning of the conference. I just want to make a point about data, because it was made clear that we're short of data, particularly for wages. And the suggestion was made that we should look at previous experiences in Europe, for instance. The problem with that is that European wage data is almost uniformly unsuited for policy-relevant work in the United States until quite recently. And the reason is simple, is that throughout the majority of history, where these time series are available, you have things like binding national collective bargaining and mandatory wage indexation in place in these countries, which means that we can debate why nominal wages are sticky in the United States, but moving them downwards in many European countries was a crime. And therefore, this is perhaps relevant for academic papers, where referees only care about the econometrics that were used in the data. But for policy-relevant work this is absolutely not to be pursued, in my opinion.

Then I think, as Karen also did in the introduction, it's useful to ask what is meant by structural reform. Because I certainly think that in Europe sometimes structural reform is just something that policy makers can propose, and then say that the result can only be found after the next election and therefore they're not accountable really for their actions. It can also be, in a more broad sense, things that raise employment and potential growth. And if that's the case, well then Europe actually, in my opinion, has some broader lessons to teach the United States. One is, as Karen also mentioned, immigration reform.

Europe has actually gone through, in the last considerable number of years a dramatic increase in immigration. If you look at the EU 15 for instance, legal permanent migration into the EU 15 is actually, since the end of 21st century, roughly twice the level of the United States. It's even higher, of course, in the UK after expansion of the EU. And then there is this other element that I was just chatting with Dave also before, which is that you have a lot of latent workers in Eastern Europe that actually can shift back and forth across borders, if there are any the natives begin to ask for higher wages. Well guess what? The employers will tell them, "You know what? We're just going to hire the [inaudible 00:32:24], who's waiting to come in."

Another thing that the Europeans wisely have resisted is the insanity, in my opinion, of having a direct link between employment and healthcare. Europe has never had that and I think, in terms of a whole host of labor market issues, that is we can debate back and forth about the ACA, but severing that link would be certainly something that I think the United States should also do and move to a single payer system.

So there are things that Europe more broadly on structural issues, I think could teach the United States. Well then the issue is what about labor markets specifically? And there I would say that there is essentially two types of lessons. On the one hand the one type of lesson you can learn is you learn from my mistakes. And the other type of lessons is you learn from my successes. And I would say the most important lesson that Europe can teach the Unites States when it comes to structural labor market issues, is the one that I have on the first slide, which is "Do nothing stupid." The doctrine of not doing stupid things when it comes to labor market reforms in response to crises is actually, in my opinion, extraordinarily important. Because if you look at many of the labor market rigidities in Europe right now they all started out by and large as well-meaning attempts to reduce suffering in response to crisis after, or particularly 1973. And they come in many forms; I list a number of them here. Excessively early retirement options, facilitating early retirement through unlimited unemployment benefits for all the workers, lose definitions of disability, et cetera, all basically things that facilitate premature exits, permanent exits from the labor market.

Essentially variations of sort of the lump of labor market fallacy. And then you also have, this is also the origins of many of the excessive, in my opinion, legal restrictions on dismissals for economic reasons that you have in many European countries. It's the origins of why labor courts are so dysfunctional in a number of European countries, because they were basically tasked with interpreting these rules. And then particularly one, which is that it leads to excessive duality in the European labor markets. And that is, in fact, probably the single biggest problem that Europe has at the moment. And by duality, I mean that you have part of the labor market that consists of highly protected insiders and then you have another part of the labor market that are essentially, instead of part-time, temporary, essentially very flexible and unregulated employment, because that gives rise to a whole host of issues. I mean, if you want to understand why is it that Spain or Greece and others have about 50% youth unemployment. Well, it's very simple. It's because the youth were disproportionately employed on these easy-to-fire outsider type contracts and they of course, when the economy collapsed, they are the ones that were laid off.

And you also have a problem with the political economy of dealing with this issue, because actually the pre-crisis labor market performance in Europe was not that bad. Employment rates, as I think some of the numbers that Jennifer also showed before, are actually generally rising. But a lot of that came through the expansion of sort of outside a work. You liberalized temporary and part-time, but you really didn't do anything to lower the protections of inside workers. And that is why Europe and particularly countries like France, Italy, are in such a pickle, because I think the sad reality of political economy of reforms, of labor market reforms in Europe, is that these types of reforms, meaning reforms that reduce protection for labor market insiders, they only happen in a crisis. They do not happen at any other point in time. So if you want to understand why the ECB is doing perhaps less than what many would want it to, you should understand that many on the governing council of the ECB, in my opinion, recognize that the only way to keep or perhaps get a serious labor market reform of insiders in countries like France and Italy, is to keep the screws on the macro economy, unfortunately. So this is certainly something that you should not pursue.

And then on the next slide, I mean given that this is in some ways a follow up conference to Jackson Hole, I can't resist to say that this is a zombie that perks up in many forms. And the latest articulation of this idea of introducing crisis rigidity in labor markets is the proposal to have so called dynamic labor market rigidities, which is a uniformly terrible idea, in my opinion, for all the political economy reasons that I just discussed. So I'm not going to go into details of why that is, but that is a very bad idea.

So the next question then becomes, well what can Europe positively, what are the successes, if you like, that can, in labor market sense, perhaps instruct some of the policy-making in the United States? The first thing I want to point out is one type of policy is actually the German policy of so called "Kurzarbeit" or subsidized short-term work. But it's important to recognize that in the German concept of Kurzarbeit it's actually introducing an additional type of flexibility. It's introducing an additional way of reducing total labor input at a time of crisis and at the same time, because those workers who go on reduced hours they then get a wage top-up from the government, it's a way to introduce in a crisis a very, in my opinion at least, a very high multi-plicator fiscal, a counter-cyclical fiscal stimulus that really will do quite a lot to protect total consumption.

And I think it's also important, as this slide shows, that this isn't something that the Germans just cooked up in 2008. This is something that they have been using historically in every major recession in Germany since World War II, so it's deeply embedded in Germany. And it's a very ration… it's not a silver bullet; it doesn't work everywhere. But in my opinion, that if you have a highly specialized, competitive sector of the economy with highly skilled workers that suffer an external shock for a relatively brief period of time, which is a.k.a. the German export, machine tools in manufacturing sector in 2008-2009, this is a very, very rational policy and it's very, very effective as well, in my opinion. And this works of course, especially if you have a labor market that also suffers from demographic constraints so that businesses are particularly worried about losing their high-skilled workers. So I think this is something that could be facilitated and relevant for some sectors in the US economy.

Then the next and last slide is sort of, I'm saying this not just because I'm Danish, but it goes back to this issue of active labor market policies. And again, I will highlight that this isn't a silver bullet; it's not going to overcome many of the cyclical effects. I mean, the slide shows that if you're Ireland or Spain you can spend a lot of money on this but it doesn't help you if the housing and construction sector collapses. You can also spend a lot of money on this stuff but if you have French labor market rigidities it also doesn't work very well. But I will suggest that this slide does indicate that if you want to get back above 70% employ—this is working age, because it's OECD data, you want to get above 70% employment rate, it does suggest that perhaps the United States could spend more on this. And all the other Anglo-Saxon countries, countries like Japan and Korea, which have a lower government budget than the United States, spends about twice what the United States does, which over the 5-year average that I plot here, was about 0.14% of GDP. The only two OECD countries that spend less than the United States is Chile and Mexico. Not necessarily countries that compete on productivity high wage et cetera.

So I would suggest that this is another way in which the United States could learn something from Europe, but it may also and this is because active labor market policies tend to work better the closer they are to the shop floor. So those countries in which they are genuinely very successful tend to have relatively cordial social relationships between employers and labor unions. That may or may not be the case in all sectors in the United States, but nonetheless, I certainly believe that one of the lessons from Europe is that you could spend quite a bit more money on this particular issue. Thank you.

Karen Dynan: Thank you. Michael?

Michael Strain: Well thank you very much. Thank you Adam for asking me to speak. Today has been absolutely outstanding. It's really just been a wonderful, wonderful day. And it's a model for the other think tanks in town about how to do this, I think, because it's really just been so good and the panels have been so great, and the people who've been here. Do you want a little of that? Maybe later.

Jared Bernstein: But with PowerPoint.

Michael Strain: Yes. I have the dubious honor of being the last speaker of the day, so I'll keep this brief. And I didn't prepare any slides, so I'll keep it informal as well. I'd like to start by just going up to the 50,000-foot level and making an observation that could be considered trite, but that work is very important and having people in jobs is very important. Everybody in the room, or at least a lot of us in the room are economists and nobody needs to be told how production functions work and that if you don't have a labor input you don't really produce anything. So if you want the economy producing things then you need to have people working.

But if I could be a human being for a minute and not an economist, work is very important for society. And when [inaudible 00:44:05] came over to the United States and wrote his famous book, what he was so struck by were the voluntary associations that defined American life. And to a large extent we still have a lot of these. We have little leagues, we have scout troops, we have churches, we have neighborhood associations, we have clubs, we have all these things. And if people aren't working those things just wither and die and that's terrible for society; it's terrible for the health of society as a whole.

Work is essential to human flourishing. Again, if we're up at the 30 or 40,000-foot level what do we have an economy for? Do we have workers to serve an economy? Do we have workers to fill roles in markets or is it vice versa? Do we have an economy to help people live flourishing lives? Do we have markets to help people find what they're best at and contribute as best as they can? I think the latter.

And so when you have policies in place, demand shocks, supply shocks, whatever is the problem de jour, that is a threat to work that's a threat to human flourishing and it requires a policy response. And that's something that I think that everybody should agree on, whether you're a conservative or a liberal or whatever. We can debate what the policy response should be and there's plenty of room to do that, but I think hopefully, we can agree that there should be at least some kind of a policy response.

Obviously, demographics matter and that's where a big focus of what we talked about today, with respect to labor force participation. But for prime-aged workers we should be concerned by what we're saying, both with respect to men and women and we should try to design policies to encourage work. That's a normative statement; it's a statement I'm comfortable making because I'm not being an economist right now, I'm being a person. I'll go back to being an economist in a minute. But I think we should encourage work and I think that society works better. I think it's better for people. I think it's obviously better for the economy and it's something that I don't think a lot of people in the room would disagree with, especially based on what everybody said so far.

So how do we do that? In some cases it means reforming programs that could be better. In some cases it means using public policy to give workers and non-participants a hand up so they can participate. And so I'll just throw a few of those ideas out. Some of these will help in the immediate crisis, but since focus of this panel was on structural issues I was thinking more kind of medium-term, but some of this obviously will help in the short run.

So to start with things that could be reformed, we have an unemployment insurance system. I think it works reasonably well. I was a proponent of extending emergency unemployment benefits back in December. And knowing what I know now I would do the same thing back in December. But that's not to say that the program can't be better. I co-authored a paper for Jared in his full employment project, which is fantastic and I would encourage everybody to read all the papers, especially mine I should say, on work sharing. Work sharing is a very simple idea. If you're a firm, say you have a hundred workers and they all earn the same wage you need to reduce your labor cost by 20%, you can fire 20 of your workers or you can just tell everybody to stay home on Friday and if they stay home on

Friday, the government gives them 20% of an unemployment check; very simple.

A lot of firms probably wouldn't want to do that, but I think some would and I think that that should be an option. The last time I checked only about half the states had this as an option. I think it should be an option in every state. I think the Federal government should do things to make it an option in every state and I think that the governors and other folks should use the [inaudible 00:48:02] pulpit to make sure that businesses know that this option is out there, because I think a lot of them would rather do that than lay off a whole bunch of people. And keeping people in jobs, especially in a massive downturn like we've had, where you had six, seven job seekers for every job opening, keeping people in jobs helps avoid the massive problems that we're trying to deal with. So that's one kind of structural reform that I think we should be doing.

I think we should be offering relocation assistance to long-term unemployed workers. If you're a 50, 55-year-old guy who didn't graduate high school and you drive a truck in New Jersey, it's going to be pretty hard for you to get another job and you'd have to wait a long time in order for the economy in New Jersey to heal. New Jersey had historically high unemployment, relative to the other—relatively high unemployment compared to the other states.

So it's fine, I mean, we can give that guy 99 weeks of unemployment benefits. And like I said, that's better than having him starve to death. But what would be even better than that would be to give him the opportunity to take a check from the Federal government or a loan or whatever so he could pay his moving costs to move to North Dakota or Texas or a place with really low unemployment where he has a much better shot at getting a job. That's the kind of structural reform that empowers people and encourages work. It's not just trying to provide for someone's material needs, but it's trying to help him get a job again. And I think that would have helped a lot of people out and in future downturns I think it would as well. So that's something I think we need to look into.

That idea is bipartisan. There is a liberal democrat congressman from California named Tony Cardenas and there's a Tea Party republican named [inaudible 00:49:46] from South Carolina, who have come together in the House to put that together and I have been working with them. And it's not going to go anywhere because there's a Senate still but ...

So those are some reforms to unemployment insurance. Other things too, lump sum payments, reemployment bonuses; there's been some experiments and some of that has been shown to work. That's more kind of quibbling around the margins.

We have a food stamp program. I like the food stamp program. In a nation as wealthy as the United States people shouldn't starve to death. But we should be having a serious discussion about whether we need to beef up the work or work-related requirements for able-bodied recipients with no dependent children. If you've got three kids at home, it's one thing. If you're a 35-year-old guy with no one to take care of and you're of sound mind and body then maybe you should at least be volunteering or doing something, preferably working. That's something that I think could help put more people into the labor market.

Social Security and Medicare, also great programs. I think we need to raise the retirement age. Maybe take away the payroll tax for the last few years of the person's life so that those years are—relatively more lucrative than they currently are. That again, would increase participation. You need to do it in a thoughtful way. If you've been working in construction or manufacturing by the time you're 65 your body may be shot, even if you've got 20 more years of life left to live. But in certain occupations amongst certain industries you really can work for longer than that and that's something that we need to adjust, a reform that we need to at least consider.

Occupational licensing, this is something I've talked with Jennifer about a couple of times. The average number of days that a cosmetologist spends in training to get her license is 372. The average number of days that an emergency medical technician spends to get his license is 33; that's an order of magnitude less. That's quite something and obviously represents a pretty serious problem. This is I think, keeping people out of working, probably. You can imagine someone who's been unemployed for seven or eight months who would say, "Hey, maybe I want to cut hair. Oh, but I have to write a thousand-dollar check to the state of New York and sit in a classroom for a thousand hours. So instead I'm going to not start a barbershop or whatever." In any case it's completely out of whack and totally ridiculous.

The Affordable Care Act is kind of a sensitive subject, but the last time I checked the Congressional budget office said that it would reduce labor supply by the equivalent of 2.5 million workers over the next 10-year period by 2024. That is a lot of workers. Again, I had mentioned a lot of people in this room were sympathetic to the Affordable Care Act and it's a normative decision, whether the costs are worth the benefits, but I think we have to at least acknowledge the costs and that's a pretty large reduction in labor supply. And maybe it's worth it and maybe it's not, but I would argue that there are better ways to achieve the goal of healthcare access for people and that those should be designed in such a way to be really careful about the labor supply effects. I think Jacob's suggestion of completely severing work and health insurances is the right goal to work towards. I'm not so wild about the single parent.

But we have a disability insurance program that is also out of control. In 1989, 2.3% of working age adults were SSDI recipients. By 2009 that share had doubled to 4.6%. That's pretty staggering when you consider that over that time period healthcare improved, the workplaces were safer and more people shifted from manufacturing into a services economy. There's no reason why we should have twice as many working age adults on SSDI as a share of the population. At least no obvious reason why. There are more people receiving SSDI benefits than work in the construction industry. That's quite something.

I just got a note that said I should wrap up, which I should. It's been a long day.

So what are some things that could be done well that opportunities for the government to give folks a hand out? Better transportation networks. There's been some good research lately, a couple of good papers that suggest that if commute times were shorter from low-income communities to commercial centers that more people would be working, especially low-income workers. To me, and I agree with Jared about this, this is an absolute no-brainer. Let's build some roads and do things with bus lines and try and cut that commute time from two hours down to one so more people can be working. I think that's obvious, that if you care about low-income people working then you should agree.

High [inaudible 00:55:10] Immigration Reform. People have talked about; that's a big one. A big one for me also is the earned income tax credit. In 2014 a childless worker could get about $500, a worker with three kids could get $6,000. Again, that's another order of magnitude difference. We want to give more to families than single people, but we should be giving more to single people than we are. If our experience with women in the 90s is any indication, if we did that, that would draw more men in.

So I'll stop. I've got more, but I'll stop. So the broad theme is that we have a lot of programs and a lot of them are good, but could be improved. And they could be improved along ways that encourage labor supply and that get more people working, which is I think what everybody wants to do, both today and over the medium-term. And there are opportunities for active government programs to really help people, especially low-income people, get into the workforce, which is something that I think should be a paramount social goal and something that public policy should play a big role in. So thank you.

Karen Dynan: We have time for a couple of questions. But before we go there I just wanted to see if any of the panelists wanted to either vigorously agree or disagree with any of the ideas that their fellow panelists had put forward. Jenny?

Jennifer Hunt: I just wanted to point a couple of things. So I too, am a big fan of short-time compensation as both Jacob and Michael proposed. I want to point out that the government is in fact encouraging this part of the recovery act. Money has gone to DOL, which is helping states either set up or transform their short-time compensation system. So Rhode Island is the leader here, and we're trying to let everyone learn from Rhode Island. I will also point out though that this is a policy to soften the blow in the downturn, so this is something we're setting in place for the next recession, but I think it's a great idea.

Relocation dollars, I thought I'd just mention also that's part of a proposal under the president's budget for a new system of training that would include a component with that in there. So I think and some of the policies we're not only in agreement, but we're already working on it.

Jared Bernstein: And I'll just add, [inaudible 00:57:38] work sharing and short-time compensation are all pretty much the same thing. It's just so, it sounds confusing, they all have different names. And it is the law of the land. And Michael and Kevin Hassett wrote a very nice paper for us. But another very nice paper was recently written for the Hamilton Project by Kathy Abraham and Sue Houseman. And if you put it all together, really what we have to do to get more of that is to get state administrators familiar with the program. I'm convinced that it's an informational—in no small part, an informational issue.

I will say I fully endorse this EITC expansion to childless adults and I do think it's pro work. And as Michael suggested, that somewhat has a lot more bipartisan support than you might think. Although I'm sure that doesn't mean it's going to happen any time soon.

I would say, on the Affordable Care Act, just to be clear and you're absolutely right, we shouldn't have a drag down about that. Most of the employment effects that you're citing are voluntary. There are people who are getting out of job lock because they now have access to the exchange in an affordable way that they didn't have before, and so they're deciding to work less, which is I think fine. I mean, I think a lot of what we're talking about today is people who want to work and can't find jobs. And then finally I fully agree that over-trained cosmetologists are a very big problem in this country.

Michael Strain: Can I respond to Jared for just a two seconds? I also agree that over-trained cosmetologists are a big problem. I have no problem with mitigating job lock and working toward severing the link between employment and healthcare would eliminate job lock, at least as it's conventionally defined. A lot of the reduction in labor supply though, was a response to the phase out of the insurance subsidies; it was not people wanting to, as Mrs. Pelosi said, wanting to go be poets or whatever else, and they don't have to stay on their job to keep their health insurance. So killing job lock, good if you're only in the job for health insurance and the Affordable Care Act allows you to get out of that, then that probably is a welfare maximizing innovation. But the problem is the phase-out of the insurance subsidies and the fact that the subsidies are so generous and they go so high up the income scale. And that is a choice in the same sense that many things are choices, but it's not responding to prices and preferences, it's responding to public policy.

Karen Dynan: Thanks. You guys are touching on a couple of questions that I had that I don't think we have time to get into, but just what levers—a lot of what you mentioned have to do with state governments, so what levers should the Federal government have in this regard? And also, kind of just the cultural issues that are playing into the over-training of cosmetologists and whether these lessons from Europe, the reforms suggested by the European experience, really could be adapted to this country. But we can save that for the next conference.

We have time for just a couple of questions. Yeah, Adam why don't we start with you?

Adam Posen: Thanks for all the kind words. I think this panel hit exactly what I was hoping it would and I'm grateful for that.

I really would like to actually pick up in a sense, a narrow version of the question Karen said we didn't have time for. Maybe we can have a time for a narrow response, particularly to Jacob and Jennifer.

Realistically speaking, okay, let's take Jacob's words of wisdom about "Don't do anything stupid." Let's agree that that's not going to happen, but we'd like that. If instead and this is also in the strain of things Julie Hotchkiss was saying earlier, if instead we wanted to try to increase labor supply, whether it's female labor supply or young people labor supply, whatever you think is the primary margin you want to go on, realistically, how big a number can we create? I mean, when we think across countries there have been major reforms in various countries, Germany, Denmark, but other places as well, on what sort of time frame and what sort of magnitudes if you do a big reform can you get out of this? Or is it all just—I mean, obviously when we're talking millions of people and the importance of work, as Michael says, anything is good. But are there big-ticket things you can do about labor supply, or is it a lot of little things?

Jennifer Hunt: I would like to phrase things again, as I phrased it in my talk, which was the talk about removing obstacles to work for people who want to work. And I think on the female side you can get kind of a ball park idea by looking just at the graph. It looks like we're probably not going to get above the peak where we were before, so let's call that the possible- Actually, let's not take Sweden because Sweden is a bad—we could take another country. Sweden is a bad example because the reason it's so high is because of women on maternity leave, that counts as being in the labor force and they're very, very long. But if you look at prime age, I think would that give you about the same answer as looking at the peak of the US? No, the US, even at its peak, would probably be somewhat below. But I think we're talking about, if we look at the total, I think we're talking about three or four percentage points maximum. And that would, I think, cost a lot.

And then, the men it's a lot less clear what you would do. Some of the issue at the lower end of the distribution is the wages is so low, so EITC helps some of that, not so much in recessions when the problem is a lack of demand. But I think we're really not so sure how much we can do about the male labor supply. And this is talking about—unless you want to—there's lots of expensive things we could do to bring in the older workers. It's already increasing actually, but you could reform social security in certain ways. That would be one possibility if your aim were to get more people working.

Jacob Kirkegaard: I think what can really still be achieved, if you look at large G7 countries, I think I can only count one country in over a relatively short period in recent time have managed to expand employment population ratio by about 5% and that's Germany after 2005. And I think there is a lot of misperceptions about why that is. There's no doubt that wage restraint, the whole Euro issue had something to do with it, but I would argue that actually the German domestic economy the Euro introduction is not that important, because Germany didn't get any different interest rates, everybody else got that. What changed for Germany was the external environment, but that's a different issue.

But what is clear, that when people talk about the Schroeder reforms, [inaudible 01:05:27], fear, et cetera, is that this wasn't a sort of hodgepodge of sort of small individual things, this was actually a sustained 5-year or so program that counted a lot of different things. They did the functional equivalent of massively reforming social security, they raised retirement age, they phased-out quite a lot of the policy mistakes that I talked about earlier, which was these excessively generous access to early retirement in German, and you can see it. I mean, participation in Germany for 55 to 64 is up by a third; 15 to 20 percentage points after 2005. They fundamentally reformed and put a lot of extra money into the German public job labor market offices, the *bundesagentur arbeit*. And this is [inaudible 01:06:31], they lowered the reservation wage. And as I think Adam also mentioned, they cut long-term unemployment benefits quite dramatically so that people would be more incentivized to do it. And then they created a whole new host of worker categories, low-wage many of them worker categories, in Germany, so called mini jobs and others.

So the whole point of others is that this wasn't sort of nibbling at the margins, this was sustained over several years. And actually, in many ways, I would argue fairly well-thought through comprehensive reforms. And if you do that, which may require the kind of political stability that you, at the end of the day, have in a place like Germany, then you can actually achieve relatively significant results. And I mean, it is just worth mentioning that Germany again today, has the highest employment population ratio in the G7 by a significant margin and that is entirely new. So you can actually achieve quite big things, but you've got to do it by reforming not peacefully, but you got to reform all different levers and parts of the labor market.

Jennifer Hunt: I'll point out a lot those, that increase in the employment rate is coming from reducing unemployment it seems like. So it's not as much on the participation margin as it is in reducing unemployment and getting people into low-wage jobs. That does seem to have been a trade-off between, as one would expect in the textbook, between lower unemployment and good wages.

Jacob Kirkegaard: No. I mean, there's no doubt that part of these reforms in Germany came from creating a much larger low-wage workforce; there's no doubt about that. And I think this was, in the case of Germany, a very direct choice and I think Chancellor Schroeder was very explicit about it when he campaigned in favor of this. He said, "We want to move people from inactivity, from long-term unemployment," which is de facto in activity, if unemployment benefits are forever and you don't have to search for work by getting them. That's inactivity for you. You want to take people out of that and into low-wage work because we cannot afford. It was a fiscal argument almost. So certainly there is that element to it, absolutely.

Karen Dynan: Other questions? Are there other people? I saw Andy's hand up, so maybe we'll make this the last question?

Andrew Levin: I'm honored to come back to Jennifer's talk because it seems crucial. I mean, I agree with all the structural reforms you have talked about and that Julie mentioned this morning. But it still seems crucial to gauge how much is slack. How much is that accounting for? So I just want to flag two facts here. One of them is this [inaudible 01:09:39] study that was published in April. It says, "A growing share of stay-at-home mothers, 6% in 2012 compared to 1% before the crisis, say they are home with their children because they cannot find a job." So again, the survey evidence here seems pretty clear and that was a couple of years ago, but that a very substantial fraction of stay-at-home moms were mostly, say 25, 35 years old, maybe 40, that was in fact because they couldn't find a job.

The other thing that's interesting and important that you can't quite see very clearly in Jennifer's pictures, is that there is no downward trend after 2000 in females 45 to 54; there just simply isn't. I have it here on the screen. Anyone who wants to look over after we're done can look. I literally just pulled it off the BLS website 20 minutes ago. The 45 to 50-year-old female participation was rising steadily until about '98. And from 1998 until 2007 it was within a one percentile range, from 76 to 77. In 2009 it started falling off and in the latest data it's down at 74. So it fell two percentage points. This is very relevant for, I think, all of the discussion we had this morning, because here's a group that actually seemed very stable. They stabilized after 2000. These are not the prime age males where there is some mystery about the long run trend. This group's stabilized and these are 45 to 54-year-olds, they don't probably have a lot of young children at home. So these things about child care and so forth, which I can agree with. So bottom line here, is at the same time we're trying to expand the labor supply you've got to provide the jobs for these people. And as you mentioned Jennifer, the big problem with under-employment is there as well. So there's a lot of evidence that there's still significant slack relevant for prime age females.

Jennifer Hunt: So 45 to 49 actually falls over the period and then 50 to 54 is the same and then above that it's increasing as it is from men. So it is a bit, it's twisting, really. The middle is falling and the older ages are rising and happens in the middle of that age range that you're looking at.

Karen Dynan: Okay. Why don't we wrap up this panel the same way we wrapped up the last panel, which is I'm going to put you on the spot. So we talked about a lot of different ideas here. I'll give you 15 seconds to just say which is your favorite? What would be the best thing we could do for US labor markets right now? It does not have to be a structural reform if you want to take the [inaudible 01:12:31] demand side stand, that's okay too. So Jared, we'll start with you.

Jared Bernstein: Real deep dive into investment in improving our stock of public goods.

Karen Dynan: Jenny?

Jennifer Hunt: I was essentially going with the same thing. I was going to say invest in infrastructure.

Jacob Kirkegaard: Well, then I will switch my one and two and say immigration reform.

Michael Strain: Now I have nothing. I would expand the earned income tax credit more than the president has proposed for childless workers, for a number of reasons.

Karen Dynan: Great. What a good suggestion.

Michael Strain: And I would return this to the gold standard as well.

Karen Dynan: Okay.

Jared Bernstein: And shorten the licensing period for cosmetologists.

Karen Dynan: I was going to say a lot of good suggestions, but I'm not going to say it now.

All right, so I want to thank the panelists for doing such a great job and thank Adam for inviting us to do this. It was a really great panel. And now I'll turn things over to Adam.

Adam Posen: Just quickly, Karen did a great thing, even better than Angel, of getting people on the spot and getting something interesting out of them. This was a terrific panel.

Some of you have stuck with us the whole day, which I'm very impressed with and grateful for. I'm grateful, particularly to Dave Blanchflower and Andy Levin who helped me get his off the ground. I'm very grateful to Yvonne, Jessica and our meetings team who, when we decided to have technological regress today, managed to get things afloat. And I'm very grateful to everyone for contributing the spirit with which this was meant, whether Larry Ball has his corrections of my nomenclature right or Jacob's views on structural versus cyclical right. I think we engaged with the issues in a very in-depth, serious and practical way, which was the goal of this and most Peterson Institute things. And thank you all for contributing.