Mitchell's Musings 5-2-11: Rationalizing Unemployment: How Long Can You Go?

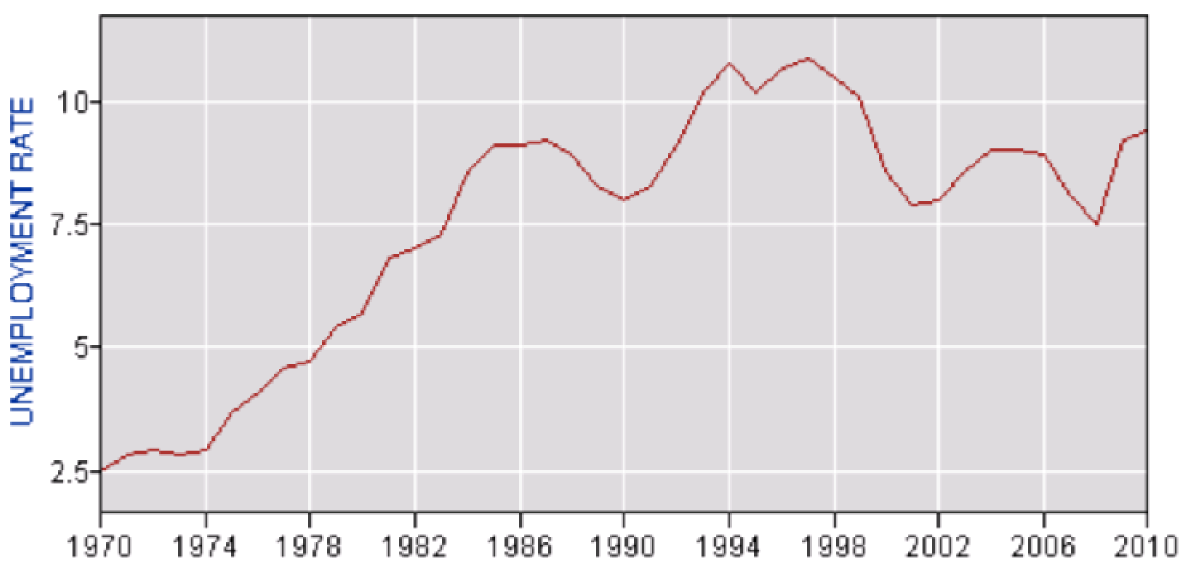
An earlier post on Mitchell's Musings noted the potential threat to federal funding for collection of international labor-market data. Happily, that threat has now receded for the time being. That development is a cheerful note for the data source. But the data found there do not necessarily lead to cheerful conclusions about political economy.

Last week, there was much fanfare when Ben Bernanke, the Federal Reserve chair, held a news conference that was viewed as a bold exercise in transparency. On the other hand, there was also criticism of the Fed and of Bernanke for being too concerned with the threat of inflation and insufficiently concerned with ongoing unemployment. But the controversy itself raises the question of how the political system reacts to extended periods of unemployment.

Most forecasters – including those at the Fed – expect a prolonged period of unemployment. Typically in such forecasts, the unemployment rate gradually declines. But, of course, once forecasting goes out over periods of years, it cannot pick up whatever surprises may be in store – negative or positive – along the way. So the tendency of forecasting models is always to return gradually to "normal" after a shock. The predicted unemployment rate oozes toward a level somewhere in the 5-6 percent range.

International data on unemployment in developed countries indicate that it is quite possible for unemployment to remain high for many years, with ups and downs along the way. The chart below, for example, shows the French unemployment rate from the early 1970s (when it was quite low) to 2010.

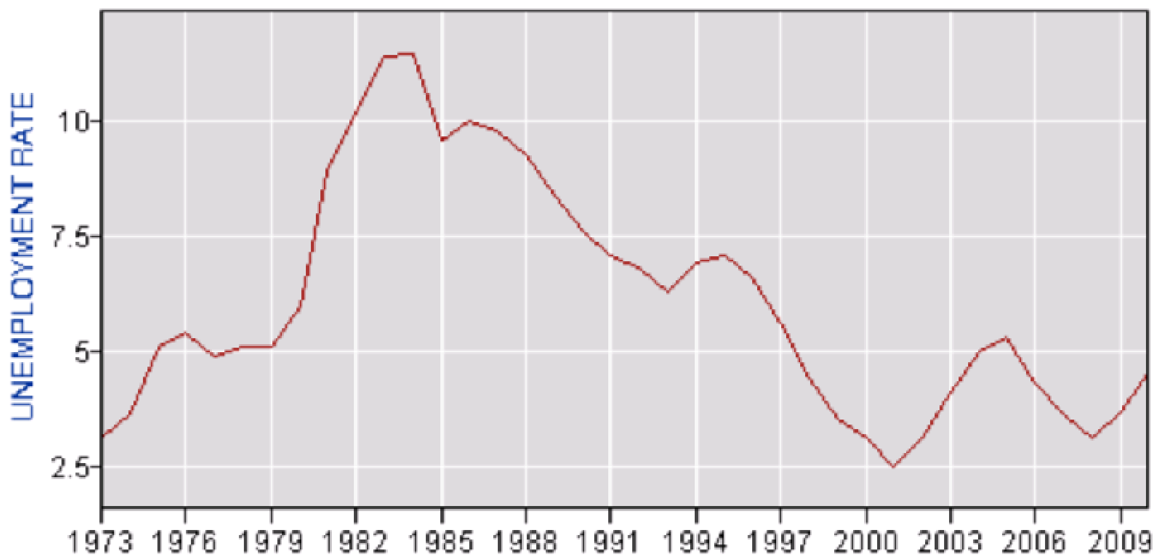
France: Unemployment Rate (US Basis)



It is worth noting that the earlier years depicted on the chart long pre-date the replacement of the franc by the euro which, as prior posts on this blog have noted, now constrains French economic policy. Governments have come and gone in France since the unemployment rate became stuck at relatively high levels in the 1980s. But those high unemployment levels seem to have become a French norm, something to fret about perhaps, but not something that leads policy makers to make drastic changes or to question basic assumptions.

What is also of interest is that the comparative data do not show uniformity in unemployment rates across EU countries. For example, the chart below shows the Dutch unemployment rate through 2009 (the latest year available currently from the U.S. Bureau of Labor Statistics database). Thus, French policy makers would not have to look very far to find a country whose unemployment rate fell notably after its rise in the early 1980s and that has generally fluctuated at lower levels than found in France.

Netherlands: Unemployment Rate (US Basis)



In short, there is reason to think that political inertia can arise in countries where unemployment remains high for an extended period. The jobless problem comes to be seen as inevitable or structural or is rationalized as due to some cause that cannot be much affected by policy.

"Technology" was a common villain in the U.S. of the 1930s. It was revived again during the "automation scare" of the 1950s and early 1960s. [See the accompanying video posted at http://www.employmentpolicy.org/automation-scare-1950s.] In both cases, wartime expenditures (World War II after the 1930s; Vietnam after the early 1960s) dropped the unemployment rate dramatically.

The technology/structural stories in the U.S. faded away both times after the unemployment rate dropped. But memories in policy circles are short. History suggests old tales can return. Indeed, they already have.