

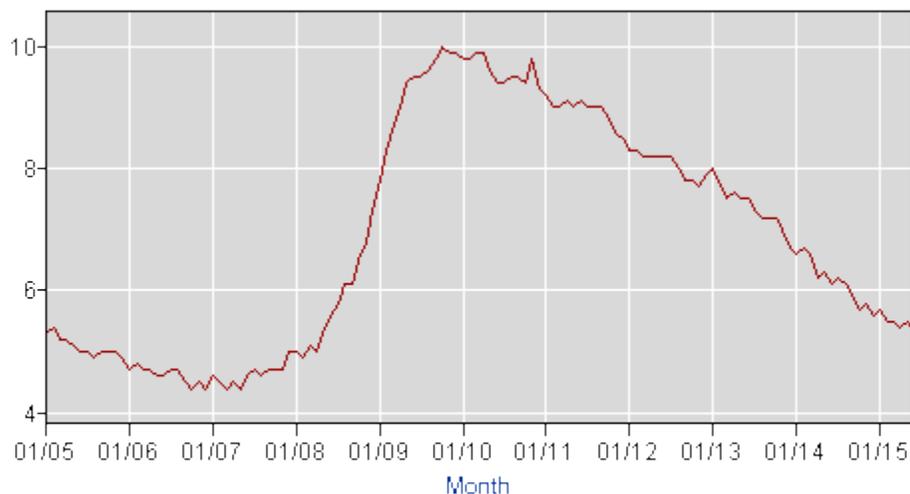
Mitchell's Musings 7-13-15: Worker-Skill Mismatch or Something Else?

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Has the labor market changed since its last business cycle peak in 2007? Between then and now, we had the Great Recession which presumably could have made structural alterations to the way the labor market functions. The most widely used measure of labor market conditions is the official unemployment rate. Unemployment by that index is falling towards levels similar to the last peak as can be seen on the chart below. So, although we are not necessarily at the next peak, are we coming back to “normal”?

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Unemployment Rate, Seasonally adjusted

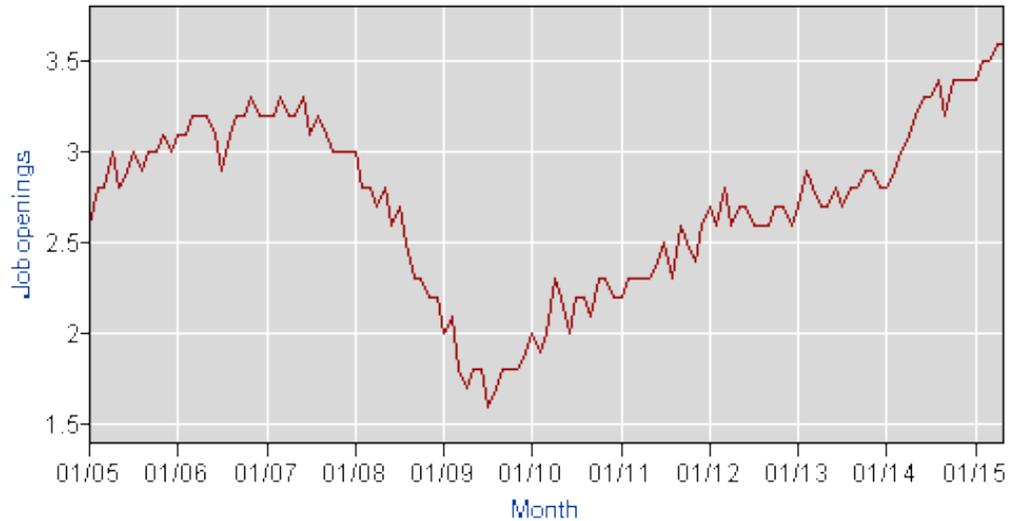


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There are other measures of the labor market which suggest that things now are “different” relative to what they were at the 2007 peak. Among them is the job openings rate (or vacancy rate) which is currently above the previous-peak levels even though unemployment is still higher than at prior-peak levels. The chart below illustrates that shift between the prior peak and now. It shows, as just noted, that the job openings rate is higher now than then.

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Job Openings Rate, Seasonally adjusted



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Moreover, the job openings rate shift seems to have occurred at around the time the Great Recession bottomed out in 2009. That is, it is not just recently that job openings could be viewed as higher than you might have expected *given the condition of the labor market*. The U.S. Bureau of Labor Statistics (BLS) provides a chart of the so-called “Beveridge curve,” the (inverse) relation between the job openings (vacancy) rate and the unemployment rate. A standard interpretation is that if the Beveridge curve shifts up and to the right on the chart, there is some kind of new inefficiency that has been introduced into the labor market. You can view the curve shift as indicating that it takes more vacancies than “normal” (with “normal” meaning what the relation was before the 2007 peak) to bring the unemployment rate down to any given level.

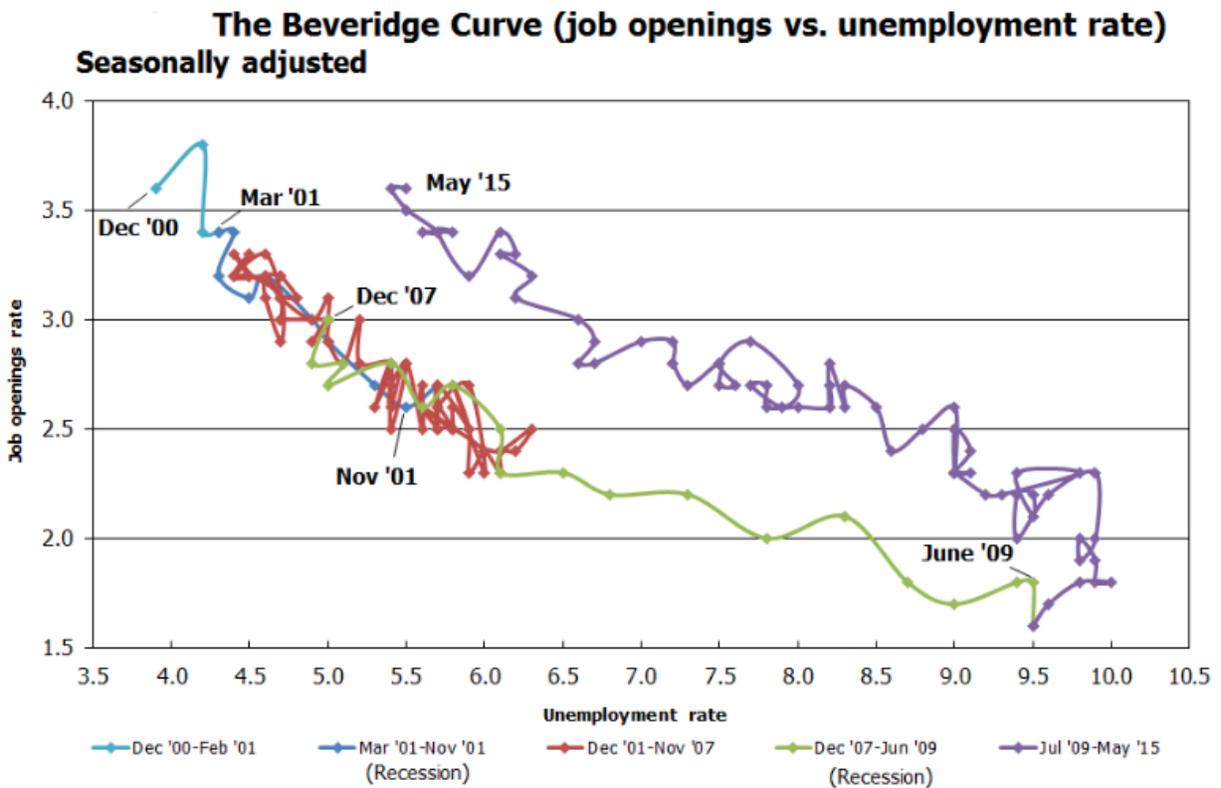
But what is the nature of that inefficiency? Whose fault is it? BLS provides a standard interpretation of the curve shift along with its chart:¹

¹http://www.bls.gov/web/jolts/jlt_labstatgraphs.pdf

The position of the curve is determined by the efficiency of the labor market. For example, a greater mismatch between available jobs and the unemployed in terms of skills or location would cause the curve to shift outward (up and toward the right).

Although the BLS doesn't specify the nature of the inefficiency, a standard story is that worker skills don't match employer needs; worker skills have somehow eroded or become outmoded.

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Source: Bureau of Labor Statistics, Current Population Survey and Job Openings and Labor Turnover Survey, July 7, 2015.

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There is a puzzle to the worker skill mismatch story. While it's possible for worker skills to become outmoded over time if they are not employed, as with capital depreciation, the effect should take a while to set in. The fancy word for this explanation of depreciating skills is "hysteresis" in the labor market. Whatever you call it, the skill erosion story seems to put the onus for the problem on the supply side (worker side) of the labor market. Workers, the story

implies, should update their skills to meet employer needs. When they do, they will get jobs more easily. If you are more liberal in your political orientation, you might alternatively say that we need public programs to subsidize retraining. Workers need retraining, in that view, but government should help them obtain it.

However, labor markets have two sides. What about the demand side (employer side)? When a sharp recession occurs, there is a period thereafter during which recruitment is easy for employers. Applicants are plentiful. Employers need not do much more than let it be known that jobs are available to have a queue of applicants. That phenomenon – long queues - is a sudden effect that emerges with a sharp recession.

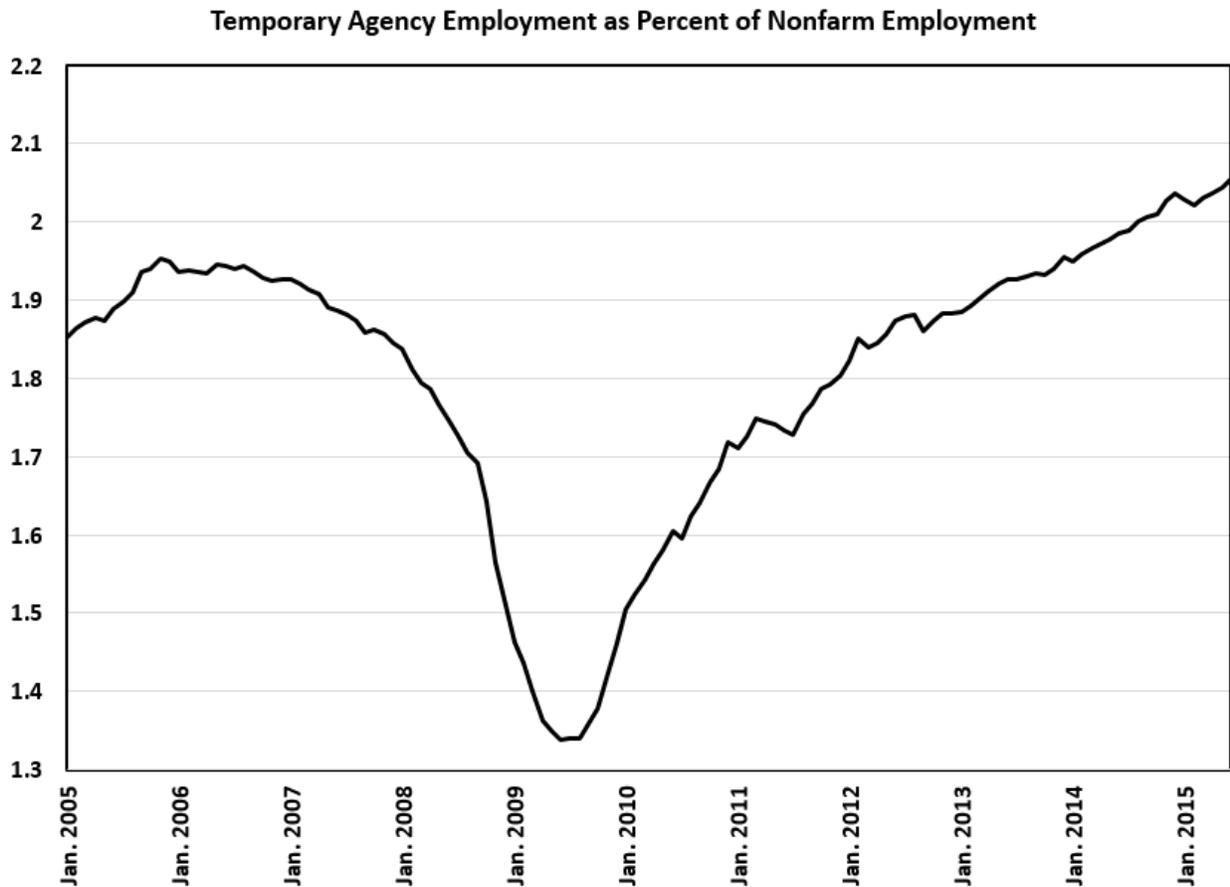
Unlike unemployed worker skill erosion which occurs over time, no gradual change is involved on the employer side. So it could be that the skill that has eroded is not a worker skill but an employer skill. The lost skill – if that is the right word - is employer aggressiveness in recruitment. Employers, in this alternative story, have forgotten that it is sometimes necessary to reshape jobs to worker needs and skills, and to outbid other employers in terms of pay and conditions.

If that demand-side explanation doesn't suit you, here is another story, also on the demand side. Hiring can be loosely considered indefinite or temporary. Temp hiring can be done through an employment agency or directly by an employer. In either form, it puts the new hires on notice that their jobs are of short duration or are explicitly temporary.

Our labor market data only measure hiring through temp agencies. The data don't reflect any distinction between temporary or indefinite hires. So if workers are hired directly by employers but with a temporary understanding, we have no measure that distinguishes such hires from "regular" employment. We do know, as the chart below shows, that the proportion of hires through temp agencies is now higher than it was at the previous peak. Temp agency hiring can be taken as a proxy for more temporary hiring in both forms (direct and through agencies).

If employers have shifted their hiring toward short-duration labor market contracting, perhaps after having experienced the trauma of having to do mass layoffs of regular employees during the Great Recession, one would expect more vacancies now. Short duration hiring means

frequently having vacancies as the temp hires are let go and replaced. Put another way, there will be more churning in the labor market which is likely to be associated with more vacancies at any point in time.



The point of this musing is not to produce a definitive story of why the Beveridge curve, as charted by BLS, has shifted up and to the right. Rather its point is that assuming the explanation is entirely on the supply (worker) side of the labor market is unwarranted. The supply-oriented explanation of outmoded job applicants has implications. It suggests that there is a skill mismatch problem and that the onus is on the worker (perhaps with government assistance) to fix it. One way or another, workers should get themselves retrained. For example, the recent interest in policies to promote tuition-free community college seems linked to such a diagnosis. But if what we are observing is a change in employer behavior, an exclusive focus on community college tuition or similar measures is aimed at the wrong target. We know from

past experience with high-demand labor markets that employers eventually come up with ways to adapt to the worker supply that is available. In past periods of high demand, employers have boosted their own training efforts. They have bused in workers from more distant areas. They have redesigned jobs. We might start, therefore, by promulgating reminders of such past efforts and by highlighting examples of whatever current efforts in that direction are now occurring.