"Not Working – Where Have All the Good Jobs Gone?" (D. Blanchflower)

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1. Introduction

I want to thank the National Institute for Economic and Social Research for giving me the opportunity to review and discuss Blanchflower's book, "Not Working: Where have all the good jobs gone?"

First, I will briefly summarise what I think the book is about. Then, I will critically evaluate a few key arguments in the book, focusing on three areas: first, different concepts and measurement of labour market slack; second, thinking about productivity and wage growth in an integrated way; and third, the distinction between good policy and good forecasts.

2. Summary

So what is this book about? Fundamentally, it is about the labour market, and the wider impact of the labour market on society. These are hugely important topics that concern all of us, as economists, as policymakers, and fellow citizens. Blanchflower deals with well-being, mental health, anxiety, and also with broad political trends, and tries to establish links between all of them, using an abundance of data.

After the introduction, the book starts in Chapter 2 by reminding us of all the reasons why unemployment is bad. It is unpleasant, it lowers well-being, it causes anxiety and stress, increases crime, drug-use and suicide.

Chapter 3 documents that wage growth has been weak since the Great Recession. Blanchflower emphasises, in particular, that even though unemployment rates in many countries, including the UK and the US, have fallen below pre-recession levels, wage growth has remained subdued. He states that "a 2% pay norm is now operating around the world" (p.55). Blanchflower argues that "the relationship between the unemployment rate and wages that existed pre-recession has been broken, apparently irretrievably" (p. 49).

After documenting the weak wage growth, Chapter 4 sets out to explain it. The main conclusion of the chapter is that labour demand has been too weak. Initially, because we were in the acute phase of the recession, but in the subsequent years, because of what Blanchflower calls the "semi-slump", a prolonged period of weak demand growth. The chapter also talks about homeownership, in particular that high rates of homeownership are bad for labour market mobility, and inhibit the creation of new businesses, and generally result in a less efficient allocation of resources across high and low productivity areas. Blanchflower also asks the question of why participation in the US has fallen in the recession and stayed low, while in the UK it remained high and even rose further. Although distinct from the question of weak average wage growth, Blanchflower also discusses inequality, especially rising wealth and income inequality in the US, and the death of the

American Dream as fewer children earn more than their parents, and fewer own their own homes.

Chapter 5 discusses underemployment. The basic insight is a simple, but profound one. The unemployment rate is not a comprehensive measure of labour market slack. There are workers who work part-time, but would like to work full time. There are workers who work part-time, and would like to work a different number of hours. There are workers who work full-time, and would like to work a different number of hours. The idea is that some workers, even though employed, are not fully employed. In other words, there is underemployment. Hence it is possible that, despite low rates of unemployment, there is still slack in the labour market. The chapter then goes into some detail to document both the existence of underemployment, and evidence of its effect on wages. The chapter comes to some quite strong conclusions. According to the book, it is not just the case that underemployment matters for wage pressure, in addition to unemployment. Blanchflower takes the argument one step further, and argues that underemployment is now the only thing that matters for wages. He says: “Underemployment matters these days as a measure of labor market slack in wage determination while unemployment does not” (p. 144). “In the post-recession period underemployment has replaced unemployment as the main indicator of labour market slack” (p. 144).

We now move to the second part of the book, entitled “The Response to the Great Recession”.

Chapter 6 discusses in some detail who did and who did not see the Great Recession coming. It also has a long list of complaints against modern macroeconomics, and argues macroeconomists have lost their way, focusing too much on theory and elegant mathematics, not enough on data analysis. There is a discussion of the economic arguments for austerity, and the fact that this, according to the book, turned out to be a big mistake.

Chapter 7 continues on the theme of being able to spot the Great Recession. There is a strong plea to do more data analysis, and an accusation that too few economists spend enough time analysing data. The chapter provides a number of examples of data sources that are – in his Blanchflower’s view – underused. Blanchflower calls his own approach to examining data “the economics of walking about” or EWA. There are amusing details on hemline length and use of lipstick, as well as the characteristics of vineyards to establish wine quality. There are also several reports of speaking to cab drivers. In the end, I am not sure whether EWA actually involves much “walking around”, or whether it involves analysing a wide range of data sources. Despite some ambiguity about what EWA actually is, there is no ambiguity about its usefulness. The chapter comes to the striking conclusion that “The crisis was totally predictable using the EWA” (p. 204).

Chapter 8 is about the wider societal impact of the economic trends of the past decade. There is a detailed discussion about the US opioid crisis, data on the rise of depression, mental health problems generally, and obesity. Many themes from earlier chapters are reprised, in particular the death of the American dream, the collapse of the white working class, and the decline of rural communities relative to urban communities. The chapter also goes into significant detail on Blanchflower's research agenda on well-being and what determines it.

Chapter 9, entitled "Somebody has to be blamed", is a political economy analysis of the rise of populist politicians and their focus on immigration. The striking contrast is highlighted between the perception of immigrants (that there are a huge number of them, who take our jobs and lower our wages) and the research findings on immigrants (that there are systemically fewer immigrants than people think, and there is no convincing evidence that they take our jobs or lower our wages). There is a lot of useful detail on the various potential economic consequences of immigration that have been studied in depth. Not only do immigrants <u>not</u> take our jobs and wages, on the contrary, they seem to add both to fiscal revenues and to GDP per capita. There is some interesting analysis of stock vs flow effects of immigration, i.e. areas where there are many immigrants seem less bothered by immigration than areas with fewer immigrants, but where immigration has been rising rapidly.

Chapter 10, "Disastrous Cries for Help", continues the political economy theme. The voters that voted for Brexit and for Trump, it is argued, live in places that are hurting, that have been neglected. They are older, less educated, on lower pay and suffer a lower quality of public services. They also, the chapter argues, feel nationalist pride and are socially conservative, and feel that mainstream political parties, which are united in a pro-immigration and pro-globalisation viewpoint, no longer represent their interests. Their anger with the status quo has been further fuelled by the aftermath of the Great Recession, which they view has having unfairly transferred public resources to those in the private sector who helped cause the crisis by taking excessive risks.

The third and final part of the book deals with the policy implications of the economic and social challenges that have been documented. It is argued that weak labour demand and the resulting weak real wage growth is the root cause of all the resentment. Policymakers should run the economy hot, get wage growth up to around 4 to 5%, which will bring back the feel-good factor, and reduce the appeal of populist politicians. If economies run at full employment, Blanchflower argues, this would obviously boost availability of good jobs, by which he means high-paying jobs. Blanchflower asserts that full employment is likely to be reached only when the unemployment rate falls to around 2.5%. That is a level not seen since the 1950s, and well below the current UK and US unemployment rates of 3.8% and 3.6% respectively. He argues that economists' estimates that the NAIRU (Non-Accelerating Inflation Rate of Unemployment) is around 4 to 4 ½% are wrong. He argues that there has been a structural break in the NAIRU since the Great Recession, which most economists and policymakers have missed.

The final chapter gives concrete policy recommendations to achieve full employment and high wage growth. Interest rate increases by the Federal Reserve and Bank of England so far have been a mistake, and have been "based on no data" (p. 316). Interest rates should go back to zero or negative until wage growth exceeds 4%. There should be increased government spending on infrastructure. There should be increased education on the economic benefits of immigration to reduce anti-immigrant sentiment. Childcare should be subsidized, as should the costs of moving home. The tax burden on low earners should be eased. And the idea of a jobs guarantee or universal income should be studied further, and implemented as pilot programmes to test their potential.

3. Critical review

I will now turn to my critical evaluation of a few sections of the book. There is much in the book that I liked and agreed with. Danny's long-standing research agenda on well-being is a welcome broadening of the economics discipline beyond income and employment. His attempt to bring together economic and political consequences into a single framework is commendable. But since I was asked to provide a critical discussion, I will now focus on those parts of the book on which I have a different point of view.

a) Underemployment and the NAIRU

My first topic will be about the measurement and concepts of labour market slack and underemployment, and their impact on wages. Blanchflower has made useful contributions in this area, not only in the econometric analysis, but more broadly in bringing the concept of underemployment to a wider audience. I have a lot of sympathy with the concept, as do many of my MPC colleagues. Detailed analysis of underemployment is part of our regular toolkit, and I have, for example, analysed it in some detail in a recent speech[1] as one of the reasons why wage growth has been subdued despite low unemployment. We are in agreement on the big picture importance of this concept.

But there are several aspects of Blanchflower's analysis where I reach a different conclusion. First, the finding that the underemployment rate matters, but the unemployment rate does not, is just not robust in my view. As Blanchflower's own charts (Fig 5.2, Fig 5.4) show, the two are highly correlated. That means it is difficult to ascribe wage effects to one rather than the other. I was not able to find economically meaningful effects in UK panel data, although Blanchflower shows some results to that effect, which I have not been able to replicate. To identify such effects reliably, a lot of cross-country and time variation is needed, which is why the IMF study that Blanchflower also cites[2] is so useful, and they find that both underemployment and unemployment matter. When they break down the sample into different subgroups, the coefficient on the unemployment rate becomes insignificant, but the precision with which the coefficient on underemployment is measured also drops sharply, to only borderline significance, so this just shows that the effects of unemployment vs underemployment are hard to distinguish.

A second consequence of the fact that unemployment and underemployment are highly correlated, is that they tell a very similar picture right now about the amount of slack in the UK labour market. Bell and Blanchflower's own constructed underemployment index, which is updated regularly on the Resolution Foundation's website, has in fact fallen back below its pre-recession level. On the most recent data, it stands at 4.1%, the same level as in 2005. Using this measure does not suggest there is a large amount of labour market slack left.

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[1] Vlieghe (2018), ,"From Asymmetry to Symmetry: Changing Risks to the Economic Outlook", speech to CBI, Birmingham.

[2] Hong et al (2018), "More Slack than Meets the Eye? Recent Wages Dynamics in Advanced Economies", IMF Working Paper 18/50.

I also want to discuss Blanchflower's strong assertion that the NAIRU has fallen to 2.5%, and that it has experienced a structural break since the Great Recession.

First, empirical models of the NAIRU are, it is true, rather imprecise. But they indicate that the NAIRU has fallen gradually, to levels around 4%, not suddenly, to levels around 2.5% as Blanchflower argues.

Second, the underlying drivers of the decline in the NAIRU that Blanchflower suggests, such as globalisation, lower union membership, and reduced bargaining power of workers, show no sharp break at all. Globalisation has been a gradual process over multiple decades, and it did not accelerate since the recession. Similarly, UK union membership has been declining since the 1980s, and shows no break since the recession. The argument about bargaining power shifting away from labour towards capital has to be confronted with the fact that UK data on the share of labour in value added has been little changed over the past two decades[3].

Third, Blanchflower's reasoning that declining homeownership since the recession has increased labour mobility which will lower the NAIRU, stands in contrast to findings in both the US and the UK that geographical labour mobility has been on a declining trend[4]. For me to put a lot of weight on the idea that NAIRU has experienced a structural break sharply lower, I would need a more convincing set of reasons than Blanchflower has proposed so far.

b) An integrated view of productivity and wages

The next issue in the book that I want to address is productivity growth. While productivity growth appears occasionally in the book, it is largely divorced from the main themes of the book. Blanchflower defines the weak wage puzzle by noting that nominal wage growth is still below its pre-recession rate, even though the unemployment rate has fallen below the pre-recession level. He claims to solve the puzzle by noting that there must be insufficient labour demand, and that the resulting slack is evident in underemployment.

I feel strongly that we should discuss wages and productivity jointly. Blanchflower has some isolated reference to productivity. Once he notes that the UK has hired more low-paid, less productive workers. And once he simply asserts that weak productivity growth has been due to austerity and weak investment. But Blanchflower never engages with the argument that, if productivity growth has fallen from 1 ¾ - 2 % in the years leading up to the recession to a pace of ½ to ¾ % since the recession, the pace of wage growth consistent with full employment might be 1 to 1 ½ percentage points lower than it was before the recession.

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[3] Measuring the labour share is difficult because one needs to take a stand on how to allocate mixed income. Using four different methods suggested by the ONS shows that none of the measures trend down over the past two decades, and some in fact trend up slightly. See Sidhu and Dunn (2018), "Estimating the impact of the self-employed on the labour share", ONS Notice.

[4] Molloy, Smith, Trezzi, Wozniak (2016), "Understanding Declining Fluidity in the US Labour Market", Brookings Paper on Economic Activity. For the UK, see Judge, L (2019), "Moving Matters: Housing costs and labour market mobility", Resolution Foundation.

This seems a fundamental omission from the analysis. It is also consistent with the cross-country IMF study on the determinants of wages[5], which finds that productivity growth is a major determinant of wage growth, with a coefficient of between 0.6 and 0.9. This is not just a finding that might be put down to data mining or spurious results. Instead, I would argue this consistent with most macroeconomists' view of one of the fundamental long-run drivers of real wage growth in equilibrium, which the data seems to support.

I thought he would perhaps argue that, if only there was more demand stimulus, higher productivity growth might return, i.e. that some part of the lost productivity is cyclical and reflects lower intensity of factor utilisation, not structural developments. I would have some sympathy with that idea. But he does not make this argument anywhere in the book. In fact, he points out that the MPC have been consistently too optimistic on productivity growth. I do not see how one can simultaneously argue that productivity growth is permanently weaker, but nominal wage growth can nevertheless be boosted back to pre-recession levels without causing inflation to go above the target.

c) Forecasting recessions, and the usefulness of macroeconomists and policymakers

The third theme of the book where I differ from Blanchflower is on his discussion of forecasting and monetary policy. There is a historical element to this, related to predicting the 2008 recession, and there is a current element to this, related to the MPC's recent wage forecasts and monetary policy decisions.

I have previously argued[6], as have countless others, that the usefulness of policymakers (or macroeconomists more generally) should not be measured by their ability to forecast recessions, in the same way that the usefulness of doctors is not measured by their ability to forecast heart attacks. Instead, the usefulness of policymakers lies in their response to a recession when it is happening, and their understanding of general risk factors beforehand, just as the usefulness of a doctor lies in her treatment of a heart attack once it is happening, and her prescriptions for a healthy lifestyle to reduce the risk of a heart attack beforehand.

Let us take the historical perspective first. Blanchflower claims that there was a failure of policymakers, and macroeconomists generally, to spot the 2008 recession beforehand, which is true. However, I would emphasize that policymakers generally responded aggressively and appropriately once the recession hit, by cutting interest rates by large amounts in a short space of time, and engaging in large scale asset purchases. In addition I believe that by the time the financial imbalances in the economy had been built up, it would have made little difference if the interest rate cuts had happened a few months earlier than they actually did.

A careful look at the timeline of Blanchflower's own decisions while on the MPC, and his own recollection of events as detailed in the book, are useful to make these points. Blanchflower claims it was all obvious to him, and everyone else was making a policy mistake. But in his own detailed time-line of events on pages 198-205, he describes the

[5] Hong et al (2018), ibid.
[6] Vlieghe (2017), "Good policy vs accurate forecasts", speech at Bloomberg, London.

following evolution of his thinking. From October 2007, he started voting for a 25bp interest rate cut. Two months later, in December, the MPC started cutting rates. In the spring of 2008, Blanchflower was becoming more concerned about the outlook, but did not think the economy was necessarily heading for a recession. Rather, he thought, and said, there was a risk that the UK may fall into recession. By August 2008, by his own admission, he doubted his own gloom, given the reasonably strong preliminary data for Q2 of that year. In any case, he was still only voting for a 25bp rate cut, while the majority of the MPC had paused between May and October 2008. In September 2008, Blanchflower became convinced the recession was happening, and voted for a 50bp cut. By the following month, the rest of the MPC had come to the same conclusion and did in fact cut by 50bp, followed by a further 400bp in the next five meetings.

I want to draw two conclusions here. First, in real time, it was in fact not "obvious", even to Blanchflower, that the recession was coming, according to his own detailed version of events. Second, even though he must get some credit for being a little faster to catch on than his colleagues, he was just a few months ahead of them, and he generally only voted for small changes in interest rates. I find it hard to believe that cutting interest rates by a small amount a few months before the MPC actually did, would have made much difference to how the economy responded to the recession. To argue that a 50bp cut one month earlier, or interest rates 25bp lower for the previous year, would have made any material difference is strongly at odds with all the data we have on the effects of monetary policy.

Next, I want to discuss briefly the more recent years of policymaking. Blanchflower points out repeatedly that the MPC's wage forecasts that were too optimistic. He claims the MPC was forecasting that wages would "explode" or "rocket". It is true that for several years the MPC wage forecasts were too optimistic, as were the MPC's productivity forecasts. But the forecasts were for wage growth to pick up gradually from 2% to 3% and sometimes to 4% several years into the future. Hardly an explosion of wages. More importantly, for most of that period the MPC did not actually raise interest rates. While some MPC members did at times signal and vote for rate rises, the committee overall were sufficiently cautious about the outlook, and modest about their ability to forecast wages several years out, that they did not respond to higher wage forecasts, only to higher wage data.

Blanchflower insisted there was a 2% "wage norm". This is a concept that is not particularly useful to a policymaker, because it basically says that wage growth will be 2% until it is no longer 2%. In fact, in the past years the data have shown a slow pick-up in wage growth, from around 1% in 2013-2014, to 2-2 ½ % in 2015-2017, to 3 – 3 ½% in 2018-2019. That was consistent with a reduction in labour market slack while productivity growth remained weak. The policy response by the MPC was to raise rates by just 25bp in 2017 and 25bp in 2018. Hardly the response of a committee that expects a wage "explosion". Despite overly optimistic wage forecasts, the committee acted cautiously, did not blindly follow any particular economic model, and responded only when the data showed actual improvement.

Blanchflower rightly deplores the loss of trust in experts. The role of experts in policy is to use all available evidence and methods to engage in a debate to inform policy. There is room for disagreement by those doing careful analysis based on data. But summarily dismissing and mischaracterising alternative views, as Blanchflower does, risks being unhelpful. By insisting that policymakers have made poor decisions “based on no data”, and that the mark of a good macro-economist is that he or she should see a recession coming, he might in fact needlessly fuel the mistrust that already exists. Mistrust that arises from misunderstandings about what policymakers can and should do, and what macro-economists can and should do.

As I said at the start of this section, there is much in the book that I like and agree with, and I have focused my critical comments on those areas where I disagreed. The book has therefore stimulated debate already, and I fully expect it will continue to do so, contributing to improved decision-making and a well-focused research agenda in the process.