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WEEK OF APRIL 10, 2006—MORE JOBS?

The strength of any recovery depends on both the quantity and quality of jobs. This recovery from the 2001 recession is no exception. We have to date created more than 5 million jobs since then, which is a bit sub-par as recoveries go. But job formation seems to be picking up steam this year, though much of it (202,000 in March) is in the lower paying service sector of our economy (which includs real estate), according to the Household survey—one of two surveys used in the Labor Department's monthly unemployment report.

That is both good and bad. It is good because slower rising wages mean less worry about wage inflation. Wages in fact have been rising at just the rate of inflation—3.4 percent of late. It is bad because 80 percent of our labor force that are paid wages and salaries have been borrowing heavily since 2001 to keep consuming. The rest of the work force is either self-employed, or just plain independently wealthy.

The question is whether the Federal Reserve will think this is too much of a good thing. I.e., as the unemployment rate continues to sink—it just dropped back to 4.7 percent in March—jobs will become scarce and so ignite wage inflation (Wages are two-thirds of product costs.). Barron's Magazine columnist Gene Epstein believes that we have already reached that point. He in fact believes the jobless rate could continue to fall to 4 percent over the next 12 months at the present rate of job formation and so inflation pressures will continue to increase.

The "Non Accelerating Inflation Rate of Unemployment", or NAIRU, is the name given to the unemployment rate that signals when the jobs market is overheating. In the 1990s it was believed to be 6 percent, and beholden to what is called the Phillips Curve. This is a formula that equates a certain low unemployment rate with higher inflation.

But then something that former Fed Chairman Alan Greenspan foresaw happened. Labor productivity soared due to the high tech revolution, and one worker could produce more. It therefore cost less to produce an item, and inflation pressures stayed low for much of the 1990s, even at a very low unemployment rate. (The rate fell as low as 3.9 percent in 1999.)

Our new Fed Chairman Ben Bernanke seems to believe otherwise. Though he stated in a recent address to the New York Economic Association that the Phillips Curve had become outmoded, he believes we still have to remain vigilant about inflation (with a low unemployment rate)!

The question then is how tight is the labor market? A recent book by the New York Times labor columnist Louis Uchitelle entitled "The Disposable American", says that since 2000, at least, there have been more skilled workers than jobs—2.6 workers per job, in fact. This is mainly because more are graduating from college than ever—30 percent of our population, vs. 10 percent in the 1960s. There are now 5,000,000 more workers looking for work than there are jobs, according to Uchitelle.

It has been a myth that wage inflation was caused by a tight labor market, in other words. Rising wages were caused by other factors that enhanced the bargaining power of

wage earners, such as labor unions, pro-labor laws, and regulation of certain sectors such as airlines, banks and broadcasting.

Now that regulation has all but disappeared and globalization taken hold, labor has lost its clout to maintain a wage scale that is above the inflation rate. The competition for jobs is not only between domestic vs. cheaper foreign workers, but skilled domestic workers now must compete with each other. The American worker has become disposable, in a word.

No one has yet come up with an answer for the problem of the underpaid and over indebted wage earner in this business cycle. American workers have not accepted this situation in past recovery cycles, such as after the 3 recessions from 1981 to 1991—not when they make up 80 percent of the workforce. Either lawmakers will cry for more protectionist legislation, or better educational opportunities, or stronger labor laws, or a better governmental safety net of unemployment benefits and pensions, as has happened in Europe and Japan.

The Federal Reserve may be getting the message that further tightening could damage what has been a weak recovery. Release of the last FOMC minutes show that many Fed Governors were becoming concerned that they had pushed interest rates too high, and that a pause may be necessary to assess the effects of the 15 consecutive rate hikes to date.

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