



Employment Miracles

Beth Anne Wilson
Federal Reserve Board

Paper presented at the 13th Jacques Polak Annual Research Conference
Hosted by the International Monetary Fund
Washington, DC—November 8–9, 2012

The views expressed in this paper are those of the author(s) only, and the presence of them, or of links to them, on the IMF website does not imply that the IMF, its Executive Board, or its management endorses or shares the views expressed in the paper.



Comments on “Employment Miracles”

► **Beth Anne Wilson**, Federal Reserve Board of Governors

**Thirteenth Jacques Polak Annual Research Conference
November 9, 2012**



Disclaimer

The views in this presentation are solely the responsibility of the author and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or of any other person associated with the Federal Reserve System.



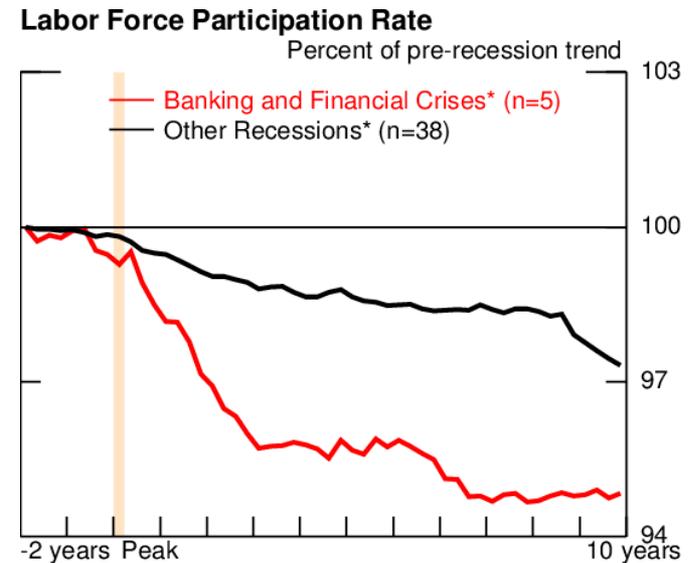
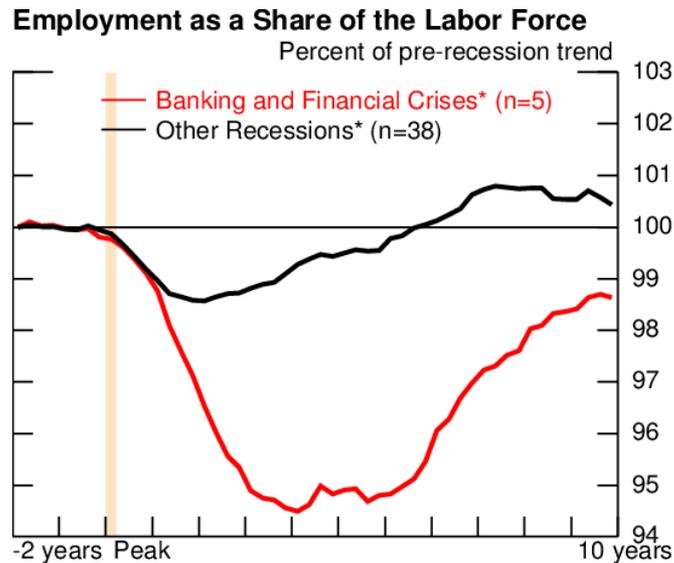
Scene Setting

- **Economists and policymakers alike have been focusing on the behavior of economies following recessions, especially recessions related to banking and financial crises.**
- **And, for the most part, the conclusions have not been encouraging.**



Scene Setting

- Most work finds it takes a long time for labor markets to recover from crises, if ever.



* Solid lines are means from data on advanced economies. Trend is exponential function growing at the 4-year average 2 years prior to the peak. Data are from Raffo and Ohanian (2010). Charts from Howard, Martin, Wilson (2011).



Scene Setting

- **Which makes this paper, “Employment Miracles” by Freund and Rijkers, particularly relevant and potentially reassuring.**



Summary

- **Many have tried to explain the level and change in the unemployment rate in terms of macro conditions, institutions, regulations, political environment, etc.**
- **Freund and Rijkers take a bit different approach. Start with successes or “employment miracles” – swift, substantial, sustained declines in unemployment rates – and see what factors predict them.**



Summary

- **Results – Of the myriad of macro, political, structural, and institutional variables that might predict an employment miracle, two stand out.**
 - **Level of unemployment rate.**
 - **Degree of economic freedom, e.g.**
 - Time to enforce a contract
 - Control of corruption
 - Rule of law



Implications

- **“How can policymakers engineer enduring reductions in unemployment?”**



Implications

- **“How can policymakers engineer enduring reductions in unemployment?”**
- **Answer from their results...**



Implications

- **“How can policymakers engineer enduring reductions in unemployment?”**
- **Answer from their results...**
 - (1) Start by running up the unemployment rate.**



Implications

- **“How can policymakers engineer enduring reductions in unemployment?”**
- **Answer from their results...**
 - (1) Start by running up the unemployment rate.**
 - (2) Have good institutions and improve them.**



Implications

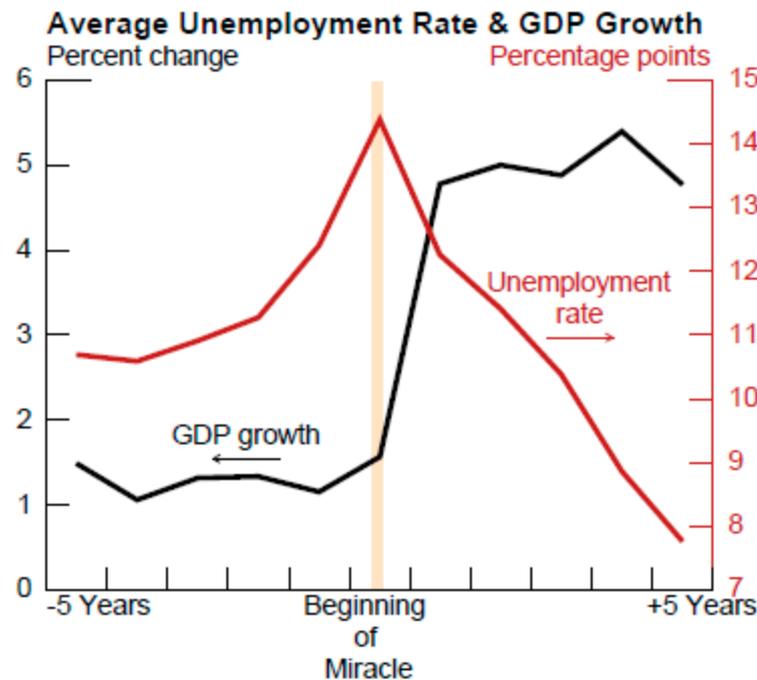
(1) Employment miracles appear to be related to the cycle.

- **“Countries that witness miracles have significantly higher initial unemployment...than countries in which miracles do not occur.”**
- **“The most potent predictor of the incidence of miracles is initial unemployment.”**
- **“Miracles coincide with acceleration in growth.”**



Implications

- See this in the pattern of unemployment rate and growth for miracles.



Source: World Development Indicators.



Implications

- **See this when look closely at each miracle.**
 - **Many miracles follow periods of financial crisis.**
 - Korea '98, Russia '99 (and related Baltic and Central European miracles), EMU crisis in early 1990s, Latin American debt crisis '82, Mexican crisis '95, etc.
 - (Need to broaden definition of crisis beyond banking in empirical work.)
 - **Vast majority follow in heels of recession.**
 - At least 31 miracles start within 2 years following a recession. (US '83, Canada '83)



Implications

- **Leaves me concerned that this is less “miraculous” and more “what goes up must come down.”**
 - **Better control for cycle.**
 - Deviation of UR at start of miracle from own country pre-miracle average.
 - Indicator for recession in previous x years.
 - Better capture crises – definition and timing.
 - Is this about strong growth or a change in the employment intensity of growth?
 - **Is there a control group?**
 - Countries that also saw big run-ups in UR but no miracle.
 - Are the miracle groups special or do all countries with big increases in UR have miracles?



Implications

- **(2) Freedom!**



- **Comforting result and somewhat intuitive.**
 - Countries with more flexible, less corrupt, better managed institutions and rules are more miracle prone.
 - Aligns with some of the work suggesting that employment growth is stronger when both labor and product markets are liberalized.



Implications

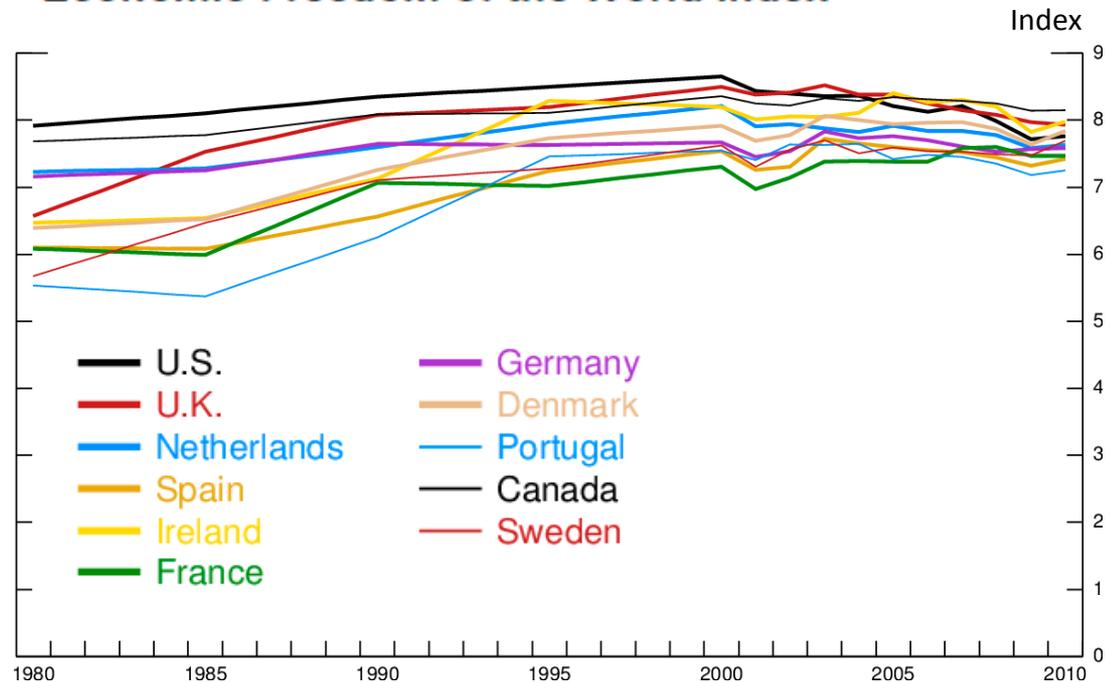
- **Where is the strength of this identification of freedom coming from?**
 - Does it hold up when industrial countries are excluded?
 - Within the industrial group alone?
- **What should we make of the fact that much of the “freedom” data are extrapolated?**
 - Especially in light of the sensitivity of some of the regressions to measurement error.
- **Why are other variables such as labor market rigidities so unimportant?**



Implications

- How should we think of the freedom results in terms of “engineering” a miracle?
 - Level’s high now, but not much room for improvement.

Economic Freedom of the World Index*



Source: Fraser Institute

*Data before 2000 is available in 5-year increments only, so linear interpolation is shown.



Conclusions

- **How comforting is this paper?**
 - **Number of industrial countries with elevated unemployment and high freedom scores.**
 - Would be interesting to use the probit coefficients and run out of sample predictions of miracles.
 - **However, probability of a miracle is likely small.**
 - **Moreover, history suggests labor market outcomes for post-crisis industrial countries are typically far from miraculous.**