

RESTRUCTURE AND RECESSION: A YEAR OF TRANSITION

"Our recent economic problems are a reminder that even a well-functioning economy faces the risk of...setbacks."

—George Bush, Economic Report of the President, February 1992

"[The pace of economic recovery] has been little more than glacial."

—Alan Greenspan, March 1992

With the economy already in recession, 1991 began with the continued threat of conflict in the Persian Gulf. The threat became a reality 15 days later with a war that was swift, ceasing before March, and considered decisive. Real gross domestic product (GDP), however, fell at an annual rate of 2.5 percent the first quarter (see figure 1).

Many forecasted that the end of the war would bring the beginning of economic recovery. Such forecasts appeared to be accurate as the second quarter of 1991 showed signs of improvement. The return of soldiers from the Gulf brought momentary increases in consumer confidence and spending. Real GDP grew at a moderate annual growth rate of 1.4 percent during the second quarter.

Meanwhile, other events revealed that the anticipated recovery had little strength. Notices of staff reductions, which had been circulating throughout many firms in many industries, affected many workers in an unprecedented number of occupations. Unemployment rates climbed and numerous individuals, some for the first time, faced job insecurity.

As usually happens, blue-collar workers with production positions in durables manufacturing suffered the most. Notably, more white-collar workers with professional and management positions were cut than ever before. While some of these losses were due to the declining demand associated with the recession, others resulted from industries and firms reorganizing to survive in an increasingly competitive global market. These structural changes caused many jobs to be eliminated permanently.

Not surprisingly, the economy of the Eighth District during 1991, behaved similarly to the national economy. The Eighth District grew little and was not immune to the restructuring present in many industries. Parts of the District, though, did perform better than the nation, primarily due to the types of industries located in those regions. Key developments in the District and national economies for 1991 are examined below.

Recessionary or Restructural?

Worker cutbacks, temporary as well as permanent, were a pervasive feature of 1991, prompting widespread concern about job security. Declining demand for goods and services can explain the employment reductions; however, it is only a partial explanation given current events. Industrial restructurings contributed too.

The U.S. economy is currently undergoing transformations not experienced since mass production redefined manufacturing. These transformations are occurring in the context of global markets and challenging fundamental ideas about "conducting business," as firms find that their competition is not only from Louisville, Little Rock and Memphis, but also from London, Frankfurt and Tokyo. It is toward this new global capitalism that today's firms are adjusting. Unfortunately, the timing for the restructurings is not ideal because many of the changes have

occurred during the current recessionary period.

To categorize changes in demand as recessionary or restructural, one must attempt to identify the changes as either temporary or permanent, a task easier explained than executed. Recessionary changes are temporary losses in demand that will be regained as the economy begins to expand. Restructural changes are permanent losses in demand caused by external factors, such as advances in technology or changes in people's preferences.

Restructuring requires firms to reorganize. Dismissing employees is generally a key aspect of reorganization. Of the many job losses in 1991, a substantial proportion can be attributed to firms' reorganization plans. For example, on December 18, 1991 General Motors announced its plan to eliminate approximately 74,000 employees over the next four years. One is hard-pressed to observe a decline in demand so dramatic as to warrant this magnitude of reduction. If these changes were because GM foresaw a temporary shift in demand, the adjustments would probably not occur over a four year period.

Another example is the more than 10,000 workers McDonnell Douglas laid off, the majority of whom were released during the latter half of 1990 and early 1991. These layoffs occurred during the height of Operations Desert Shield and Desert Storm, a period during which the United States also witnessed the gradual diminution of the Soviet Union as an adversary. The decline, and eventual demise, of the Soviet Union instigated a major reduction in the demand for defense-related output. This changed international situation will likely cause a shrinking national expenditures for defense during the 1990s and a restructuring of those firms engaged in defense-related production. To prevent or, at least, minimize the effects on the firms from restructuring, many will pursue production for the civilian market.

The recession has also taken its toll. When the Armour Food Company announced the

closing of its Louisville plant in January 1991, citing obsolescence and excess capacity at newer plants as reasons for the shutdown, recessionary forces were at work. When the Essex Group, Inc. closed its Siloam Springs, Arkansas, factory because of poor economic conditions, it too was reacting to recessionary forces.

A firm's decision to move its operations to another part of the District, country or world is more difficult to classify as recessionary or restructural. Many times, moving production to another location is undertaken as a cost-reducing strategy. This strategy can be the result of slackening economic conditions. Possibly, though, the move represents a decision that, from a long-run profit-maximizing perspective, should have occurred earlier. In this case, the onset of the recession exacerbates the existing signals indicating change.

Whether restructural or recessionary, the effects of the changes can be drastic in the short-run. We will see, however, that the outcomes of the two processes can differ. The next section, detailing employment in the District and the nation, launches our discussion into long-run trends of these markets.

District and National Employment in Perspective

To refine the preceding description of employment changes, an overview of the relationship between the District and the nation is in order. Figure 2 depicts employment concentrations for both the District and nation in 1991. The numbers represent the percentages of the nonagricultural work force that are employed in each sector. Overall, the District mirrors the nation with a few noticeable exceptions.

The manufacturing sector is the most obvious exception. While approximately 17 percent of all nonagricultural workers in the United States were employed in the manufacturing

sector, about 21 percent of the District's nonagricultural workers were employed at manufacturing jobs. Between 1990 and 1991, the share of nonagricultural employment in manufacturing declined about 0.4 percentage points both regionally and nationally. A second difference, is that District's share of employment in the wholesale and retail trade sector remained constant last year, while the same sector declined nationally. Finally, the proportion of nonagricultural workers in the finance, insurance and real estate sector (FIRE) did not change last year either nationally or regionally; however, this sector's percentage of District employment remained significantly below its percentage of national employment.

Figure 3 presents three panels which demonstrate the evolution of employment in the nation and District over the past four years. (Note that the left scales are for the District and the right scales are for the United States.) The top panel shows that District movements in total nonagricultural employment were similar to national movements. The nation, however, did record a sharp drop in employment at the start of the current recession, whereas District employment was relatively stable in its employment until the first quarter of 1991. To evaluate these movements, nonagricultural employment is separated into its components, nonmanufacturing and manufacturing employment, and displayed in the middle and bottom panels of figure 3.

The middle panel reveals that changes in District nonmanufacturing employment mirrored the nation's until the first quarter of 1990. At that time, the District's nonmanufacturing employment continued to grow while the United States' declined and then rose sharply until the start of the recession in the third quarter of 1990. At that time, U.S. nonmanufacturing employment began a gradual decline. Meanwhile, District nonmanufacturing employment continued along its upward trend until the first quarter of 1991. Between July 1990 and January

1991, District nonmanufacturing employment grew at an annual rate of 0.5 percent, while national nonmanufacturing employment fell 0.8 percent. During 1991, District and national nonmanufacturing employment exhibited little change.

The bottom panel shows that manufacturing employment has undergone relatively larger changes, fluctuating substantially more in the District than in the nation. (The difference in the scales for the two series, however, slightly exaggerates these relative fluctuations.) U.S. manufacturing employment began its decline as early as the first quarter of 1989, while District manufacturing employment continued to grow until approximately the first quarter of 1990. The District's sharp decline did not begin until approximately the start of the recession. It bottomed out by the second quarter of 1991, which some have suggested as the tentative date for the end of the recession. The decline from July 1990 until April 1991, however, resulted only in an annualized 4.2 percent drop in the District's manufacturing employment levels. During the same period, U.S. manufacturing employment fell at an annualized 5.3 percent. In contrast, for the remainder of 1991, District manufacturing employment did not change, while the U.S. continued to lose these workers.

Long-Run Trends in Employment

Recent employment changes reflect a trend that has been present regionally and nationally for a long time: the increasing importance of employment in the nonmanufacturing sector relative to the manufacturing sector. Numerous examples of this trend exist.

We have previously cited the effects of the restructuring plans of two of the major manufacturing firms present in our regional economy, General Motors and McDonnell Douglas. Both firms specialize in the production of transportation equipment and rely on a variety of other

produced durables for their inputs, such as electrical and nonelectrical equipment. These industries employ large numbers of production (assembly line) workers, most of whom are classified as semi-skilled, they unionized and receive high wages. We have also already observed that many of these jobs have been lost permanently in the current recessionary/restructural period. As these workers attempt to become re-employed, they frequently find that most of the available opportunities are in the nonmanufacturing sectors, where the job requirements may not be compatible with the workers' skills. As a result, the job search is lengthened.

Another group experiencing high levels of unemployment is professionals, such as engineers and managers. Many of these workers also come from manufacturing firms, but their re-employment differs slightly from that of production workers. While the professionals can be classified as skilled, their work experiences may be too specific to be valuable for other firms. Engineers laid off by McDonnell Douglas, for example, are experienced at designing defense-related output. Many firms, therefore, are trying to incorporate these specific skills into civilian rather than military production to make them valuable. Managers may find that, while their skills are more transferable than engineers', the positions they are losing may not exist at firms in other industries because of an economy-wide attempt to streamline and consolidate management.

The difficulties of moving labor from manufacturing to nonmanufacturing industries, along with the mismatch of those skills possessed with the skills demanded, affect unemployment rates. Movements in the unemployment rate for the United States, the District, Arkansas, Kentucky, Missouri and Tennessee are displayed in Figure 4. ¹

¹These states are used to represent the Eighth District because they comprise more than the majority of the District's economic activity.

While much of the increase in these unemployment rates can be attributed to cyclical factors (the recession), a portion is also due to structural factors (the reorganizations). One effect of the structural component is that significant reductions in the unemployment rate may not occur, even as the economy improves because it takes longer for structurally unemployed people to find new jobs than for cyclically unemployed people. This is not to say that the full employment rate of unemployment—the rate of unemployment that exists when the economy is producing its potential level of output—has increased, only that more time may be needed to return to the full employment rate of unemployment again.

Figure 5 demonstrates that the average duration of unemployment in weeks (the average amount of time a person can expect to remain unemployed) has steadily increased since mid-1989. To substantiate the existence of an important structural component, however, we would have to observe a continued elevation of this number even after the onset of economic recovery. This remains to be seen.

Precise measurement of the full employment rate of unemployment is controversial because it is quite difficult to know exactly when an economy is producing at its potential level of output. Nevertheless, most experts agree that the rate lies between 5 percent and 6 percent. How many jobs, then, would have to be created to reduce the current unemployment rate by approximately the two percentage points needed to achieve the full employment rate of unemployment? At a minimum, such a reduction would require 2.5 million jobs nationally, with 160,000 of them in the Eighth District, given a U.S. labor force of approximately 125 million people and a District labor force of approximately eight million people.

This calculation is likely a low estimate of the number of new jobs required to reach full employment because it assumes no further increases in the number of unemployed persons. In

addition, these figures are conservative because they do not account for discouraged workers, who want to work, but who are not actively searching for a job because of recessionary conditions.² This group is not counted in the official unemployment statistic and, therefore, not included in the labor force measurements.

To illustrate, suppose the 2.5 million jobs cited above were generated and were filled by unemployed workers. Discouraged workers, seeing the job creation and the potential for finding a position compatible with their skills, now re-enter the market by actively looking for a job. As these people re-enter the market, they become included in the unemployment statistic so that it may appear not to fall even though jobs are being created and filled. This might mean three or four million jobs would need to be created to reduce the unemployment rate rather than the 2.5 million estimated above. Not knowing the rate of re-entry of these discouraged workers makes an exact prediction difficult. Hence, accounting for these discouraged workers could increase the above estimates of job creation significantly, depending on the size of the group.

Looking Backward and Forward

1991 was a year of transition. Unfortunately, the economy suffered through a recession and a restructuring. Some forecasters have suggested that the recovery began during the second quarter of 1991, and expect the U.S. economy to continue improving throughout 1992, especially during the second half of the year. The effects of the recession, while unquestionably serious to the individuals affected, were not too dramatic for the economy as a whole. The effects of the restructuring, on the other hand, will continue to be felt until firms and individuals adjust their

²For an explanation of discouraged workers and their effect on unemployment rates, please see Adam M. Zaretsky "How Well Does Unemployment Explain the Low Levels of Consumer Confidence?" Pieces of Eight – An Economic Perspective on the Eighth District, Federal Reserve Bank of St. Louis (March 1992), pp. 1-4.

conceptions and expectations to the demands of the new system. Emerging from this restructuring, however, we should find an economy better equipped to compete in international markets.