

UNDERSTANDING THE SEVERITY OF THE CURRENT LABOR SLUMP

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Many observers of the labor market have underestimated the severity of the current labor slump by focusing on the unemployment rate and the gains in real hourly wages. In fact, the current slump is setting records for severity in terms of sustained loss of jobs, the increase in labor market slack, and the decline in aggregate wage and salary income.

A number of factors must be considered in order to understand the severity of the current labor slump:

- **The record length of time that jobs have failed to recover**—Prior to the current slump, jobs had never fallen over a two and a half year period since monthly job numbers began in 1939. After five months of job gains, payroll jobs in January remained 2.3 million below the level of March 2001.
- **The growth in the working age population since the recession began in March 2001**¹—Even as jobs were shrinking by 1.8%, the working age population (i.e., the number of people of working age) was growing by 3.7%. Had job growth kept up with working age population growth over that period, 7.1 million more payroll jobs would have been filled in January 2004.
- **The effect of the “missing” labor market on the unemployment rate**—The unusually prolonged period without adequate job growth has caused an unprecedented number of people to refrain from actively looking for work, and therefore to be excluded from the unemployment measurement.

Had the labor force grown more in line with the population—as it has in past labor slumps—another 2.2 million people would have been in the labor force in January 2004. This “missing” labor force is significant because the unemployment rate would have been 7.1% had the 2.2 million “missing” workers been considered as unemployed.² The 7.1% unemployment figure provides a better measure of current slack in the labor market than the actual unemployment rate of 5.6%. The 1.5 percentage-point difference reflects the people pushed to the sidelines of the labor market who can be expected to seek work again once job prospects improve. As a result, the official unemployment rate should not be expected to fall very much when the employment picture actually begins to improve.

- **The loss of wage and salary income**—Although real hourly wages have grown since the start of the recession, those gains have been more than offset by declines in the number of jobs and the amount of hours paid per job. Although hours of work have increased, in recent months real hourly wages have stopped improving.

The U.S. labor market has remained mired in a slump since the recession began in March 2001. This Briefing Paper compares the severity of the current labor slump with that of earlier slumps in terms of both depth and duration, and in terms of both absolute decline and the decline relative to a target based on keeping pace with population growth. Because of the extended period of job loss, the current labor slump is the most severe on record by several important measures:

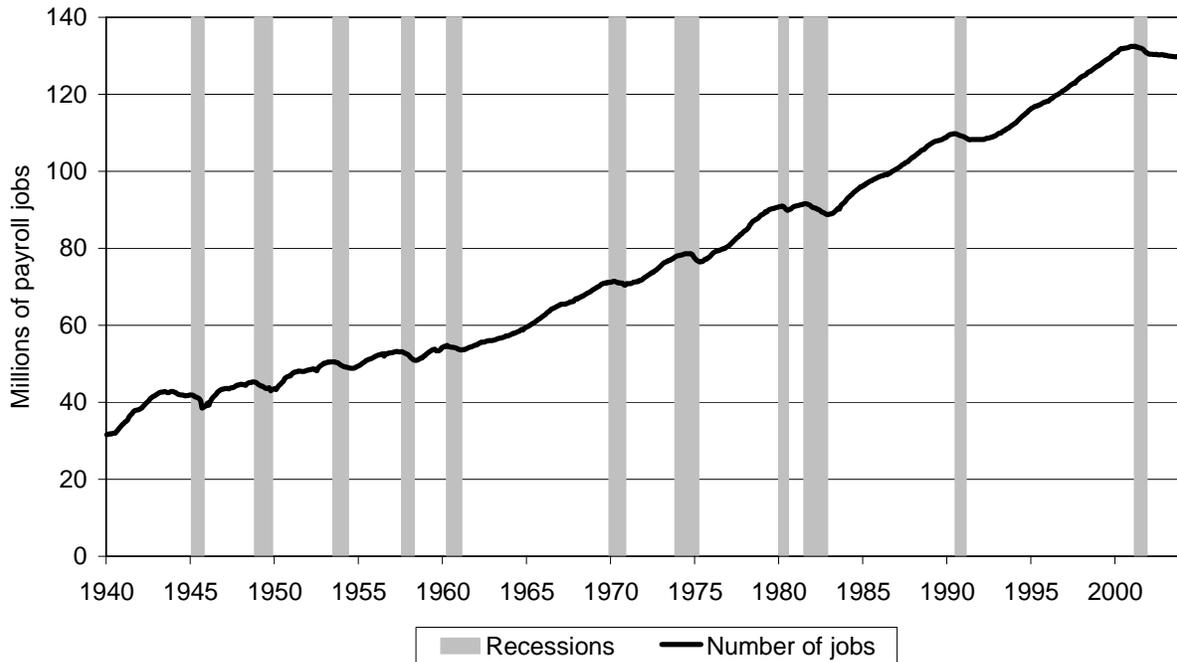
- This slump saw the longest duration of job loss—29 months.
- This slump is the first time in which there was not a full recovery of jobs within 34 months after the recession began.
- This slump is the worst in terms of the rise of the unemployment rate (after adjustment for the “missing” labor force) 34 months after the recession began—up 2.8 percentage points.
- The current slump has also been unique in terms of the actual loss of aggregate real wage and salary income 33 months after the recession began—down 0.7%.

A severe and sustained loss of jobs

The Bureau of Labor Statistics (BLS) provides monthly data on the labor market from two sources: the payroll survey of employers and the household survey. In response to some who have emphasized the household survey’s employment numbers, the BLS,³ Federal Reserve Board Chairman Alan Greenspan, the Economic Report for the President for 2004, and the Congressional Budget Office⁴ have strongly recommended the payroll survey as the better gauge of the job situation (for a more complete analysis of the payroll versus household employment numbers, see EPI’s Briefing Paper *Measuring Employment Since the Recovery*, by economist Elise Gould). By this gauge, the total number of jobs had dropped by 2.3 million, or 1.8%, below the pre-recession level. Payroll employ-

FIGURE 1

Payroll jobs



Source: Bureau of Labor Statistics and National Bureau of Economic Research.

ment reached its lowest level in August 2003, 29 months after the recession began. That set a record for duration of job loss.

Commentators often assert that “employment is a lagging indicator” as a way of dismissing the continued decline in jobs since the end of the recession. While true, such assertions are misleading; historically there has been a very short lag between the end of a recession and the start of sustained job gains. As **Figure 1** and **Table 1** show, the lag between the end of a recession and the trough in jobs had never exceeded three months prior to the current labor slump.

As shown in the second column of Table 1, the low point for jobs following every recession between 1945 and 1990 came between six and 17 months after the start of the recession. The labor slumps from 1945 through 1960 were all more severe in terms of their maximum depth. But, among the six recessions since 1960, only the 1981 recession’s 3.1% decline in jobs was greater than the current 2.0% decline. It is worth noting that the 17 month decline in jobs in 1981-82 was completely reversed within 10 months.

The current job slump is the first of 11 recessions since 1939 in which there has not been a complete recovery of all jobs by the 31st month after a recession has begun. As shown in the third column of Table 1, full recovery of jobs back to the pre-recession level was reached within 10 to 31 months after the onset of the past 10 recessions. However, in January 2004, 34 months after the last recession began, jobs still remained down by 1.8%.

TABLE 1
Payroll jobs in past labor slumps

Year recession ended	Number of months from recession onset to jobs trough	Number of months from recession end to jobs trough	Number of months to regain previous peak	Percent decline in jobs at trough	Percent change in jobs 34 months after start of recession
1945	7	-1	16	-8.1%	6.4%
1948	11	0	19	-5.0	6.1
1953	13	3	22	-3.4	3.9
1957	9	1	19	-4.2	2.3
1960	10	0	19	-2.3	2.6
1969	11	0	17	-1.2	4.8
1973	17	1	25	-1.9	2.5
1980	6	0	10	-1.1	n.m.*
1981	17	1	27	-3.1	1.7
1990	10	2	31	-1.4	0.3
2001	29	21	n/a	-2.1	-1.9

n.m.* Numbers for 34th month following the 1980 recession are not meaningful because that month fell during the middle of the 1981-82 recession.

Accounting for growth in the working age population

The U.S. working age population stood at 222.7 million people in January 2004, up 3.7% from the March 2001 population of 214.5 million.⁵ The working age population has been growing 1.2% annually and, at that rate, will expand by another 2.8 million people in the next year. As a result of the increase in the working age population, millions of young people are finishing school and facing a labor market where jobs are scarce. Because of the influx of working age people, it is not satisfactory just to restore employment back to its previous peak level. For decades, as employment has grown faster than the working age population, the share of the population employed has risen. Job growth should at least be at a high enough level that the share of the population employed should not decline (at least until baby boomers reach retirement age).

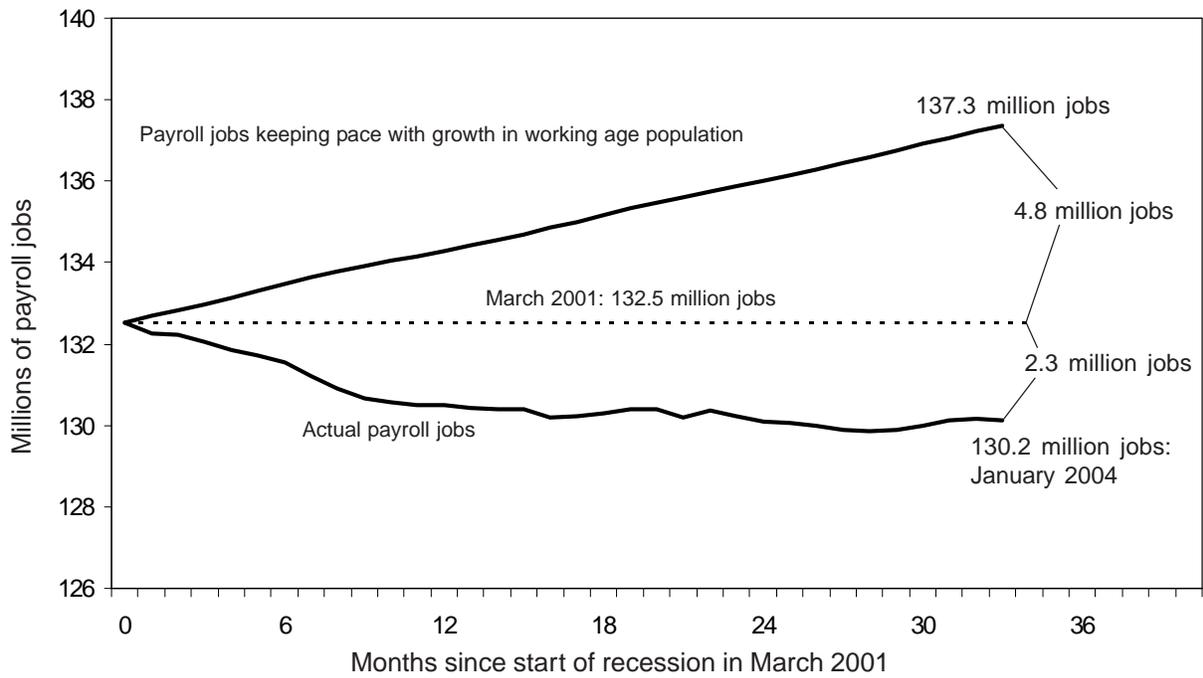
The combination of 3.7% working age population growth and the 1.8% shrinkage in payroll jobs has created considerable slack in the labor market. The difference between actual payroll jobs in January 2004 and the number of jobs necessary to keep up with the growth in the working age population since March 2001 is 7.1 million jobs. That gap reflects not only the 2.3 million jobs lost, but also the 4.8 million jobs necessary to keep pace with working age population growth (see **Figure 2**). It will take years of very strong job growth to reduce such a wide gap.

The Current Population Survey and the working age population

Although the BLS, Fed Chairman Alan Greenspan, the Council of Economic Advisers, and the Congressional Budget Office strongly favor the payroll measure for gauging the employment situation in

FIGURE 2

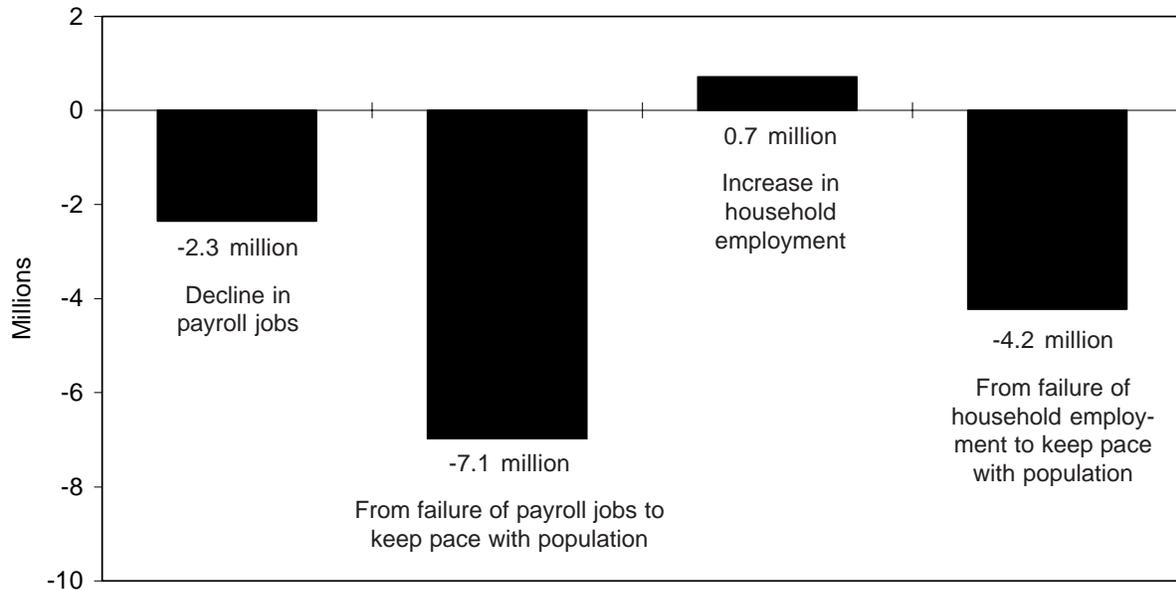
Actual payroll jobs vs. job growth necessary to keep pace with increase in working age population (since March 2001)



Source: Authors' analysis of Bureau of Labor Statistics data.

FIGURE 3

Four measures of the employment shortfall since March 2001



Source: Authors' analysis of Bureau of Labor Statistics data.

FIGURE 4

the current slump, some commentators have drawn attention to the more favorable trend in employment in the household survey, also known as the Current Population Survey (CPS). The CPS shows an employment increase of 714,000 between March 2001 and January 2004, in contrast to the payroll drop of 2.3 million jobs (see **Figure 3**). Most of the discrepancy in the trends for the two measures occurred in 2001 and early 2002. As Elise Gould shows in *Measuring Employment Since the Recovery*, the household measure of employment has also had a very disappointing trend since mid-2002 when adjusted to be on the same conceptual basis as the payroll survey.

Even the CPS numbers show a wide gap between actual job creation and the jobs needed to keep pace with an expanding population. CPS employment would have needed to grow by 4.2 million over those 34 months in order to keep up with the working age population growth.⁶ The increase of 714,000 jobs, together with the 4.9 million gains needed to keep up with population growth, leaves a gap of 4.2 million people without jobs.

The employment-to-population ratio

The gap in household employment relative to working age population growth may also be approached from the perspective of the employment-to-population ratio. That ratio has dropped from 64.3% in March 2001 to 62.3% in January 2004. The 4.2 million employment gap simply reflects the 2.0

TABLE 2
Employment-to-population ratio in past labor slumps

Year recession began	Number of months from recession onset to employment-to-population trough	Number of months to regain previous peak	Percent decline in employment-to-population ratio	
			at trough	at 34 months
1948	11	21	-2.8	-1.1
1953	12	28	-4.0	0.5
1957	11	107	-3.0	-0.7
1960	17	62	-2.5	-2.3
1969	18	46	-3.3	-2.0
1973	19	48	-4.2	-2.3
1980	n.m.*	n.m.*	n.m.*	n.m.*
1981	20	33	-3.4	1.0
1990	17	51	-2.5	-1.7
2001	30	n/a	-3.5	-3.0

n.m.* Numbers for the 1980 recession are not meaningful because the employment to population ratio did not recover before the 1981-82 recession.

percentage-point drop in the employment-to-population ratio multiplied by the current population of 222.7 million.

Like the payroll jobs shown in Figure 1, the employment-to-population ratio has normally started to rise with only a short lag after the end of a recession (see **Figure 4**). In the current slump, however, that ratio has continued to fall long after the recession ended. As shown in the second column of **Table 2**, the employment-to-population ratio always rebounded within 11 to 20 months of the start of past recessions. Although the employment-to-population ratio fell by larger amounts in three past labor slumps, no other single-recession slump had nearly as large a decline 34 months after the start of the recession as the current one (Table 2, columns four and five).

The unemployment rate adjusted for the “missing” labor force

The exceptional slack that has developed in the labor market has led to an extraordinary number of people going to (or staying on) the sidelines of the labor market. These potential workers have either withdrawn from actively looking for work or delayed entry into the labor force. The size of this “missing” labor force can be estimated by subtracting the size of the actual labor force in January 2004 of 146.9 million from the size of the labor force that would have existed that month had it grown along with the working age population since March 2001 (149.1 million). That results in an estimated “missing” labor force of 2.3 million as of January 2004.⁷

The current unemployment rate of 5.6% fails to account for this enormous “missing” labor force. An unemployment rate can be constructed that adds the “missing” labor force both to the number of unemployed and to the labor force. A constructed unemployment level that incorporates the “missing” labor force would be 10.6 million unemployed (instead of the official 8.3 million), with a constructed unemployment rate of 7.1%.

TABLE 3
Unemployment rate in past labor slumps

Year of peak	Unemployment rate at the start of recession	Constructed unemployment rate at peak month	Difference between unemployment rate at start of recession and peak	Month into slump when unemployment peaked	Constructed unemployment rate at 34th month	Difference between starting unemployment rate and constructed unemployment rate at 34th month
1948	3.8%	6.5%	2.7	11th	2.7%	-1.0
1953	2.6	6.6	3.9	12th	2.2	-0.5
1957	4.1	7.0	2.9	11th	4.8	0.7
1960	5.2	7.5	2.3	17th	7.4	2.2
1969	3.5	6.7	3.2	18th	5.4	1.9
1973	4.8	8.8	4.0	19th	7.1	2.2
1980	6.3	n.m.*	n.m.*	n.m.*	n.m.*	n.m.*
1981	7.2	10.4	3.2	19th	6.3	-0.9
1990	5.5	7.9	2.4	17th	7.1	1.6
2001	4.3	7.6	3.4	30th	7.1	2.8

n.m.* Numbers for the 1980 recession are not meaningful because the constructed unemployment rate did not fall significantly before the 1981-82 recession began.

A constructed unemployment rate for past labor slumps can also be estimated by using the same procedure to incorporate the “missing” labor force. Because the “missing” labor force is much larger this time than in any previous recession, the current slump has a constructed unemployment rate that resembles the highest constructed unemployment rate for previous labor market slumps that were widely recognized as severe. In contrast, the official unemployment rate would suggest that this recession generated less labor slack than others.

The rise in the constructed unemployment rate

The increase in the constructed unemployment rate over the course of past labor slumps should also be considered. The official unemployment rate of 4.3% at the start of the latest recession was lower than at the start of the last four recessions. The constructed unemployment rate rose steadily for 30 months through September 2003 to reach 3.4 percentage points above the March 2001 level.

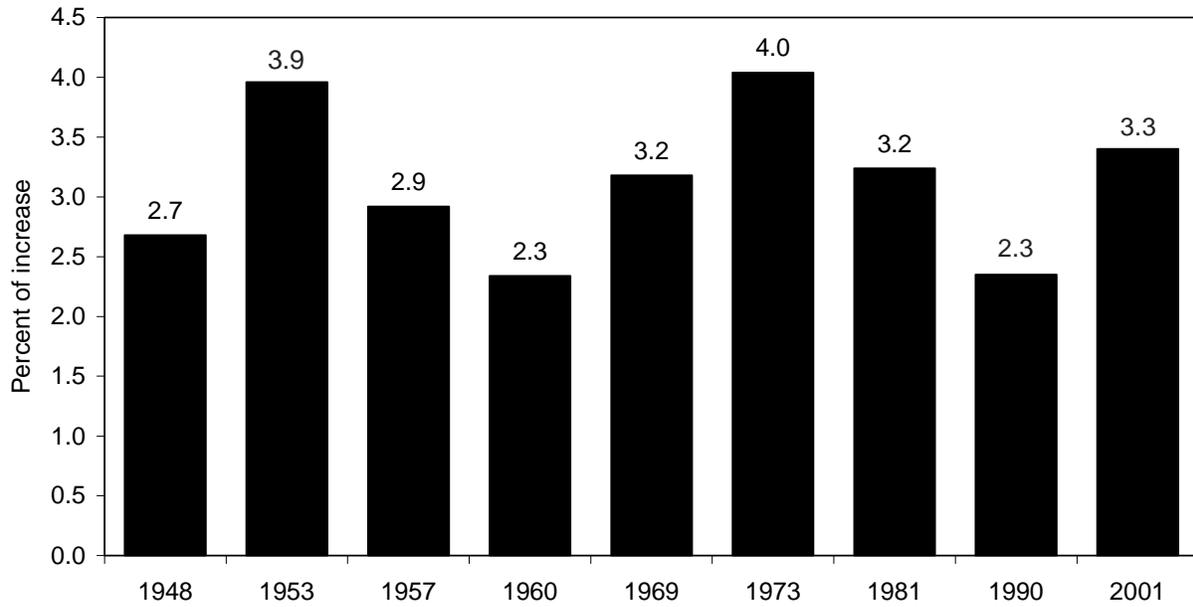
Larger increases in constructed unemployment have occurred only twice before (see **Table 3**, column four). This measure rose by 3.9 percentage points 12 months after the 1953 recession began and by 4.0 percentage points by 19 months after the 1973 recession (see **Figure 5**). By 34 months after every other recession began, however, the increase in the constructed unemployment rate was well below the current 3.0 percentage-point increase (see Table 3, column seven).

Loss of wage and salary income

Just as the focus on the unemployment rate has led to a distorted perception of the slack in the job market, attention to real *hourly* wage gains has led to the false conclusion that real *aggregate* wage

FIGURE 5

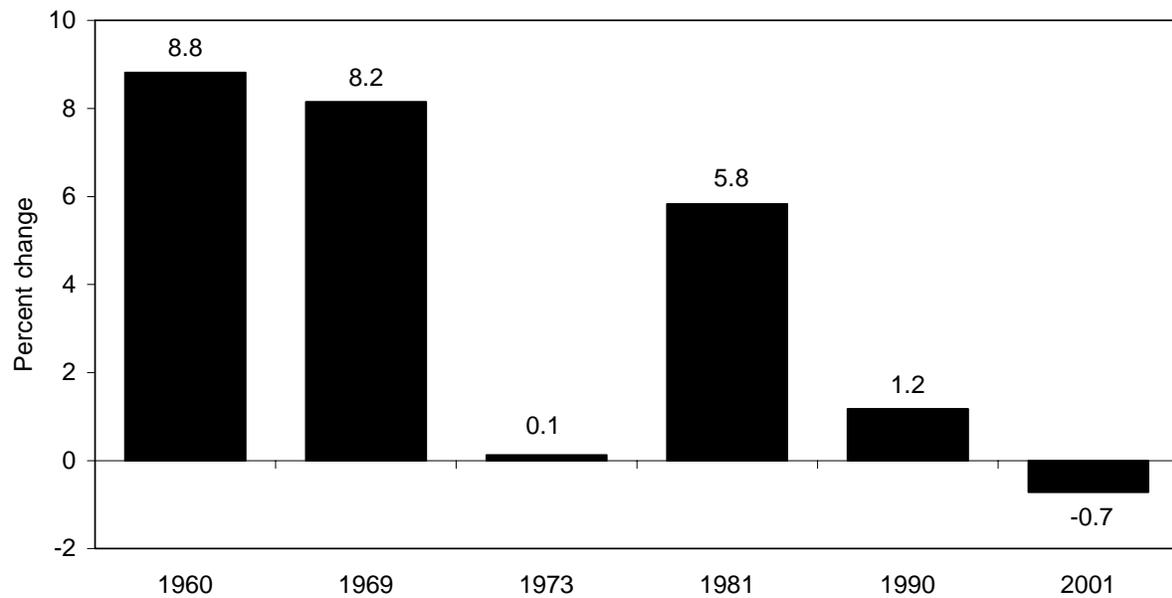
**Rise in constructed unemployment rate,
from start of recession to highest point in ensuing slump**



Source: Authors' analysis of Bureau of Labor Statistics data.

FIGURE 6

**Percent change in real wage and salary income
33 months after the start of a recession**



Source: Authors' analysis of Bureau of Economic Analysis data.

gains are fueling income growth and consumption. Aggregate wage and salary income is a function of hourly pay multiplied by paid hours worked. Although real wage and salary income per hour has grown over the last two and a half years (but are growing more slowly with increased slack in the labor market), that gain has been more than fully offset by declines in the number of jobs and in the number of hours paid per job. The latest productivity tables show a 4.2% decline in business-sector hours from the first quarter of 2001 to the fourth quarter of 2003.

Contrary to the impression left by the hourly figures, the current labor slump is setting records for its persistent decline in real aggregate wage and salary income. The Bureau of Economic Analysis (BEA) publishes monthly data for aggregate wage and salary disbursements and for an appropriate inflation measure for personal consumption. Seven recessions have occurred since 1959, when consistent data for these two measures begin. The most recent data available are for December 2003, 33 months after the start of the latest recession. In the latest month, real aggregate wage and salary income remained 0.7% below the level at the start of the recession. In contrast, real wage and salary income had fully recovered to the pre-recession level by the 33rd month after the start of all of the last six recessions⁸ (see **Figure 6**).

U.S. workers received total wage and salary income of \$4.845 billion dollars in December 2003 (in 2000 dollars at an annual rate). That is \$35 billion below the amount they received in March 2001, after adjusting for inflation. Over the last 33 months, nominal wage and salary income has risen by 3.4% while nominal gross domestic product (GDP) has risen by 12.2%. Had wage and salary income grown as much as the GDP over the last two and a three-quarter years, it would have been more than \$300 billion greater.

The widely held view that gains in real wage and salary income is supporting consumption growth has no foundation. Consumption has grown since the start of the last recession despite the downward trend in aggregate wage and salary income because of increased borrowing, lower taxes, and increased income from sources other than wages and salaries.

Conclusion

The unemployment rate, the most widely used gauge of labor market distress, peaked at 6.3% following the most recent recession and now stands at 5.6%. This gauge alone would indicate a very mild recession and recovery period. Many commentators have also noted that real hourly pay has grown since the recession began. Unfortunately, neither the unemployment rate nor real hourly pay has proved to be a reliable measure of labor market distress in the recent period, and the labor market remains in a severe slump.

Jobs have not remained down for so long since the monthly payroll data series began in 1939. In each of the 10 recessions since 1945, the job total hit bottom within six to 17 months and had fully recovered within 10 to 31 months. In contrast, the lowest point thus far in the current slump came 29 months after the recession began and jobs remained down 1.8% in January 2004, 34 months after the start of the recession.

To fully gauge the slack in the current labor market, the 3.7% growth in the working age population since March 2001 must also be considered. Based on the payroll jobs numbers, there is an esti-

mated shortfall of 7.1 million jobs. (Using numbers from the less reliable household survey of employment, a shortfall of 4.2 million is estimated.)

The labor market will return to the healthy job conditions prior to March 2001 only if jobs grow fast enough to eliminate the loss of jobs since the start of the recession, to catch up to the growth in labor supply since March 2001, and to keep up with the continued expansion of the labor supply. Treasury Secretary John Snow recently predicted that two million jobs would be added over the next year and suggested that such job growth would be a great accomplishment.⁹ However, to keep the jobs gap from widening further over the next year, employment in the household survey must expand by 1.8 million and payroll jobs by 1.7 million. While far better than further job loss, a gain of 2.0 million would only modestly exceed the number of jobs needed to employ the expanding working age population at the current rate and is not enough to make a serious dent in the shortfall that has developed. Consequently, the creation of two million jobs would narrow the 4.2 million gap in the CPS employment by only 0.2 million and lower the 7.1 million gap in payroll jobs by just 0.3 million. At that rate, it would take decades to close either jobs gap.

When the “missing” labor force of 2.2 million is added both to the current labor force and to the number unemployed, the constructed unemployment rate peaked in September 2003 at 7.6%, a 2.8 percentage point increase in the 30 months after March 2001. Only the slumps triggered by the recessions of 1953 and 1973 had larger increases, and their peaks occurred 12 and 19 months after the onset of those respective recessions.

Finally, the prolonged loss of jobs in this slump has brought the worst change in total wage and salary income between the start of the recession and 33 months later. Total real wage and salary income has fallen by 0.7% since March 2001. In contrast, total real wage and salary income had completely recovered within 32 months after every other recession since 1960.

The depth and duration of the job decline since the start of the recession, along with the growth in the working age population, the fact that many people who have moved to the sidelines of the labor market are not included in unemployment measures, and the loss of wage and salary income, all indicate that the current labor market remains in severe and record-setting distress.

Endnotes

1. The term “working age population” in this Briefing Paper refers to the civilian, non-institutional population 16 years of age and older.
2. This assumes that the actual level of employment would have been no higher. This number represents a counterfactual upper-bound estimate for the unemployment rate. Had the entire “missing” labor force of 2.3 million persisted in looking for work, some small fraction would have added to the employment total and not just displaced others who now hold jobs. The fact is that these “missing” would-be job seekers do not now hold jobs, but a better job market should draw them back into a search for employment.
3. Statement of Kathleen P. Utgoff, Commissioner, Bureau of Labor Statistics, before the Joint Economic Committee, United States Congress, September 5, 2003: “the payroll survey provides more reliable information on the current trend in wage and salary employment.”
4. Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2003, page 34: “The establishment survey better reflects the state of labor markets.” The establishment survey is the same as the payroll survey.
5. The population for March 2001 was derived with the same methodology used by the Bureau of Labor Statistics to boost the employment levels for 2000 through 2002 to be consistent with the increase in the population controls that began in January 2003.
6. CPS employment exceeds payroll jobs largely because it includes self-employed and agricultural employment. 3.7% growth from the March 2001 base through January 2004 would have generated 4.8 million more payroll jobs and 4.6 million more people employed in the household survey.
7. This counterfactual case invokes a conservative assumption that the percentage of the population working or looking for work would have remained the same from March 2001 forward. In fact, this ratio has risen steadily for decades.
8. Real wage and salary income fully recovered after the 1980 recession before falling again in the 1981-82 recession.
9. *Times of London*, October 20, 2003.