Federal Reserve Bank of Cleveland

# Another Jobless Recovery?

by Mark Schweitzer

*It seems to be 1992 all over again, with the labor market stalled and unlikely to move higher soon.*

—"Jobless Recovery: the Sequel," *CNN/Money*, October 3, 2002, Mark Gongloff

The previous economic expansion was the longest on record, lasting from March 1991 to March 2001. It resulted in substantial increases in income and wealth and was hailed as the "New Economy." However, it began slowly and uncertainly. One unusual feature of the early portion of that cycle was the uncharacteristic way the labor market behaved. At the start of the expansion, employment, which historically rises steadily at the beginning of a business cycle, remained weak for many months, leading economists to dub the budding expansion a "jobless recovery." The implication was that economic activity might be picking up, but the benefits were not trickling down to the unemployed.

Some commentators see parallels in recent employment figures and have begun to predict another jobless recovery. As in the previous expansion, where total employment took 31 months to reach its previous peak level, employment growth now seems to be uncharacteristically weak. From December 2001 to January 2003, the U.S. economy lost 86,000 jobs, according to Bureau of Labor Statistics' preferred employment measure.[1] Average gains following a recession would have implied around 195,000 new jobs by this point.[2]

Even the Committee for Business Cycle Dating of the National Bureau of Economic Research has decided to delay announcing the official date of the trough of the most recent recession, because it wants to be sure that "any subsequent downturn would be a separate recession, not a continuation of a past one."[3] The limited employment gains to date have made this determination an uncertain proposition and are a continuing indication of the fragility of the current economy.

Are we in the midst of another jobless recovery? To answer that question, it helps to compare current labor market data with those of the previous and the other postwar business cycles. To discover the extent of the current recovery's resemblance to the previous expansion, this *Commentary* looks at the nine business cycles for which we have complete labor market data and compares patterns in three measures of labor force activity: nonfarm employment, unemployment, and the labor force participation rate. While each of these indicators assesses the quantity of labor utilized, each exhibits its own business cycle pattern because of differences in what each measures. But close inspection of these differences can also reveal differences in how firms and potential workers are reacting to the economic downturn.

When making the comparisons, the beginning of the cycle is taken as the previous cyclical peak (rather than the trough). Starting from the peak implies that the scale of the losses in the recession is relevant for the recovery.[4] Each comparison is in terms of levels rather than growth rates, which clearly shows that the economy takes months of growth to get back to prerecession levels in most expansions. A standard error band is plotted for each variable to represent the variety of experiences that have occurred in the other postwar expansions, so that the "typical" response of the economy is not taken to be the mean in each case. With only labor market data from nine business cycles to work with, any prognostication runs into the difficulty of separating the unique features of particular cycles from business cycle patterns.

**The expansion of the 1990s began with such unexpectedly slow employment growth that commentators called it the "jobless recovery." As the economy now begins to expand after the most recent recession, will employment follow the typical path of most postwar recoveries, or will it repeat the pattern of the 1990s? A look at trends in employment, unemployment, and the labor force participation rate reveals important similarities with the jobless recovery. That said, one feature that stands out is an unusually low level of labor force participation, which suggests the recovery might be better characterized as "jobseekerless."**

## Employment

The Bureau of Labor Statistics' preferred measure of employment for the United States is derived from surveys of 300,000 business establishments covering about a third of all workers. This broad coverage of the labor market makes the sampling error small enough that month-to-month changes in employment are reliable and frequently statistically significant. It is this measure that was used both to judge the previous expansion jobless and to focus attention on the current cycle as well.

Figure 1 shows the typical pattern of sharp employment losses and slow recovery in the three years following a peak in the business cycle. The line labeled *average* is the average

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percentage change from the previous peak (for all nine business cycles), while the shaded area (labeled *average range*) shows the 95 percent confidence bands around this estimate. Again, these bands should be viewed as a narrow conception of "normal," as they imply that observations within that range are statistically indistinguishable from the mean.

While it isn't sensible to expect all recessions and recoveries to produce the same patterns, the current cycle's observations (*2001–present*) have almost always remained within the 95 percent confidence bands. The declines through December 2001 (a frequently mentioned candidate for the trough) were less sharp than is typical; the employment level fell 1.2 percent, not 1.7 percent, as it does in the eighth month of the average recession. Employment losses continued after this point through March, and to-date gains have been miniscule. Only in December 2002 did the pattern become unusual as compared to other postwar cycles.

So far, the current pattern does resemble the jobless recovery of the early 1990s (line labeled *1990–2001*), which also was not exceptional until almost two years after the July 1990 peak. While at that point some job growth had taken place, it was much slower than is typical after a recession (which was dated as having ended in the eighth month of the cycle or March 1991). At the time, the explanations for this focused on employers' concerns about taking on additional employees in light of uncertain demand for their products, but as the figure makes clear, employers typically take almost two years to return to previous employment levels.

## Unemployment

Studying only employment figures tends to focus attention on employers' hiring patterns, which is reasonable because the initial phase of a recovery is largely about reabsorbing underutilized resources. That said, employment growth might also be affected by the availability of labor, and a look at the unemployment rate, which counts the number of people looking for work, tells us how much labor is available to employers (see figure 2). If finding a suitable job is time-consuming or if wage expectations have to be substantially lowered, the unemployment rate would tend to rise or stay high even after employers decide to expand their workforces.

The pattern of the unemployment rate is generally the reverse of the employment growth pattern, but it is not a mirror image. On average, the unemployment rate peaks around the fourteenth month after the business cycle peaks, while employment growth is on average evident in under a year. Recessions cause a buildup in the stock of people looking for work, which takes substantial time to work off. Even the three-year period of the figure is not long enough to reach the previous cyclical peak's unemployment rate.

Both of the latest business cycles have generated unusually low unemployment rates. The rate had been exceptionally low in the current recovery until October 2002. One of the features that distinguished the jobless recovery of the 1990s was the late peaking of the unemployment rate—two years after the business cycle peak. Still, even though the peak occurred later, the rate always remained within or below the range of the average business cycle, making the recovery weak in employment growth but not atypically high in the level of unemployment reached. While it is still too early to tell if unemployment in the current recovery will peak late, the rate is staying low, lower even than in the previous recovery.

## Labor Force Participation

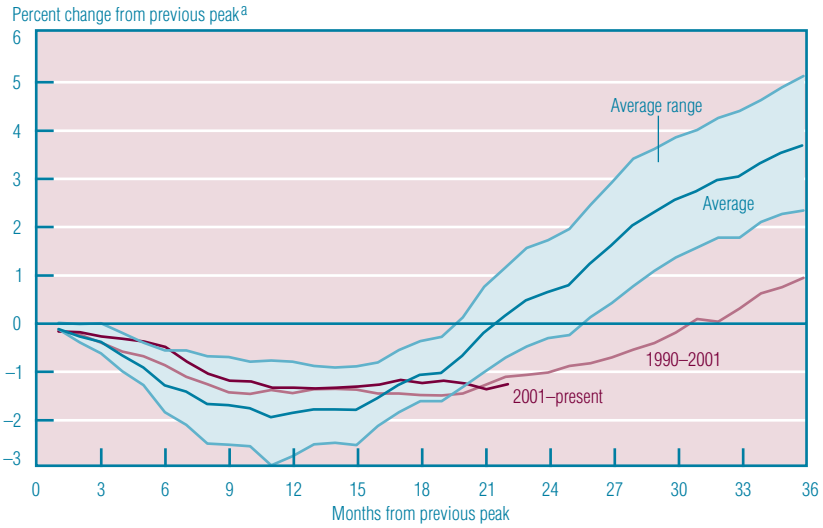
How can we have had fairly normal levels of job declines and gains for the first two years of the latest business cycle *and* fewer unemployed people than is typical at this point in a cycle? These facts seem inconsistent with each other, but an explanation can be found by examining another group whose numbers can also change over the cycle: nonparticipants in the labor market. These are people who are neither working nor looking for work but are doing one of a variety of other activities that are grouped under the heading of nonparticipation: going to school, taking care of relatives, or living in retirement. Trends for this group are implicit in the labor force participation rate—the proportion of the population (over age 16) working or looking for work (see figure 3). In a typical business cycle, labor force participation changes little after the peak for at least the first couple of years, but the last two cycles have seen the rate decline during this period. This means that during the current and preceding business cycles, an important fraction of the population has been busy doing things other than participating in the workforce. Typically, decisions to participate in the labor force, while economic in nature, are guided by long-term factors such as children or the return to schooling rather than the cyclical state of the economy.

The jobless recovery period of the early 1990s and, even more so, the current business cycle stand out from these patterns. Labor force participation rates dipped noticeably from their previous peak levels in both recessions. During the 1990s business cycle, participation rates began to rise midway through the second year of the cycle, which implied much of the simultaneous rise in the unemployment rate despite the weak turnaround in employment levels.

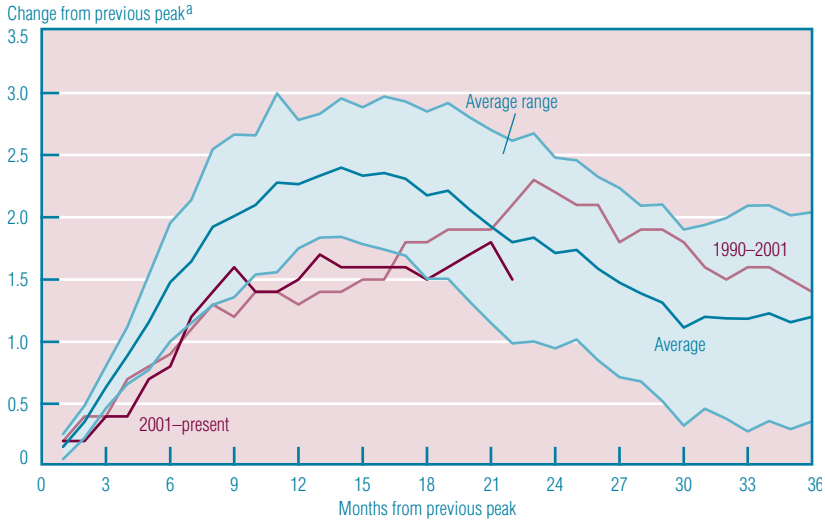
So far, the current cycle has not seen any sustained return of the participation rate. This could, in part, be due to the record levels of labor force participation that were reached in the 1990s and the tendency for some participants—those who need the most incentive to join the labor force because they have the most highly valued alternatives to it—to willingly stay out of the job market now that the economy has slowed. Alternatively, the unemployed could have become so discouraged that they aren't searching for work. Both explanations are consistent with the decline in participation but clearly would be interpreted very differently from a societal perspective.

One piece of related evidence is that the official tally of discouraged workers (wanting work but not searching because they believe the search would be futile) has risen by only 48,000 since March 2001. This means 98 percent of the increase in nonparticipation stems from individuals who do not want a job.[5] This is not totally conclusive because people who indicate on the survey that they do not want a job (for example, because they have decided to stay home to watch their children) may also be discouraged about their prospects. Still, the behavior of individuals outside the labor market will likely be a critical factor in how the labor market performance of the current expansion develops and is viewed. If the participation rate stays at these lower levels, then the unemployment rate would also stay fairly low, without further declines in employment.

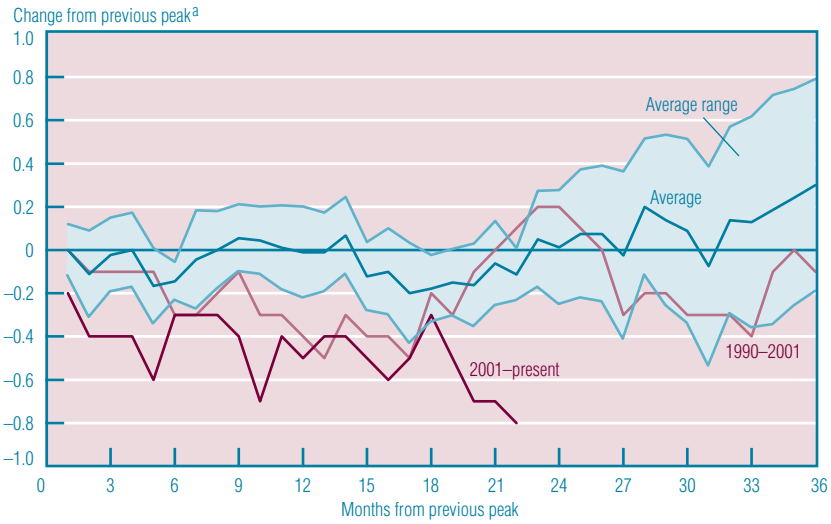
## FIGURE 1 EMPLOYMENT




## FIGURE 2 UNEMPLOYMENT RATE




## FIGURE 3 LABOR FORCE PARTICIPATION RATE




a. The previous peak occurred in April 2001 for the 2001–present line and August 2000 for the 1990–2001 line.
SOURCE: Author's calculations with data from U.S. Department of Labor, Bureau of Labor Statistics.

### It's Beginning to Look a Lot Like Another Jobless Recovery

Up to this point in the current recovery, employment appears to have grown unusually slowly, as it did during the jobless recovery of the early 1990s. While it is only in the last two months that this pattern has clearly deviated from typical levels of employment growth, this is again much like the jobless recovery, whose exceptionality did not stand out until almost two years after the business cycle's peak. As was the case for the early part of the jobless recovery, unemployment levels in this recession have risen less and stayed lower than is typical.

Both recoveries appear to be distinguished by the unusual role labor force participation seems to be playing in the employment picture. Without a return to higher participation, unemployment rates will only gradually increase even if employment growth remains anemic. The current business cycle could prove to be outstanding primarily for the lack of job seekers, which would have implications for other aspects of how the economy is likely to grow in at least the early phases of the recovery. In any case, the low unemployment figures should temper any view that this recession has had an inordinate effect on the labor market.

Of course, some analysts may be basing their pessimism on forecasts rather than on the data on hand. However, typical forecasts (for example, Blue Chip consensus) are that output growth will approach trend growth after the current quarter. So the expectation that there will be little job growth implies very strong productivity growth. However, by construction, productivity growth is difficult to forecast, making both a continued jobless recovery and a return to a more typical pattern of employment growth sensible forecasts.

Recoveries are not all the same, so economic policies need to adapt to the situation at hand rather than following a predetermined recovery path. During the jobless recovery, the federal funds rate target was kept low despite evidence of and forecasts for continued recovery. The current recovery may turn out to be similar or it may be very different from the previous recoveries. Correctly judging the situation is critical for any economic policies focused on the next one to two years.

## Footnotes

**1.** These figures are for nonfarm employment as of the February 7, 2002, release of the employment situation. December 2001 is a commonly cited, although not yet official, date for the trough.

**2.** Average gains following a recession would have implied around 195,000 new jobs by this point. (This calculation is based on the average response for being 20 months out from the peak since the trough has not been identified by the NBER business cycle dating committee.)

**3.** "The NBER's Business Cycle Dating Procedure," November 5, 2002 <http://www.nber.org/cycles/recessions.pdf>.

**4.** This does not account for any deviation of realized levels from an underlying trend. Such information might be very helpful in explaining subsequent patterns, but necessarily builds in additional assumptions. The implicit assumption here is that the position of the labor market variables relative to their trends at the peak of the cycles is not substantially different.

**5.** Unfortunately, incompatibilities in the survey prevent direct comparisons of these patterns over other business cycles.

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