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When will US Employment Recover from the Great Recession?

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The Great Recession of 2007 has taken the worst toll on U.S. workers since 1947. The unemployment rate during this recession has increased more than any previous recession during the post-WWII era, surging from 4.6 percent when the recession began to 10.1 percent after two years into the downturn. Despite the effort of a major stimulus package enacted in the early stages of the recession, nearly 8.5 million people joined the ranks of the unemployed during this period, bringing the total number of unemployed to 15 million. All population groups have been affected by the rise in joblessness, but as in the past, minorities and the less educated are most vulnerable.

Although the recession has been declared over and the economy has been growing at about 2.3 percent for the past six quarters, employment has been much slower to recover. Real GDP is within one percent of its pre-recession peak, while total private employment is still nearly 6 percent below the employment peak of December 2007. The question on so many people's mind is when will employment growth begin to take hold and the number of jobs return to pre-recession levels? The consensus forecast is for real GDP to grow at about the same rate as it did during the past four quarters, but so far employment has not followed suit and few forecasters see employment fully coming back to pre-recession levels any time soon. It should be noted that employment growth after the 2001 recession was not exceptionally strong, so the longer-term question is whether the economy can create the jobs necessary to accommodate the growing labor force.

The urgency in restoring employment and reducing the ranks of the unemployed is critical not only for the millions of workers looking for jobs to sustain themselves and their families, but also for sustaining the somewhat fragile recovery. Domestic consumers account for a large portion of GDP growth, and high unemployment is putting a drag on future growth and has cast a pall of uncertainty over the economy. While the financial sector, the culprit in this recession, seems to be getting back on its feet and the real estate sector is gradually recovering, most agree that the recovery cannot be sustained without substantial improvement in the labor market. Therefore, one of the most awaited economic news events in the country is the monthly labor report. During the past year, the monthly reports have shown positive increases in total private employment, a monthly average of 112,000 since employment bottomed out, but the gains fall short of the increases needed to reduce the unemployment rate to more normal levels.

How Bad was the Recession?

According to the NBER Business Cycle Dating Committee, the organization that determines the dates of recessions and expansions, the Great Recession of 2007 lasted 18 months, the longest by two months since the Great Depression. In announcing the end of the recession, the committee made clear that this does not mean that the economy has returned to operating at normal capacity but only that it has stopped contracting. Not only was the recession the longest in the post-war era, it was also the deepest both in terms of real GDP and employment. Real GDP fell 4.1 percent from peak to trough; total private-sector employment dropped 6.5 percent. The job loss pushed the unemployment rate up by 5.5 percentage points—the largest increase in the past 65 years—and it has stubbornly stayed at or above 9.4 percent since then. In every previous recession during the post-WWII era, the unemployment rate started to return to pre-recession levels much more rapidly.

The severity of the recession for workers goes beyond what is captured by the official unemployment rate. The Bureau of Labor Statistics compiles additional measures of the underutilization of labor. These measures include the duration of unemployment, the percentage of workers who have become discouraged and have stopped looking for work but indicate that they want and are available for work. Another measure includes those who prefer full-time work but have taken a part-time job because a full-time job is not available.

All three measures have reached unprecedented levels during this recession. The long-term unemployed, as measured by the percentage of civilian workforce unemployed 15 weeks or longer, has exceeded 4 percent only once since the measure was first compiled in 1948. Currently, it stands at 5.7 percent, which given the 9.4 percent unemployment rate means that more than half of the unemployed have been out of work for 15 weeks or longer. Even more disturbing is the surge in the share of unemployed workers who have been out of work for more than a year. The group's share of total unemployment jumped from 9.5 percent in the second quarter of 2007 to a record high of 30.9 percent in the second quarter of 2010. The ranks of this group swelled from 625,000 to 4.5 million. Men, minorities, and older workers are more likely to be unemployed for a year or longer, but the distribution of the jobless for a year or more is similar to the distribution for total unemployment. The longer duration of unemployment has important implications for the capacity of the nation's workforce safety nets, primarily the unemployment insurance system, to help workers during extended periods of joblessness. It also forebodes the slow recovery as the longer-term unemployed tend to find jobs at a slower pace than the shorter-term unemployed.

In addition, the percentage of workers constrained to working part-time for economic reasons has also reached an all-time high. In September 2010, the number stood at 9.5 million, comprising 7.2 percent of total nonfarm employment, an increase of 4.8 percentage points, or 5.6 million workers since before the recession. More than two-thirds of these people worked part-time because their hours were reduced; the other third could only find part-time work. The large number of part-time workers who would prefer to work longer hours may allow firms to increase the hours of incumbent workers rather than hire new workers, extending the period of time before employment would increase even as GDP increases.

The number of workers who have left the labor force because they have extensively searched for a job without success has also risen, particularly in the past year. The numbers have increased by 389,000 to 1.3 million from December 2009 to December 2010. With this pool of workers ready to reenter the labor force when conditions improve, the unemployment rate is likely to remain high for some time as these people enter the labor force and look for work. Furthermore, there is reason to believe that they may take longer to find work than those who continue to actively search since employers may not consider them as qualified to fill their positions as people who continuously look for work.

Probably the most comprehensive measure of the difficulty in the U.S. labor market is the percentage of the working age population employed. Unlike the unemployment rate, which includes only those who are actively looking for work, the employment-population ratio reflects a more structural aspect of the labor market. That ratio has fallen more during this recession than in any of the previous post-WWII recessions. In a short two-year period, the recession dropped employment-population ratios from 62.9 percent to 58.2 percent, levels not seen since the early 1980s and before. The group most affected is African Americans, particularly young men. The employment-population ratio for African Americans overall has fallen nearly 6 percentage points from 57.8 percent to 52.0 percent. Whites have also experienced a decline, but by not as much. The employment-to-population ratio for whites fell from 63.4 percent at the beginning of the recession to 59.5 in October.

Even more highly educated workers were not able to avoid an increase in joblessness. While workers with higher educational attainment are less likely to experience unemployment, the unemployment rate for workers with a college education more than doubled during the recession from 2 percent to around 5 percent. In fact, unemployment rates more than doubled for all levels of education: Those with only a high school education saw their unemployment rates rise from 4 to 11 percent, and those with less than a high school education experienced an increased in unemployment rates from 7 percent to over 16 percent. While such increases for all education groups are typical during recessions, it is the magnitude of the increases that set this recession apart from the others.

What Happened?

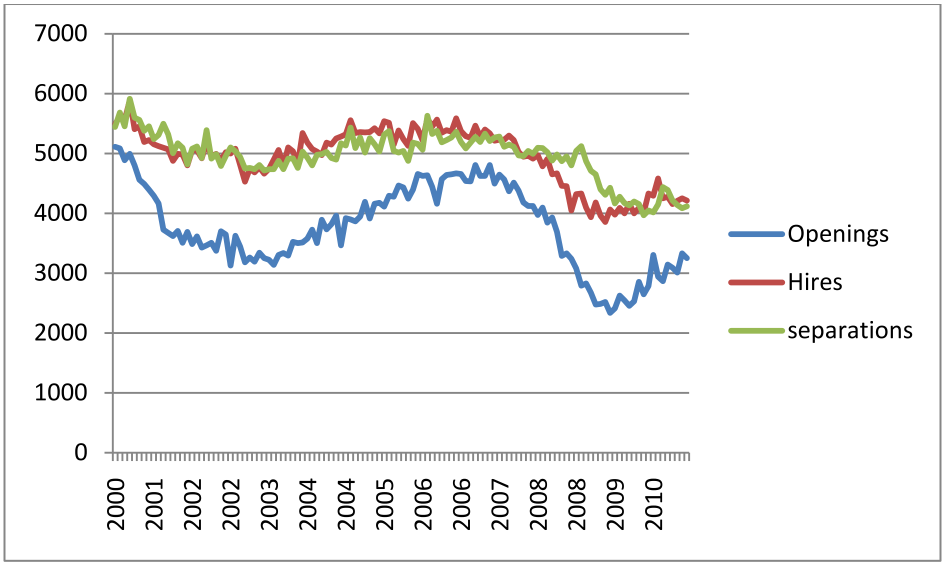
The 2007 recession began like most recessions. The first 10 months of the recession experienced a steady but modest decline in labor input. Businesses first cut the hours of their existing employees and then as the recession progressed, they shifted predominately to layoffs.[1] Within a short span of a few months during the fourth quarter of 2008, layoff events jumped from 1,581 prompting 290,453 layoffs to 3,582 causing 641,714 separations. Mass layoffs peaked in the first quarter of 2009, with nearly 4,000 events causing 705,000 layoffs and initiating 835,000 unemployment insurance claims. Throughout the recession, job cuts accounted for 70 percent of the reduction in labor inputs and reduction in hours accounted for the rest. However, the surge in job cuts did not last long. Within five months, they returned to their pre-recession monthly levels.

The other side of the story is hires and job openings, as shown in Table 1. Several months before the recession officially started, the number of monthly new hires began to decline along with the number of job openings. By November of 2008, eleven months into the recession, the number of new hires each month declined by 1.1 million. Job openings followed a similar pattern. As job cuts remained about the same each month, the continued reduction in job openings and new hires further reduced the number of employed workers. Competition among those looking for work intensified. The number of unemployed per job opening climbed dramatically during this period from around 1.6 before the recession to nearly 7 at the end of

[1] Elsby, et al., 2010, p.8.

2009. Separations actually started to decline toward the end of 2008, but the gap between new hires and separations created a large pool of unemployed, which faced fewer and fewer job prospects. By the middle of 2009, at about the time the recession was declared over, separations and new hires converged once again but at a much lower level—slightly less than 4 million per month each, which is nearly a million less per month than at the beginning of the recession. Although the number of new hires closely matched the number of separations once again, a greater rate of job openings is needed to absorb the pool of unemployed that are finding it increasingly difficult to find employment.

Table 1: Job Openings, New Hires, and Separations (in 1,000s)



Source: Job Openings and Labor Turnover Survey, Bureau of Labor Statistics

Current Recovery

Productivity gains drove the initial increase in GDP, which marked the end of the recession. As GDP started to increase in the middle of 2009, labor input, particularly employment, still continued to decline. Consequently, output per hour surged throughout 2009, starting two quarters before GDP began to expand in July of that year and continuing into the first two quarters of 2010. Some have speculated that the increase in productivity resulted from changes in technology, such as cost-saving reorganizations that took place in the financial sector and the auto industry, for example. Productivity gains have slowed recently, and have even turned negative, so it could be that the rest of the expansion may be driven by increases in hours and hiring.[2]

If so, the relative strength of the employment recovery is determined by two factors: the number of new job openings created and how quickly the unemployed can move into these new positions. During the first 16 months of the recovery, job openings increased 39 percent, which is nearly double the increase in job openings during the previous expansion after the 2001

[2] Willem Van Zandweghe, "Why Have the Dynamics of Labor Productivity Changed?" Economic Review, Third Quarter 2010, Federal Reserve Bank of Kansas City.

recession. Job openings increased from 2.3 million per month to 3.3 million per month. However, hiring has been flat, increasing by only 3.6 percent. How can job openings be increasing so much faster than new hires. Obviously, these new openings are going unfilled, but why? Several factors may come into play. First, workers may not qualify for the new positions because their skills don't match the job requirements. This may occur if considerable structural change has taken place. Workers displaced from a declining industry may have to search in another industry that has job opportunities yet their skills may not easily transfer over to that industry. This view is somewhat controversial, however, with several studies pointing to less structural change and more cyclical.[3] The considerable restructuring and downsizing of the auto industry, and its geographic concentration, point to one example of structural change that could impede the filling of job openings. The real estate slump and its effect on the construction sector, is also regionally focused, with California and Las Vegas particularly hard hit. Valletta and Kuang find imbalances early in the recession caused by restructuring but they appear to dissipate in the second half of 2009. The effect of restructuring across these industries may be mitigated because these sectors are a relatively small share of the nation's economy.

The uneven geographic distribution of job losses and job gains requires that households move to find job opportunities. The U.S. is a relatively mobile society. However, the decline in housing values leading to negative home equity and even foreclosure for many households reduces their ability to move to find employment. Studies have shown that declining house values do curb a household's ability to change locations. Both lead to substantially lower mobility rates. Owners suffering from negative equity are one-third less mobile, and every added $1000 in real annual mortgage costs lowers mobility by about 12 percent.[4]

Yet another factor in the slow filling of job vacancies is the overhang of the long-term unemployed. Studies show that the longer duration of unemployment the harder it is to get a job. Therefore, the large pool of long-term unemployed will keep the unemployment rate higher for a longer period of time.

Some economists point to the extended unemployment insurance benefits that Congress enacted during the depth of the recession as a disincentive for workers to find and accept jobs. The effect could be small, but Elsby et al. calculates that between 0.7 and 1.8 percentage points of the 5.5 point increase in the unemployment rate could be explained by the extension of benefits.

When will Employment and the Unemployment Rate Return to Normal Levels?

How significant these factors might be in slowing the labor market recovery is unclear, but they will likely impede the speed of the filling of jobs and the reduction in the unemployment rate. Another factor that comes into play is the labor force participation rate. Currently it is at 64.3 percent. Before the recession it was around 66 percent. Several agencies have estimated

[3] For instance, Elsby et al. (2010) and Rob Valletta and Katherine Kuang find little evidence of structural change while Jacob Kirkegaard's study does. See Rob Valetta and Katherine Kuang, "Is Structural Employment on the Rise?" Federal Reserve Bank of San Francisco Economic Letter, November 8, 2010; and Jacob Kirkegaard, "Structural and Cyclical Trends in Net Employment over US Business Cycles, 1949-2009: Implications for the Next Recovery and Beyond," Peterson Institute for International Studies Working Paper 09-05, August 2009.
[4] Fernando Ferreira, Joseph Gyourko, and Joseph Tracy, "Housing Busts and Household Mobility," *Journal of Urban Economics*, 69 (2010), pp. 34-45.

the monthly job growth needed to lower the unemployment rate, taking into consideration an increase in participation rate, which makes the task of lowering the unemployment even harder. And it is conceivable that the labor force participation will increase as discouraged workers enter the labor market when signs of better job prospects appear. In addition, some estimates take into consideration the future consequences of the large overhang of part-time workers who want to go full-time and how this might slow the addition of new jobs in the economy.

For instance, the Congressional Budget Office expects the unemployment rate to decline to 7.96 percent in 2012 and the participation rate to increase to 64.8 percent. This requires an average job growth of 227,000 per month over the next two years—about twice the current rate and slightly under the 2006 average rate 268,000 per month. Using the Federal Reserve Bank of Philadelphia's recent forecast of employment growth in 2011 of 170,000 jobs per month and extending that rate forward paints a bleaker picture. The Upjohn Institute calculates that at that rate the unemployment rate would not come down to 8 percent until the end of 2015. In order to return to the average unemployment rate that prevailed before the recession of 4.8 percent by 2014, the economy would have to generate 338,000 jobs each month between now and then. It's not impossible, but monthly growth rates of this magnitude have occurred only in short spurts, and these estimates require sustained growth rates at this level.[5]

Some economists believe that returning to the days of unemployment rates below 5 percent may not be in our future, at least not in the short run. They believe that the recession has caused the long-run natural unemployment rate to be higher than in the past, for the reasons just discussed. Their concern is not the length of time for employment to return to its pre-recession levels, but a long-run increase in the natural unemployment rate. The fact that the previous two recessions—1990 and 2001—were followed by slow employment growth does not bode well for a quick recovery in the labor market, especially since this recession was so much more severe. Obviously, a faster rate of job creation would help to speed up the process. Congress and the Obama administration recognized the importance of job creation to put this recovery on more solid footing and passed the Tax Relief and Job Creation Act in December. Some argue that this bill places too much emphasis on tax relief and not enough on incentives to create jobs, but it was also accepted as a necessary compromise given the Republican-dominated House.

Politics aside, the recession has left the U.S. with a weak employment situation. Job creation is picking up, but hires are flat, and the labor market is less dynamic than before, with fewer job openings and separations—a measure of labor market churning and flexibility. If job openings continue to increase and the structural changes are minimal, then 2011 may see a more substantial rebound in employment than many expected a few months ago when the unemployment was hovering above 10 percent. Yet, it will take at least several more years beyond 2011 before the labor market situation resembles what it was before the recession.

[5] Brad Watts of the Upjohn Institute calculated these estimates.