What Happened to the Recovery?

Part I: Weak Employment, Stagnant Wages, and Booming Profits

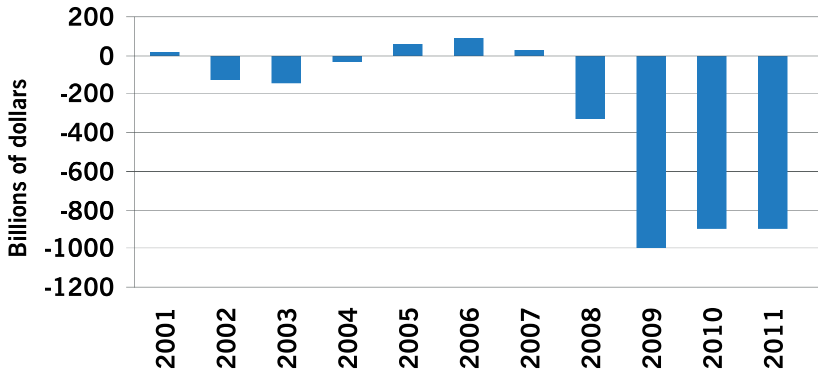
BY GERALD FRIEDMAN

The 2007-2010 recession was the longest and deepest since World War II. The subsequent recovery has been the weakest in the postwar period. While total employment has finally returned to its pre-recession level, millions remain out of work and annual output (GDP) is almost a trillion dollars below the economy's "full-employment" capacity. This column explains how high levels of unemployment have held down wages, contributing to soaring corporate profits and a remarkable run-up in the stock market. (Part II, to be published in the July/August issue, will focus on the reasons for the weak recovery, and the failings of various government policy responses.) D&S

GERALD FRIEDMAN is a professor of economics at the University of Massachusetts-Amherst.

SOURCES: Bureau of Economic Analysis, "Real Gross Domestic Product Chained Dollars," (bea.gov); Congressional Budget Office, "Real Potential Gross Domestic Product," (cbo.gov); Economic Policy Institute (EPI), "Output Gap: Real GDP compared to potential GDP, 2000-2013" (stateofworkingamerica.org); Bureau of Labor Statistics, Employment Level (Series ID: LNS12000000) (bls.gov); Economic Report of the President 2013, Table B–47: Hours and earnings in private nonagricultural industries, 1966–2012, Table B-90: Corporate profits with inventory valuation and capital consumption adjustments, 1964–2012 (whitehouse.gov); Dow Jones Industrial Average (stockcharts.com).

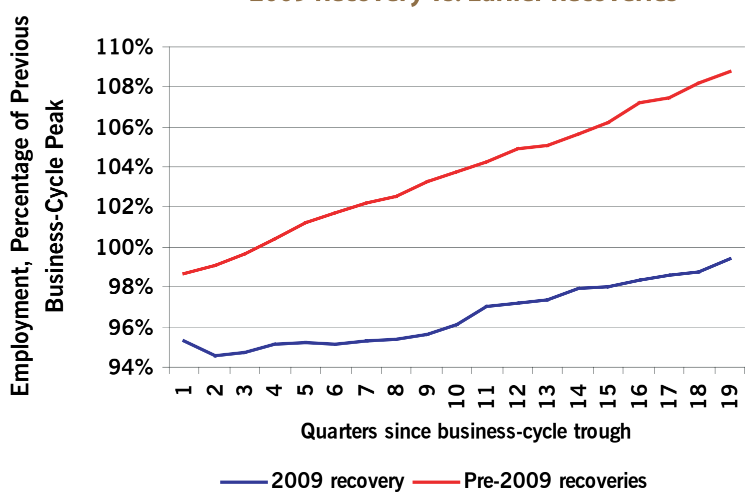
Figure 1: Output Gap (Actual GDP Minus Potential GDP), Inflation-Adjusted, 2000-2013



There was a sharp fall in output (GDP) at the onset of the Great Recession, down to 8% below what the economy could produce if labor and other resources were employed at normal levels ("full employment" capacity). Since the recovery began, output has grown at barely above the rate of growth in capacity, leaving the "output gap" at more than 6% of the economy's potential—or nearly $1 trillion per year.

With eight million jobs lost, employment fell more sharply going into the Great Recession than it did in previous recessions. It took five years for the economy to recapture its pre-recession level of employment, a rate of recovery much slower than for previous post-World War II recessions. Had employment recovered at the average pace for pre-1991 recoveries, there would be more than 11 million additional jobs today.

Figure 2: Employment, 2009 Recovery vs. Earlier Recoveries



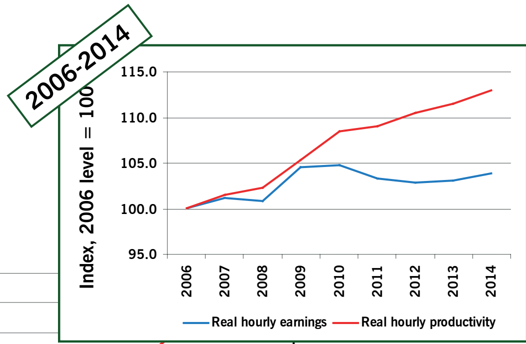
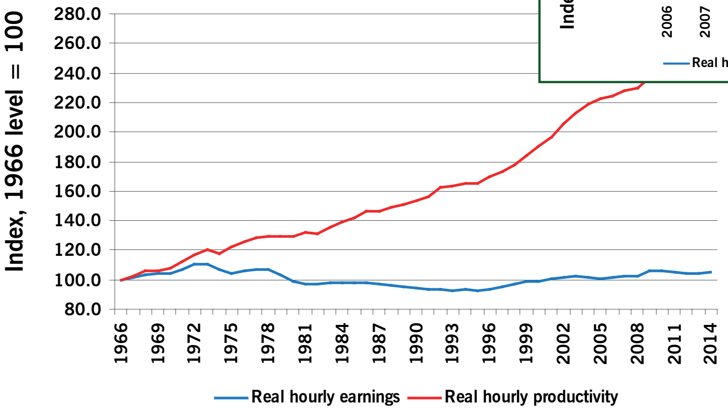
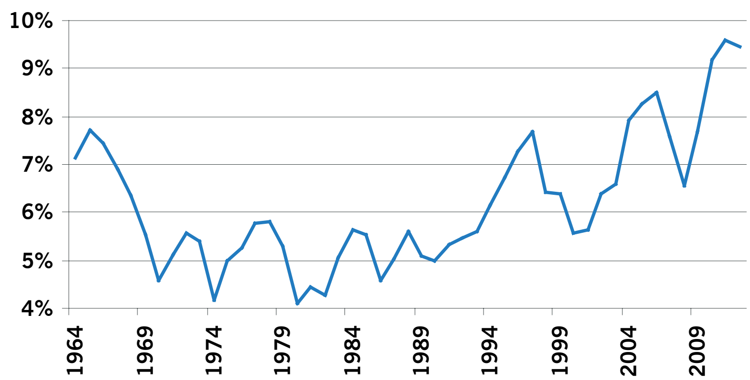


Figure 3: Hourly Earnings vs. Productivity, 1966-2014



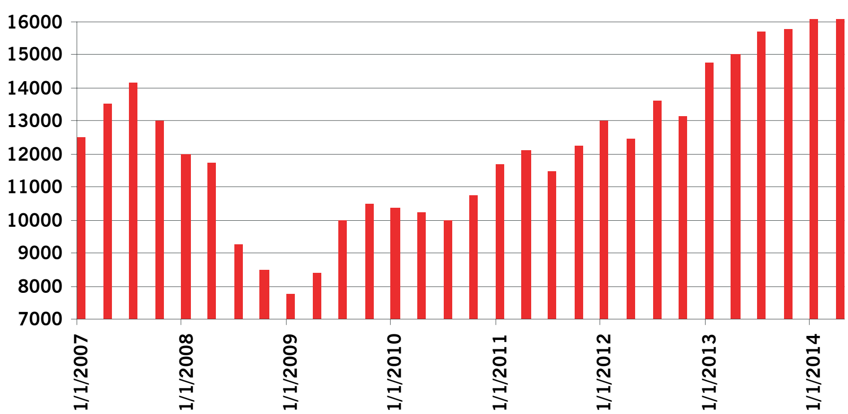
The gap between rising productivity and stagnant wages—growing since the 1970s—has increased with the Great Recession. Real output per hour has continued to increase during the recession and recovery. Wages, however, have remained stuck at a level lower than in the early 1970s.

Figure 4: Corporate Profits, After-Tax, Percentage of GDP, 1964-2012



While output, employment, and wages have remained depressed, after-tax corporate profits have soared to about one-tenth of national income. While this continues a trend that goes back to the 1970s, the rising profit rate since the Great Recession reflects how high levels of unemployment allow employers to push employees to work harder and produce more—even without paying higher wages.

Figure 5: Dow Jones Industrial Average, 2007-2014



The combination of low interest rates (which keep down corporate borrowing costs and make bonds less attractive than stocks) and rising corporate profits has produced a surge in the stock market. Despite the weak recovery, the Dow Jones Industrial Average is now well past its pre-recession peak.