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According to the latest public opinion poll from CNNMoney, 61 percent of Americans think it will take three more years for the U.S. economy to recover fully from the Great Recession. Only 3 percent think that it has already recovered, while 16 percent think it will never recover. And that was before last week’s news from the Bureau of Economic Analysis, which revised growth for the first quarter of 2014 downward to minus 2.9 percent. (See this slideshow for charts and analysis of the latest GDP revisions.)

Are the opinions of those who responded to the poll reasonable? How do their views stack up against those of professional economists?

What is a “recovery”?

The logical way to start this post would be to cite an official definition of “economic recovery,” but it turns out there isn’t one. The Business Cycle Dating Committee of the National Bureau of Economic Research, which is the group that calls the economy’s cyclical turning points, does not use the term “recovery” at all. In the committee’s words, “a recession is a period between a peak and a trough, and an expansion is a period between a trough and a peak.” That leaves no room anywhere for “recovery.”

In practice, many economists use “recovery” to refer to the early part of the expansion during which the economy puts idle capital and labor back to work. Wikipedia reflects this reflects popular usage when it says that “an economic recovery is the phase of the business cycle following a recession, during which an economy regains and exceeds peak employment and output levels achieved prior to downturn.” Those who use “recovery” in that way reserve the term “expansion” to refer to further growth beyond the previous peak.

Readers of my monthly slideshows will be familiar with the following diagram, which draws the line between recovery and expansion in the second quarter of 2011. If we use the previous peak of real GDP as our benchmark, then, the economy has long since recovered, and the majority of respondents to the CNNMoney poll are wrong.
Other economists would disagree that the previous peak of real output is the right benchmark for declaring that the economy has returned to normal. Instead, they would use potential real GDP, which means the path of real output that is sustainable in the long run, taking into account increases in the capital stock, productivity, and the labor force.

There are several ways to estimate potential real GDP, but the estimates provided by the Congressional Budget Office are the most widely used. As the CBO explains in this background paper, their estimates of potential output do not represent the maximum that might temporarily be reached during a boom, but rather, the highest level that can be sustained over a prolonged period without causing excessive inflation.

The next chart compares actual real GDP since the beginning of 2007 with CBO estimates going forward to 2025. Clearly, if the economy grows no faster than its average since the trough of the last recession, it will never reach the CBO potential GDP benchmark. That approach would seem to validate not only the views of the survey majority who think that the economy has not yet recovered, but also those of the 16 percent who think it never will do so.

Labor market benchmarks

Many people, when asked whether the economy has recovered, do not think about GDP at all. They think about jobs. The next chart shows what happened to payroll jobs before and after the onset of the Great Recession.
As in the case of GDP, the answer to whether the economy has recovered depends on what benchmark we set. If we use the prerecession maximum number of jobs as the benchmark, then the labor market completed its recovery in May of 2014, when the total number of jobs first rose above its previous peak. If, instead, we compare the number of jobs to the prerecession trend, the data seem to vindicate the view of those who think the economy never will recover.

Rather than looking at total jobs, we could look at key employment ratios for the U.S. economy. The next chart shows two of the most important, the civilian unemployment rate and the employment-population ratio (EPR).

As in our previous two charts, the data lead to contradictory conclusions. The prerecession norm for the unemployment rate was about 5.5 percent. It appears likely that the rate will reach that level before three years are out, a little more optimistic than those who think it will take three or more years for the economy to recover, but not greatly so.

At the same time, the employment-population ratio, which took a precipitous plunge during the recession, is more consistent with the view that the economy will never fully recover. Some of the decrease in the EPR—about half of it seems to be a good estimate—is due to the aging of the population. The rest appears to stem from a number of causes, ranging from an increase in disability claims by adults of prime working age to more years spent in school by younger people. Whether caused by demographics or policy problems, the falling EPR points to a post-recession economy in which each worker will permanently be responsible for supporting more nonworking students, seniors, and people on disability.

The Fed’s position

Finally, the Federal Reserve Board of Governors has its own answer to what recovery means and when it will happen. The Fed frames its answer in terms of its dual mandate to prevent excessive inflation while maintaining full employment. It considers a normal rate of inflation to be 2 percent per year, as measured by the PCE deflator, and full employment to be an unemployment rate of 5.25 to 5.75 percent.

The next chart shows the progress of the recovery toward the Fed’s idea of normal. The red crosshairs and bullseye rings show the targets. The blue arrow shows progress toward the target from the start of 2010 through the first quarter of 2014. The green circles show the ranges of the Fed’s latest forecasts for inflation and unemployment in 2015 and 2016.
If the Fed’s forecasts turn out to be correct, the economy will have fully recovered by 2016, with unemployment between 5.1 and 5.5 percent and inflation between 1.6 and 2 percent—a view that, again, is more optimistic than that of the majority in the CNNMoney poll, but only slightly.

The bottom line

The bottom line here is that although recovery means different things to different people, public and professional opinions do not differ greatly:

- Only a small minority of the public think that the economy has already fully recovered. Economists would agree that a full recovery has taken place only if measured against the most lenient benchmarks—the previous peak of real GDP (reached in Q2 2011) and the previous peak of payroll jobs (reached in May 2014).

- A somewhat larger minority of the public thinks the economy will never recover. Most economists agree, at least some indicators, such as the employment-population ratio. Some economists also think that the economy will never reach the estimated path of potential real GDP that the CBO currently projects, and that that organization will have to revise its estimates downward still further to make it realistically attainable.

- That leaves the majority of economists in the same place as the public a large, thinking that the economy will complete its slow recovery in most respects within the next few years, but agreeing that we are not there yet.

Regardless of how long one thinks it will take the economy to get back to normal, there is almost universal consensus that it will be a “new normal” when we get there. It is very likely that median incomes and hourly wages will continue to lag well behind the growth of GDP, and that GDP growth itself will likely be slower, on average, than in past decades.

As I discussed in a recent post, those are facts we will have to learn to live with. Rather than wishing that we could force aggregate indicators beyond their realistic potential and turn the clock back to a past of high employment and rapid growth, it makes more sense to look for changes in policy that directly improve the quality of life for real people.

Filed under: GDP, Inflation and monetary policy, United States

Comments (6)

I thought the EPR was only working age people. Then how does an aging population skew it?

3 replies · active 13 hours ago

danaqourley 47p · 18 hours +2 ago (#IDComment84996034)

EPR includes people over the traditional retirement age of 65. According to the BLS the definition of the employment to population ratio is: “The proportion of the civilian noninstitutional population aged 16 years and over that is employed.”
Interesting. OECD defines it as working age population. The BLS calculation strikes me as inherently misleading except in the special case of generational redistribution schemes.

You are right, some sources incorrectly report the EPR as based on working age population. Here are the actual definitions from the BLS:

"The employment-population ratio represents the proportion of the civilian noninstitutional population that is employed."

"The civilian noninstitutional population consists of persons 16 years of age and older residing in the 50 States and the District of Columbia who are not inmates of institutions (for example, penal and mental facilities and homes for the aged) and who are not on active duty in the Armed Forces."


EPR is the ratio of working age population. But as the mean age of the working age population grows, pressure on the ratio grows. Older members of the working age population are more likely to drop out of the workforce for reasons of health, early retirement, and so forth than are younger members of the total population. So as the demographic weighting shifts older EPR can be expected to decline modestly, all other things being equal.

All that said, the precipitous drop in EPR in 2008 and its all but complete failure to recover is not explained by graying of the working age population without recourse to delusional assumptions (IMHO).

If you were to superimpose the LFPR, labor force participation rate, into the fourth graph here you will see that it matches the downward ratcheting of U3 unemployment. The twenty year average for LFPR, 1988 to 2008, is 66.5%, in May 2014 it stands at 62.8%, down 3.7%, equal to 9.16 million. Raising both the denominator and numerator, the U3 would then be 11.5%, Total LF would equal 164,775,000, and total employed would remain unchanged, 145,814,000, and total unemployed would almost double, to 18,961,000. 

The Atlanta Fed posted some articles about the decline in LFPR, they state that about 1/4 is due to aging LF. I recently calculated the growth rate of the "working age population" since 2000 (up by 16.5%), and compared it with the labor force growth (up by 9.1%) and the number employed (up by 6.5%), and private sector employment (up by 5.1%) and "not in labor force" (up by 31.5%).

Here is the site: [http://www.bls.gov/web/empsit/cpseea01.htm](http://www.bls.gov/web/empsit/cpseea01.htm)

That data speaks for itself. Dan Alpert lays out the problems with the labor market very thoroughly, another EconoMonitor contributor. The so-called recovery is far away, over the horizon, I'd say. At the rate of employment growth vs. normal population growth and normal labor participation ratio, it will be 20 years before we see the same figures as in 2007, and 30 years till we see the figures of 2000.