Jobless Recoveries:
Causes and Consequences

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Although the Great Recession ended in June 2009 and overall economic activity has exhibited signs of recovery, labor market conditions remain disappointing. Payroll employment has been recovering slowly; the average duration of unemployment remains at a historical high; and the unemployment rate is projected to remain above 7.8 percent until 2013.[1] Economists are concerned that the U.S. economy is mired in another jobless recovery—when economic activity experiences growth but the unemployment rate remains high.

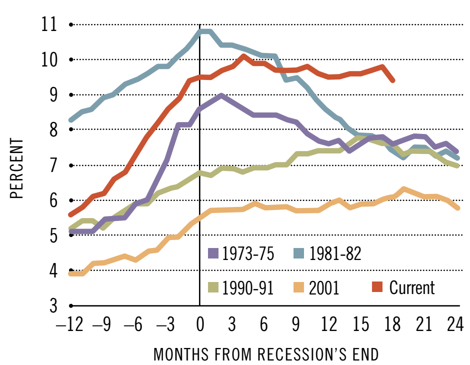
To determine the severity of current joblessness, it is useful to compare the current state of the labor market with that during previous economic recoveries. The figure shows the U.S. unemployment rate during the past four recoveries alongside the current recovery. In the first two cases, shortly after the 1973-75 and 1981-82 recessions ended, the unemployment rate started to decline; 15 months after the end of these two recessions, the unemployment rate had dropped to significantly lower levels. These were not considered jobless recoveries. In contrast, in the wake of the two recessions in the 1990s and early 2000s, the unemployment rate continued to increase 15 months after the end of the recessions. These were jobless recoveries.

Current developments in the labor market are similar to the jobless recovery cases. Since the Great Recession ended in June 2009, the unemployment rate has remained high. It topped 10 percent in late 2009, remained above 9.4 percent in 2010 and was still at 8.9 percent in February 2011—much higher than during any other recovery since the 1970s. Persistent and unusually high unemployment suggests that this jobless recovery might be more painful than the previous two.

Potential Causes of a Jobless Recovery

Many researchers have pointed to a labor market mismatch as one of the reasons for persistently high unemployment. Job growth polarization, industrial reallocation and organizational restructuring create a severe mismatch between available workers and appropriate job opportunities. Unemployed workers are forced to look for jobs in different occupations, industries and locations.

Unemployment Rates after Recent Recessions



SOURCE: U.S. Bureau of Labor Statistics

MIT Professor David Autor examined U.S. employment opportunities over the past three decades. He found that the U.S. employment growth has polarized into relatively high-skill, high-wage jobs and low-skill, low-wage jobs while middle-skill routine jobs have diminished. Some routine jobs, such as administrative and operative positions, have been replaced by computer automation. Other routine jobs, such as bill-processing and manufacturing positions, have been moved overseas to take advantage of lower wages. The Great Recession accelerated this trend: Employment in middle-skill and middle-wage occupations declined 7-17 percent during the recession.[2]

Job opportunities were also significantly reallocated between industries, suggests a study by economists Erica Groshen and Simon Potter. The 2007-09 financial turmoil and housing crisis had severe impacts on industrial structure: During the recession, employment in the construction industry dropped 20 percent, and job opportunities in the financial industry declined 6 percent. These industries continued to shrink after the recovery began. By December 2010, payroll employment dropped an additional 7 percent in construction and 2 percent in the financial industry. Manufacturing and information service industries were also badly affected. Demand in these industries may never return to prerecession levels; a portion of their job losses are likely to be permanent.

Organizational restructuring, which leads to an elimination of unneeded labor, especially by small firms, also creates structural change in job opportunities. During the Great Recession, small firms lost proportionately more jobs than larger firms: The small firms accounted for about 10 percent of total net job loss despite their 5.3 percent employment share.[3] Small firms also take longer than large firms to rehire. Moreover, small firms are more likely to close during economic contraction; some of their job losses might be considered permanent. Re-creating these jobs takes more time than rehiring.

Consequences of a Jobless Recovery

Long periods of high unemployment are without a doubt detrimental to unemployed workers and to the health of the economy. However, there are other, less-known consequences.

Yale economist Lisa Khan found that college graduates entering the job market during economic downturns experience a large, negative and persistent effect to their lifetime opportunities. Young workers who enter the job market during a jobless recovery may experience temporary unemployment and are more likely to accept less-attractive and lower-skill jobs due to limited opportunities. On average, their initial wage is significantly lower than the initial wage of their counterparts who graduate when the job market is strong. This disadvantage persists; even 15 years after graduation, their wages and career attainment remain lower than those of their luckier counterparts.

The social consequences of a prolonged jobless period may be as significant as the economic consequences. For example, the majority of studies on unemployment and crime suggest that a high unemployment rate is positively linked to increases in property crime.[4] What is more, economists Naci Mocan and Turan Bali found that the connection between joblessness and property crime is asymmetric: An increase in the unemployment rate is accompanied by soaring property crime, while a decline in the unemployment rate is followed by only a gradual drop in property crime. Serious property crimes may further damage the economic development and social welfare in urban areas, especially in inner-city neighborhoods.

A recent study by economists Dhaval Dave and Inas Rashad Kelly found that an increase in the unemployment rate results in negative changes in eating habits among a studied group of people with a high risk of unemployment. A 1 percent increase in the unemployment rate is associated with a 2-4 percent reduction in the consumption of fruit and vegetables. Such a reduction in healthy food potentially affects workers' health in the long run. In low-income families, inadequate nutrition could affect the physical and mental development of children; the stress that affects the jobless parents also affects their children.

The welfare of children in some communities could be further undermined because a high unemployment rate may affect family stability by reinforcing the retreat from marriage.[5] In less-affluent communities, economic status has been a requirement for marriage. Less-educated people are even less likely to have a job when the unemployment rate is high. Because of that, they find it harder to meet the material threshold for marrying. Persistent joblessness may result in a permanent cultural change in some communities if marriage becomes a luxury good.

A Long Road Ahead

Federal Reserve Chairman Ben Bernanke said last fall that job creation is probably the most important problem facing the U.S. economy.[6] As of January 2011, the U.S. economy needed roughly 6.8 million jobs to return to a 5 percent natural unemployment rate.[7] This estimate is more complicated if population growth, the *discouraged worker* effect and the extension of unemployment benefits are taken into account.

Unemployed individuals who stop looking for a job are called discouraged workers and are not considered part of the labor force. Discouraged workers may re-enter the labor market when the economic activity bounces back. A massive re-entry would temporarily raise the number of unemployed workers so that the unemployment rate could remain unchanged or rise even as payroll employment increases.

An extension of unemployment insurance would probably produce mixed effects on the job market.[8] Such an extension could improve the efficiency of matching workers with appropriate jobs. On the other hand, extended benefits could discourage jobless workers from accepting unattractive jobs, thus keeping the unemployment rate relatively high.

Taking these additional factors into account, if the economy immediately generates 350,000 jobs a month—the pace of the late 1990s—four years would be needed to reach an unemployment rate of 5 percent, whereas at a rate of 210,000 jobs a month—the 2005 pace—11 years would be needed to achieve a 5 percent unemployment rate.[9] Regardless, the current recovery may be remembered as the third consecutive, and likely the most severe, jobless recovery. The social consequences may be as painful as economic consequences. A generation of childhoods, career paths, eating habits and marriage culture may be permanently altered.

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ENDNOTES

1 The predicted unemployment rate is from the Survey of Professional Forecasters of the Federal Reserve Bank of Philadelphia.
2 The statistics are adapted from Autor.
3 Relevant data are from Business Employment Dynamics of the Bureau of Labor Statistics.
4 A good summary can be found in Garrett and Ott.
5 See Edin and Kefalas for details.
6 See Di Leo.
7 The Congressional Budget Office estimates that natural rate of unemployment in the U.S. is 5 percent. It defines the natural rate of unemployment as "the rate of unemployment arising from all sources except fluctuations in aggregate demand." See Congressional Budget Office.
8 See El-Ghazaly.
9 The calculation is performed based on the assumptions that population grows at a 1 percent annual rate and labor force participation rate returns to 66 percent (November 2007 level). More information is available upon request.

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