DSG

SPECIAL REPORT

March 18, 1993 No. 103-7

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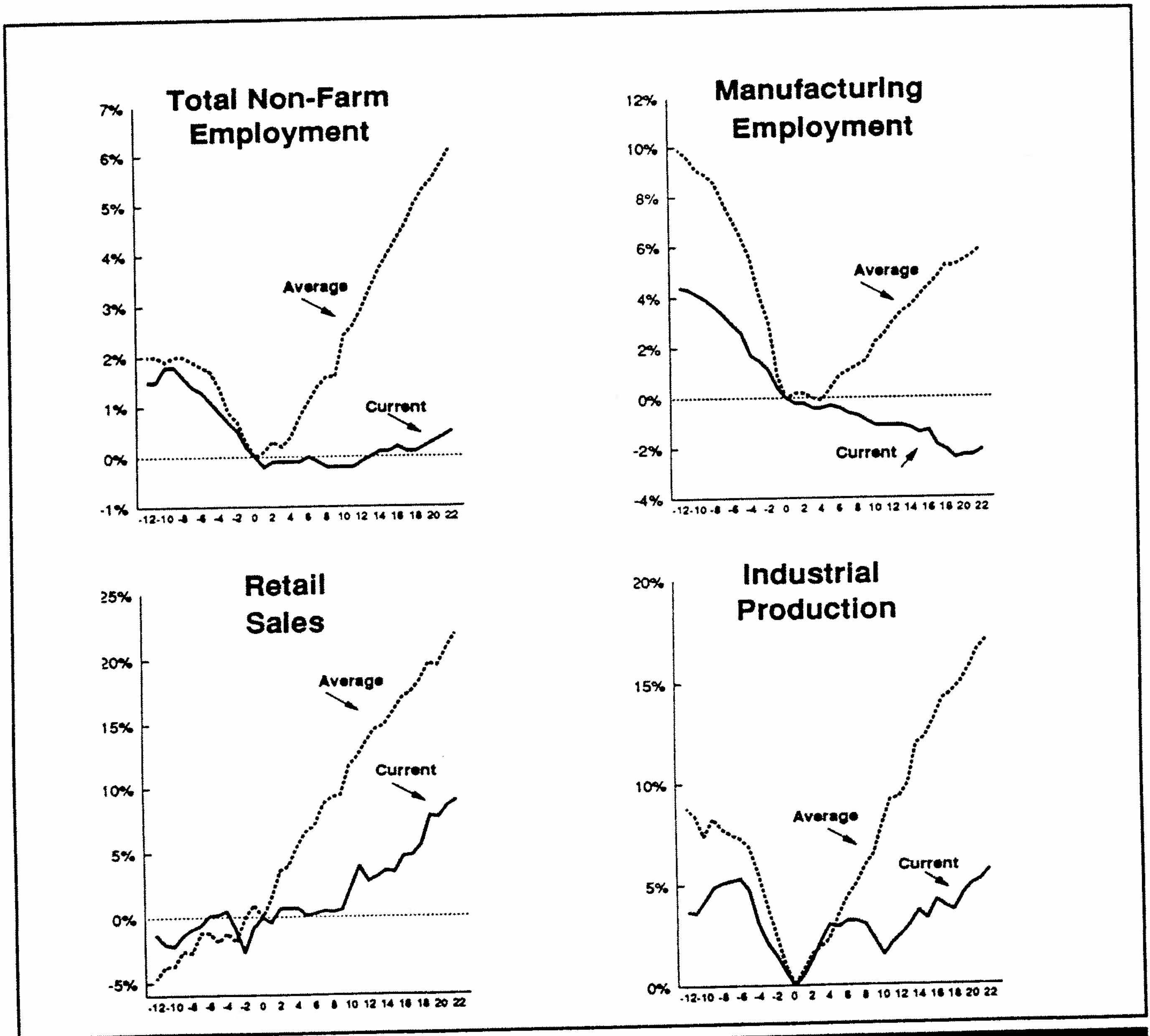
SCOTT LILLY — Executive Director

A Different Kind of "Recovery"



Democratic Study Group • U.S. House of Representatives
1422 Longworth House Office Building; Washington, D.C. 20515 — (202) 225-5858

A DIFFERENT "RECOVERY"

DSG Contact: Randall Dodd

During the decade preceding World War II, many Americans began to believe that the American economy might never recover from the economic troubles that began in the late 1920s. Following the war, however, a more regular pattern of economic growth began to emerge. Extended periods of substantial growth were interrupted periodically by shorter periods of contraction. After several quarters of negative growth, the economy would bottom out and rebound sharply for a few quarters and then settle back into a more stable period of moderate expansion.

During the last five decades, Americans have come to expect that all economic downturns would follow this pattern. While no one liked the periodic downturns, it was nonetheless comforting to know that recent history indicated that the decline would last only a short while and would be replaced by a period of strong growth during which most of the lost ground would be recaptured.

The recovery that began in 1991, however, has broken the mold and continues to shatter expectations that a brief trough followed by a sharp upward movement in real growth and job creation is a permanent characteristic of all postwar recessions. Failure to recognize that the downturn which began in 1991 is in many respects fundamentally different from its recent predecessors may easily lead to additional miscalculations concerning the future course of this "recovery" and a failure on the part of government to take adequate corrective measures.

THE COMMON CHARACTERISTICS OF RECENT BUSINESS CYCLES

While the American economy is always changing, the pattern by which economic growth has been periodically interrupted during recent decades has been quite consistent. At some point in an expansion certain imbalances develop. Most often the demand for certain services or commodities begins to exceed their availability. Prices begin to rise and eventually the Federal Reserve tightens the availability of credit in order to stabilize prices. Mortgage rates rise, auto loans become more expensive and difficult to obtain, workers begin to worry about how many more paychecks they will receive before layoffs start to occur, inventories will build up as sales of everything from houses to washing machines plummet. Factories receive fewer orders and so they cut employment and output.

Since World War II there have been 10 recessions. On average they have lasted slightly less than 11 months (measured from the peak of the previous period of expansion to the trough of the recession). The shortest was only 6 months while the longest was 16.

For purposes of simplification, we have focused on the four most recent recessions prior to 1990 to make a comparison to the latest recession.[1] The total reduction in the size of the economy during these recessions averaged 2.6%. The smallest decline was in 1969-70 — a drop of just under 1%. The biggest was the 1973 -75 recession — a 4.1% drop. The total number of

The History of American Business Cycles

Trough	Peak	Contraction (No. of Months)	Expansion (No. of Months)
December 1854	June 1857	...	30
December 1858	October 1860	18	22
June 1861	April 1865	8	46
December 1867	June 1869	32	18
December 1870	October 1873	18	34
March 1879	March 1882	65	36
May 1885	March 1887	38	22
April 1888	July 1890	13	27
May 1891	January 1893	10	20
June 1894	December 1895	17	18
June 1897	June 1899	18	24
December 1900	September 1902	18	21
August 1904	May 1907	23	33
June 1908	January 1910	13	19
January 1912	January 1913	24	12
December 1914	August 1918	23	44
March 1919	Jnauary 1920	7	10
July 1921	May 1923	18	22
July 1924	October 1926	14	29
November 1927	August 1929	13	21
March 1933	May 1937	43	50
June 1938	February 1945	13	80
October 1945	November 1948	8	37
October 1949	July 1953	11	45
May 1954	August 1957	10	39
April 1958	April 1960	8	24
February 1961	December 1969	10	106
November 1970	November 1973	11	36
March 1975	January 1980	16	58
July 1980	July 1981	6	12
November 1982	July 1990	16	92
March 1991		8	
Average, all cycles			
1854-1990 (30 cycles)		18	35
1854-1919 (16 cycles)		22	27
1919-1945 (6 cycles)		18	35
1945-1990 (8 cycles)		11	50

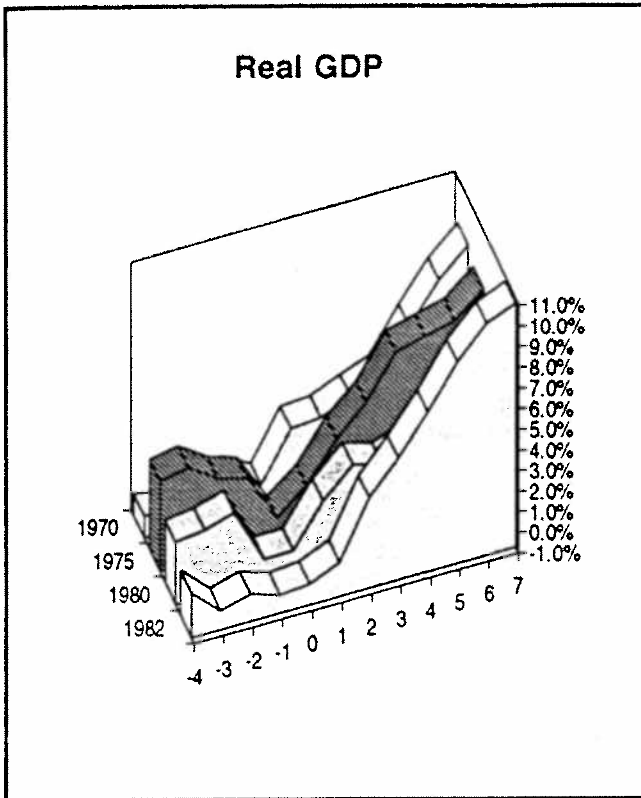
people in the country who were employed dropped by an average of 2.2% during these four recessions. The smallest decline being 1.4% and the biggest being 3.1%. Unemployment increased an average of 3.2 percentage points, with the smallest increase being 1.9 points in 1980 and the largest being 4.4 points during the 1973-75 recession.

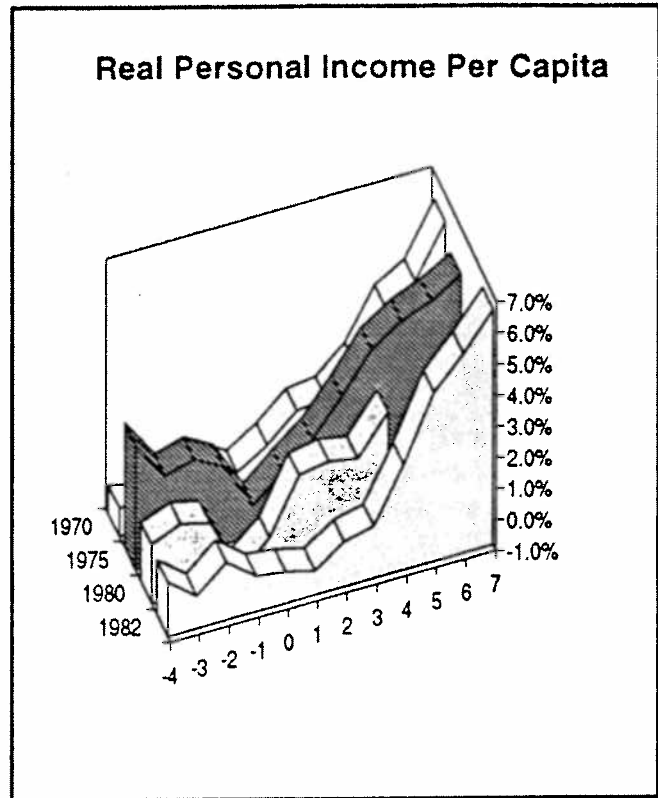
At some point in an economic downturn, the forces that caused the recession reverse themselves. For instance, in several recent recessions the demand for oil exceeded the supply and caused rapid price increases throughout the economy. When the Federal Reserve moved to tighten credit and the economy contracted, the demand for oil fell and eventually so did oil prices. When this occurred, the Federal Reserve relaxed credit and the economy moved into recovery.

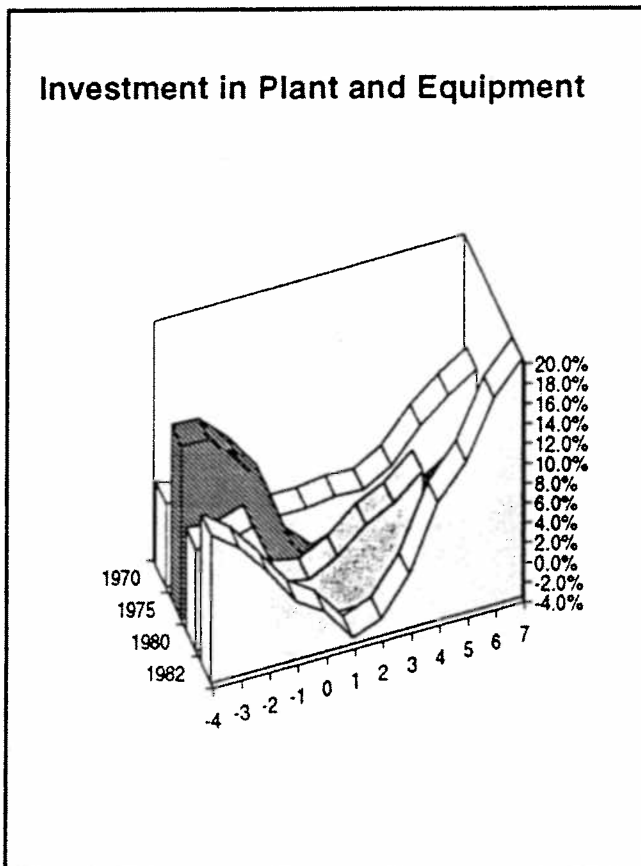
While recoveries last for varying periods of time—often depending on forces outside the American economy—the pattern of the economy during the first years of a recovery has been strikingly similar. Since we now have 22 months or about 7 quarters of data since the official trough of the 1990-91 recession, we looked at that time period for the previous recoveries. (For calculating averages, we excluded the 1980 recovery because it lasted only 12 months) Following the trough, real GDP grew over the first 7 quarters by an average of 9.3%, with the low being 8.3% and the high being 10.8%. Employment grew an averaged 6.1%, ranging from 5.4% to 7.5%.

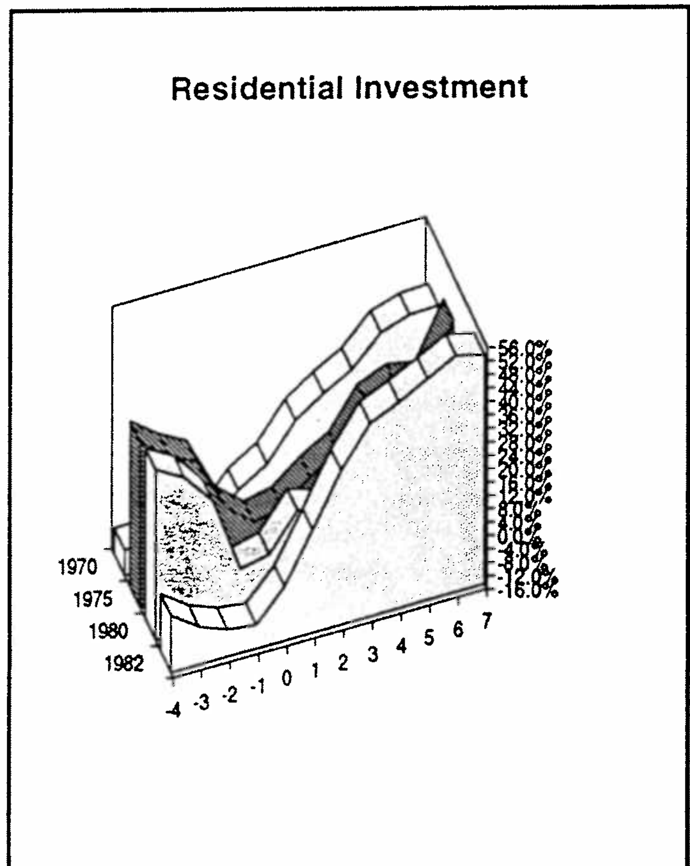
THE PATTERN OF BUSINESS CYCLES

(4 Qtrs. Before Trough - 7 Qtrs. After Trough)



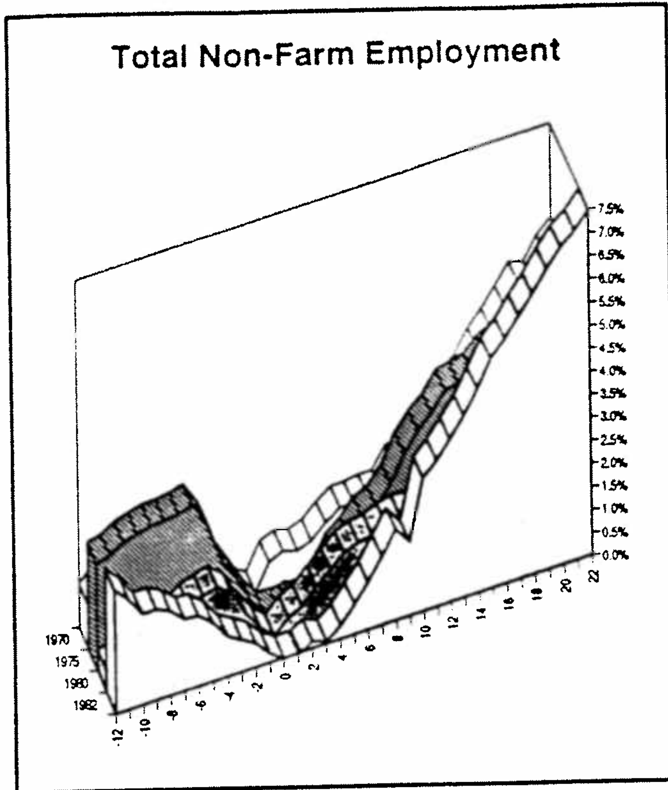


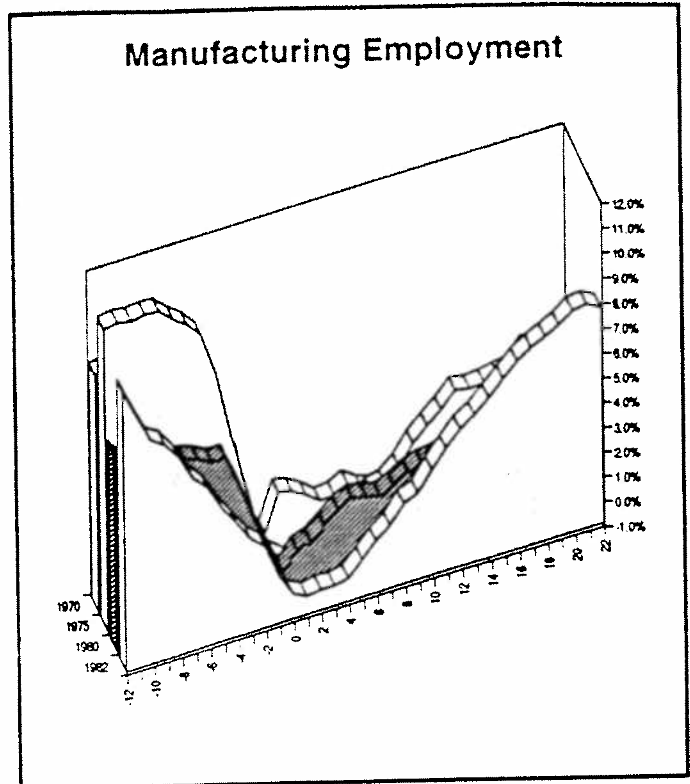


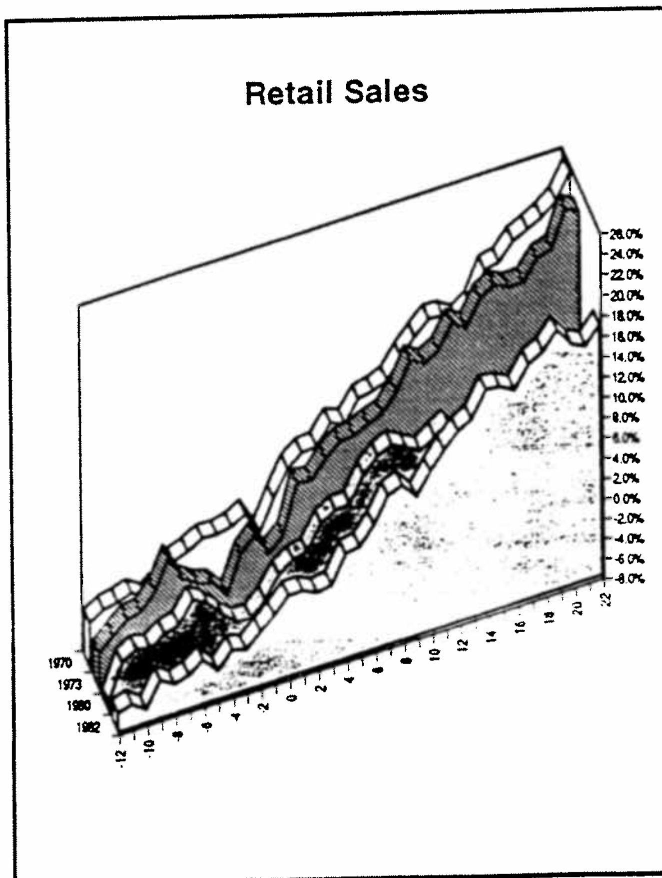


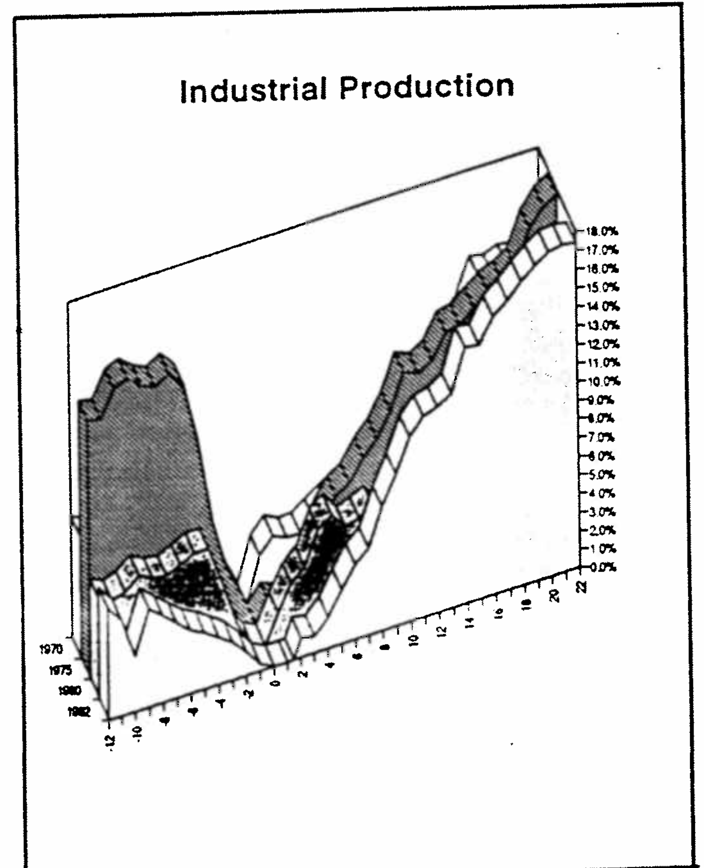
THE PATTERN OF BUSINESS CYCLES (Cont.)

(12 Mos. Before Trough - 22 Mos. After Trough)









This consistency in the performance of the recoveries is reflected by a whole range of other economic measurements. For instance, real personal income per capita rose by an average of 6.1%, ranging between a low of 5.5% and a high of 6.6%. Retail sales averaged 21.9% growth, ranging from 16.8% to 25.4%.

The charts on pages 3 and 4 illustrate the similar pattern of recent recessions and recoveries.

THIS RECOVERY BREAKS THE MOLD

The Bush recession of 1990-91 was an average recession by most indicators— well within the range of previous recessions. For example, real output dropped by 2.2% in the 1990-91 recession—somewhat below the average of 2.6% for recessions since 1970. Similarly, during this most recent recession, employment dropped by 2.0%—also a little below the average of 2.2%.

In sharp contrast, the current recovery is very different from other recent recoveries. Not only has economic performance lagged behind the average of previous recoveries, it has fallen far below the weakest of the previous recoveries on the basis of virtually every economic measurement.

In terms of overall growth, the real GDP in the current recovery has increased 4.1% in 7 quarters, compared to the 9.3% average of recent previous recoveries and the 8.3% performance of the weakest of recent previous recoveries.

The most troublesome indicator of the strength of this recovery, however, is employment. In previous recoveries, employment has expanded by 6.1% during the 22 months following the trough. In this recovery, employment has grown by 0.4% in 22 months. If you allow for the recent good news for employment in February and extend the period to 23 months, the growth has still been only 0.8%. That is less than 1/7 of the growth during the weakest of the recent previous recoveries in which employment grew by 5.7%. In addition, employment in manufacturing, which normally grows more rapidly than overall employment during a recovery has actually continued to decline during this recovery.

Real personal income per capita averages 6.1% growth during the first 7 quarters of a recovery, but during this recovery it has grown only 1.2%—less than 1/4 the growth of the weakest of the 3 previous recoveries.

Despite a good Christmas season, retail sales in this recovery are now only 9.0% above the levels of the recent trough. That compares to a nearly 22% average for previous recoveries. Investment in business structures which normally increases by 3.4% during the first 7 quarters of a recovery has plummeted by 13.5%. Investment in housing, which has led previous recoveries with 44% growth has displayed growth, but at only about half that pace during this recovery.

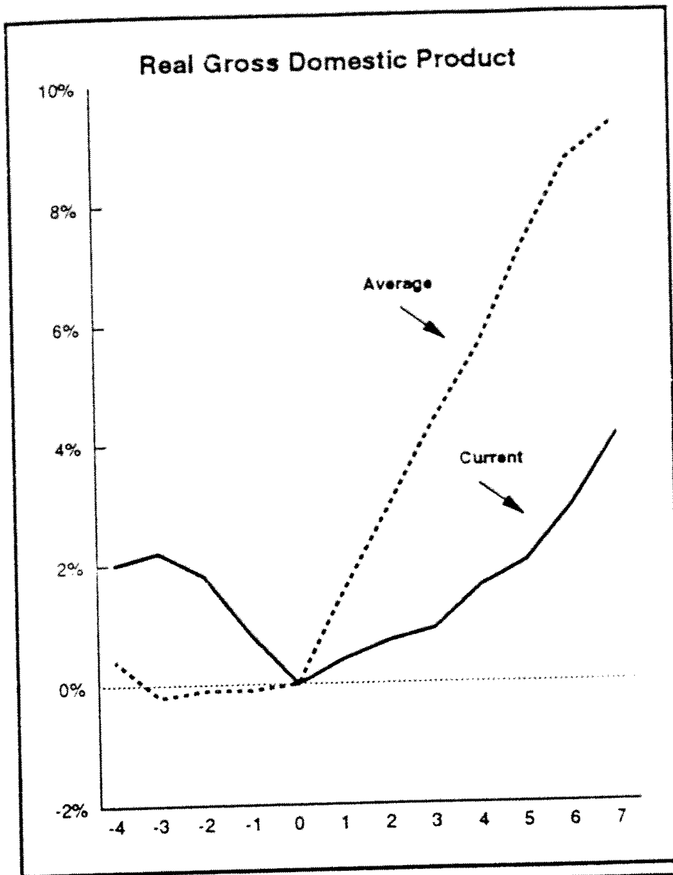
The charts on pages 6 and 7 highlight the contrast between the performance of the recovery that began in March 1991 and the average of those from 1970 to 1983. These are clearly different economic waters—ones that require us to look carefully at the appropriate policy responses.

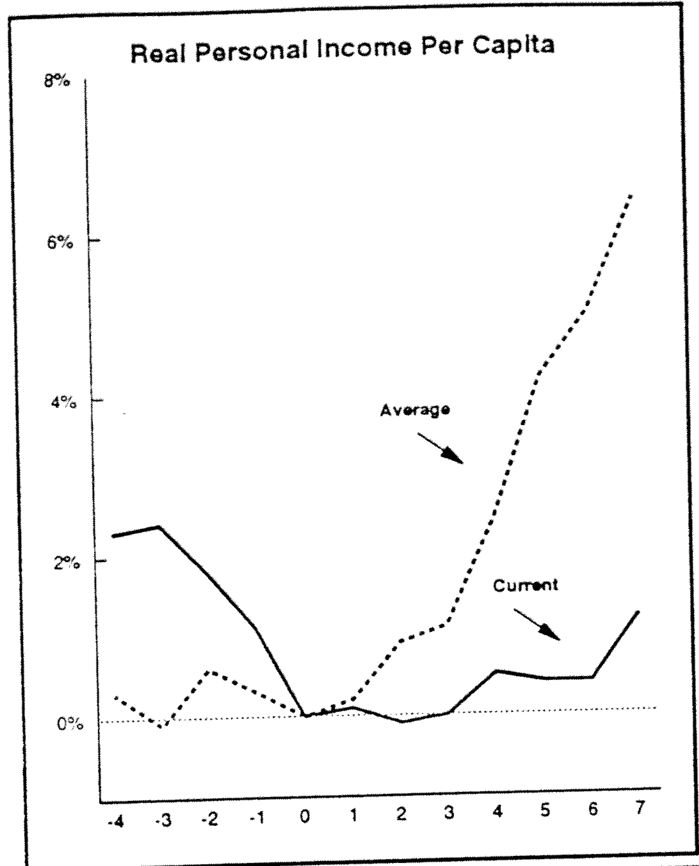
Although these charts show that the performance of this recovery has improved somewhat in recent months, it is clear that this recovery is still well below the performance of previous recoveries.

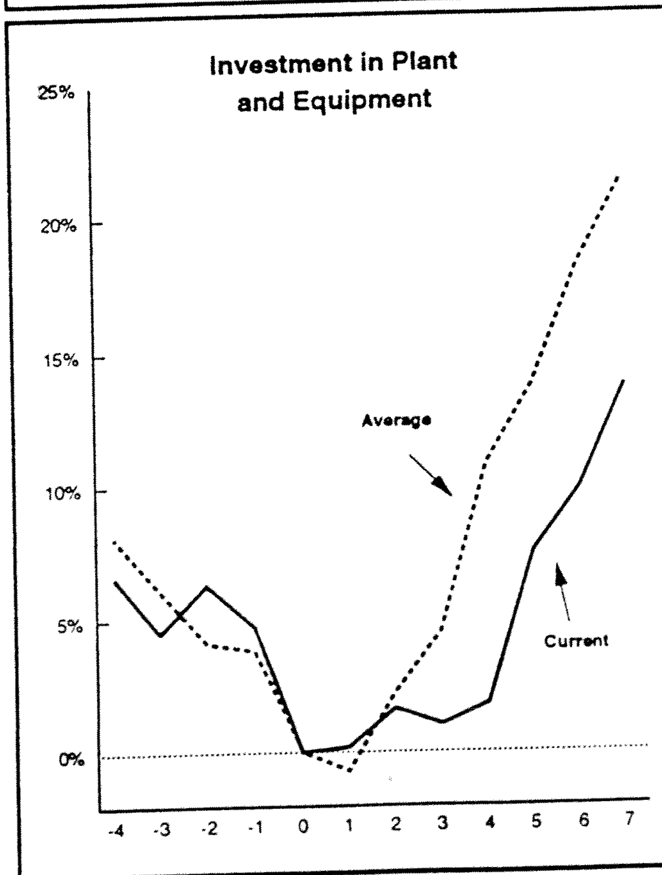
WORKING FAMILIES HAVE NOT YET RECOVERED

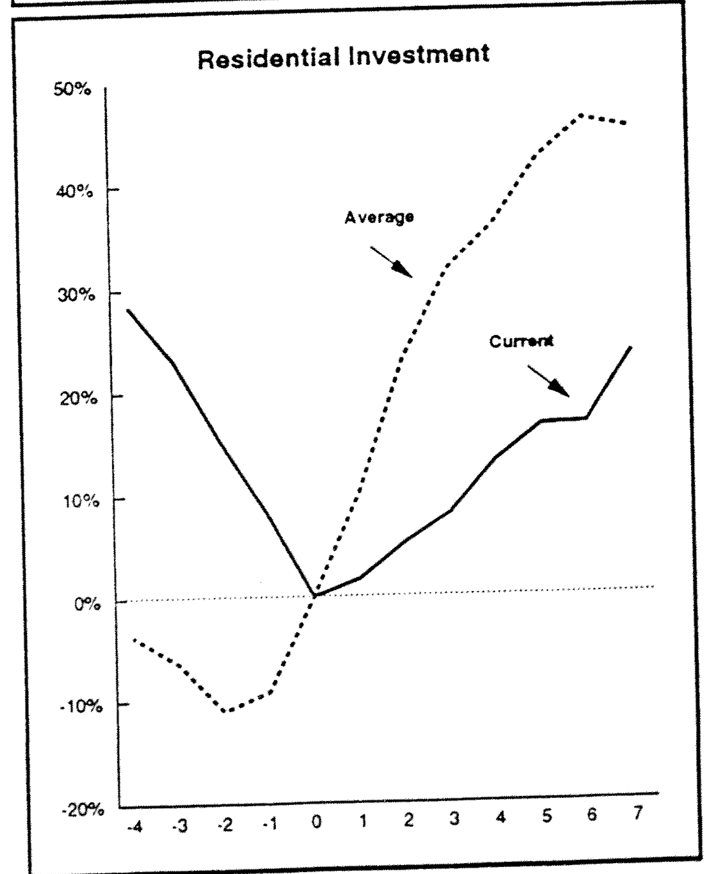
Again, although most economic indicators have improved in recent months, the round of

This Recovery Breaks the Mold
(4 Qtrs. Before Trough - 7 Qtrs. After Trough)



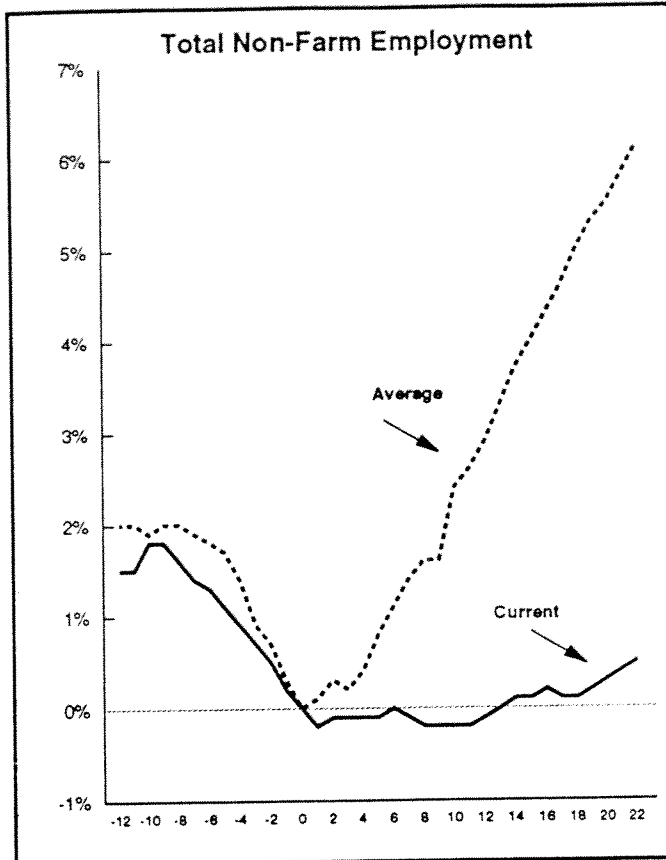


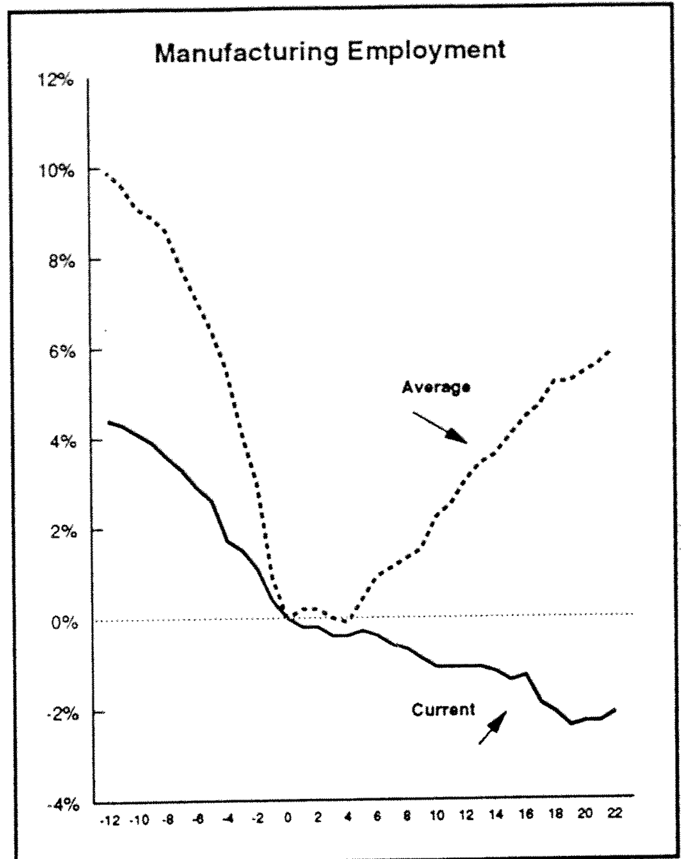


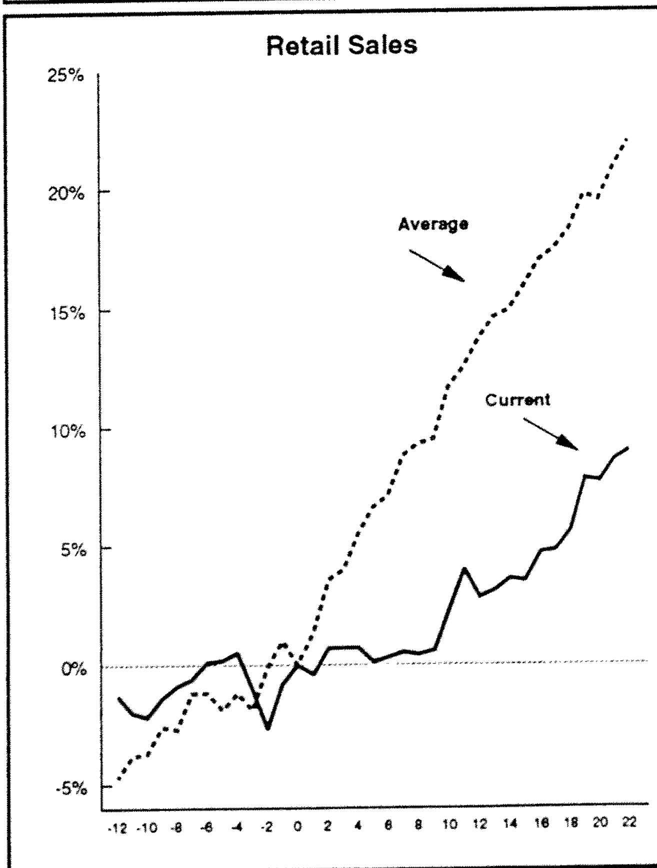


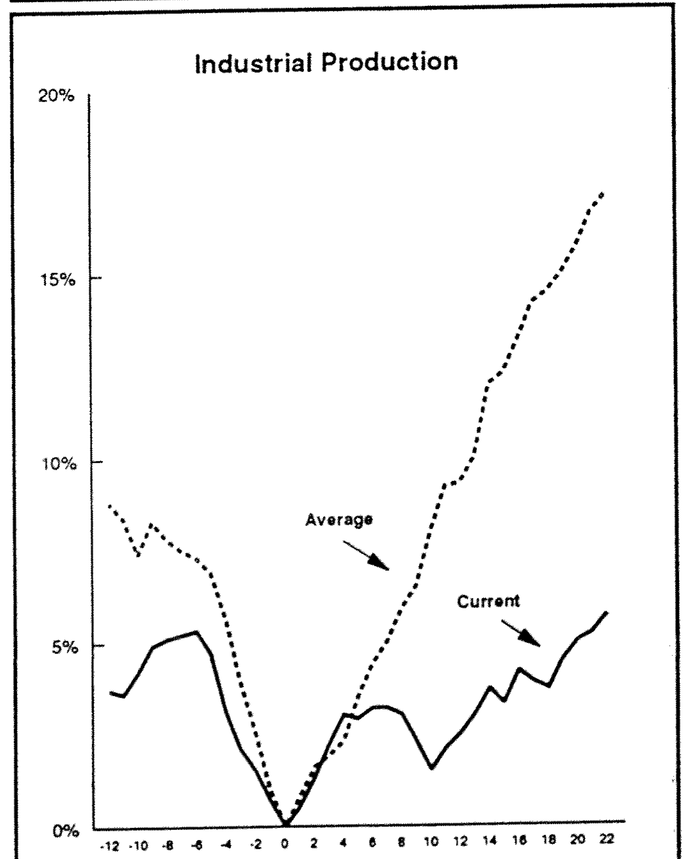
This Recovery Breaks the Mold

(12 Mos. Before Trough - 22 Mos. After Trough)





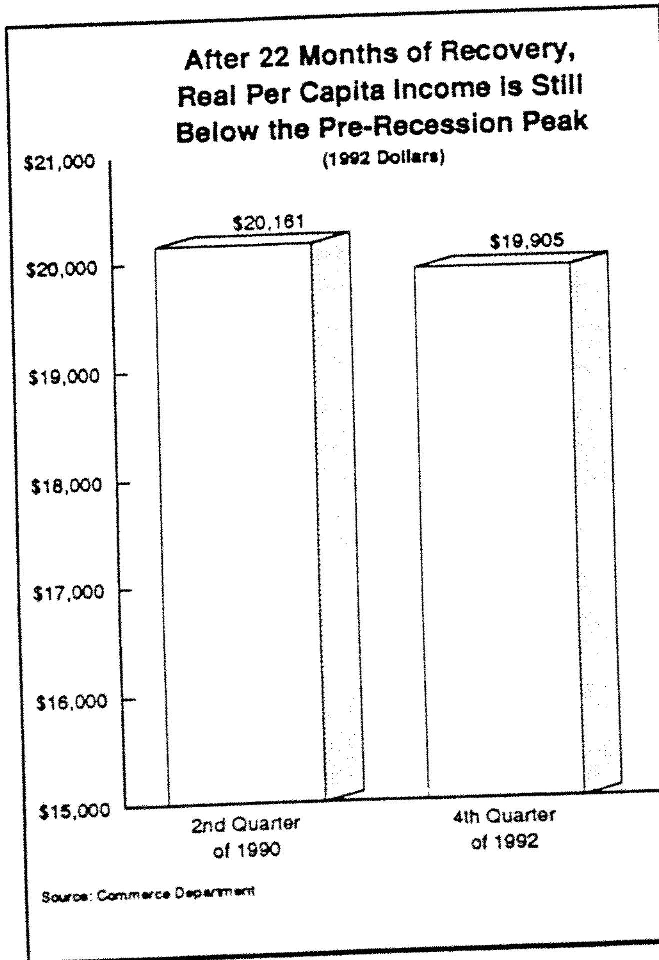


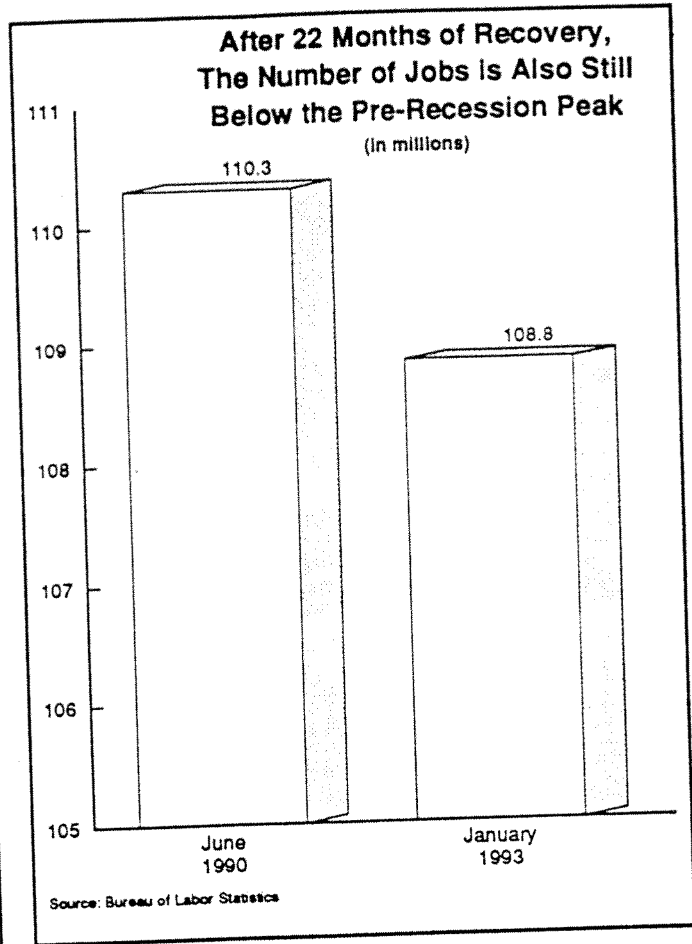


good economic news has not meant that economic hardship for many working families is at an end.

The recession cut sharply into family income through both a reduction in their real wages and the increased incidence of unemployment. The real hourly wage of non-supervisory workers fell 1.4% from the beginning of the recession to the start of the recovery. Since then it has continued to fall, and in January of 1993 the inflation-adjusted hourly wage was 1.9% lower than it was at the start of the recession. That puts the real hourly wage about where it was in 1965.

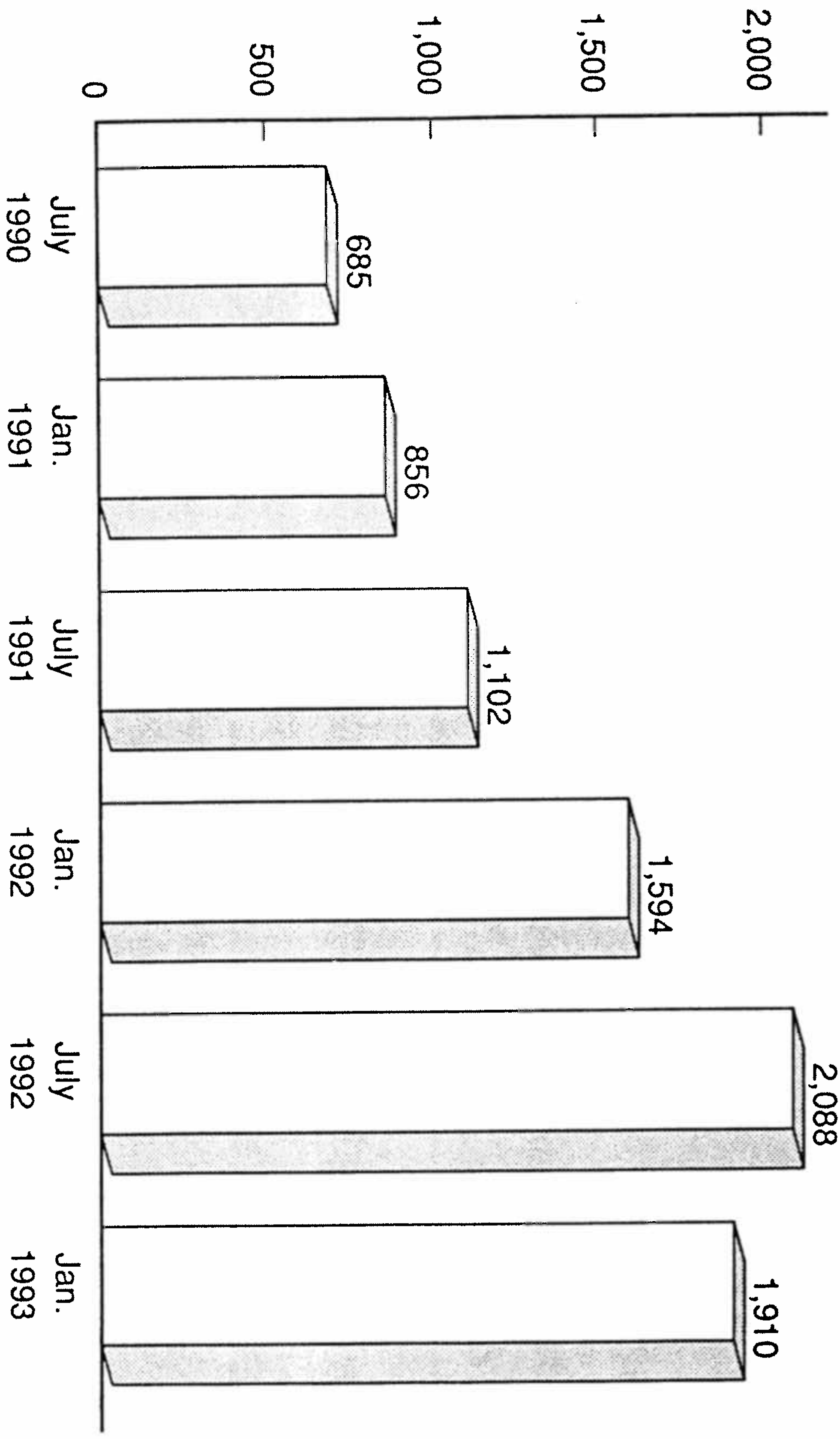
Taking a broader look at American incomes, the real income per capita, measured in 1992 dollars, has fallen from $20,038 at the start of the recession to $19,905 in the fourth quarter of 1992. Thus, after seven quarters of recovery, the real personal income of Americans has yet to return to the level from before the recession.

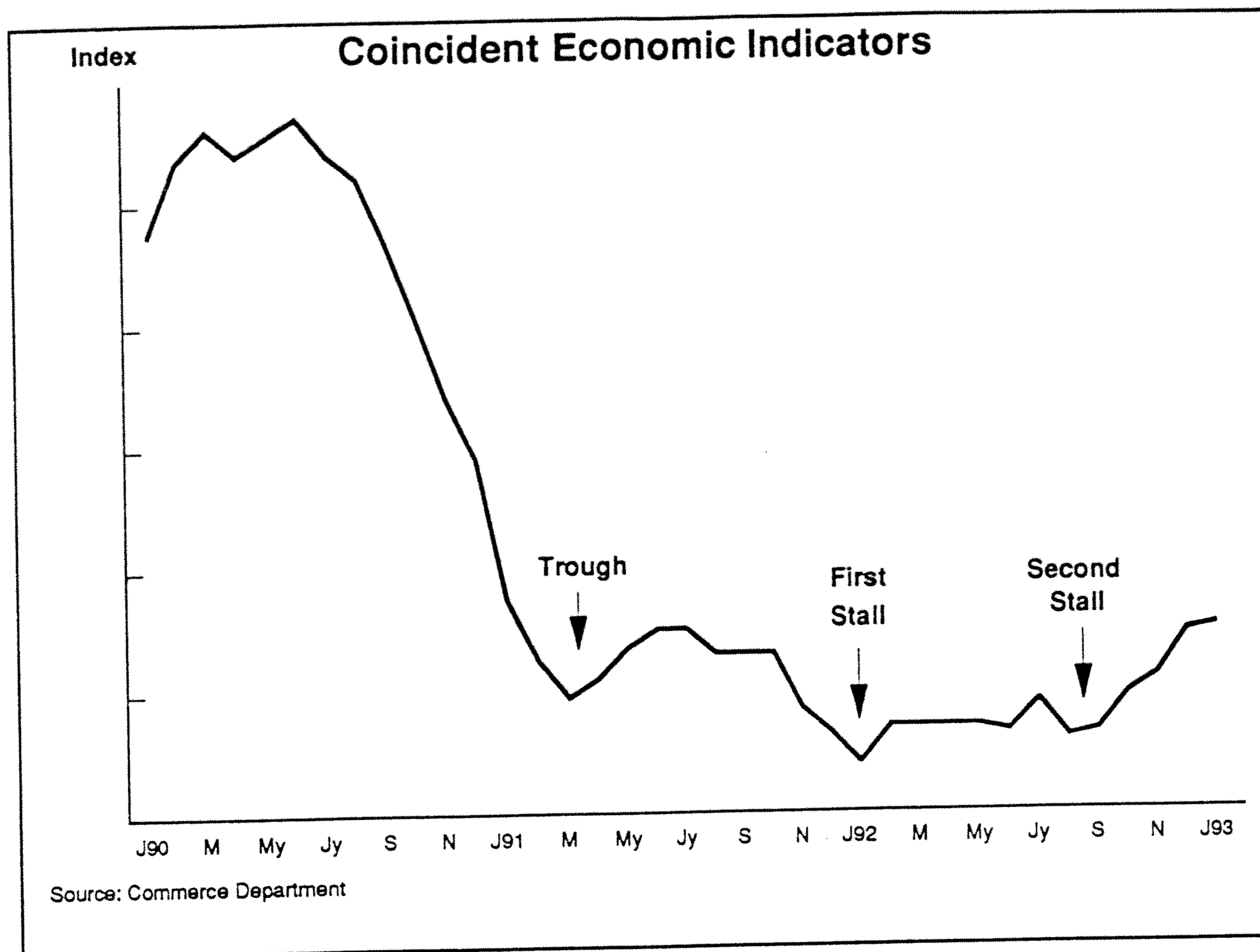




One reason for the stagnation in real incomes is the laggard growth in jobs. According to the Bureau of Labor Statistics, after 22 months of recovery, there are <u>nonetheless 1.4 million fewer jobs</u> now than there were before the recession.

Also, there are more than 2.3 million more workers unemployed now than before the recession. And these unemployed workers are staying unemployed for a longer period of time. Today, it takes an average of 19 weeks for an unemployed worker to find a job or to give up looking, while at the bottom of the downturn that average search time was 13 weeks. As the chart on page 9 shows, the number of workers unemployed for more than 27 weeks is now 1.9 million — 1.2 million <u>more</u> than at the beginning of the recession.


Number of Persons Unemployed for More Than 27 Weeks
(in thousands)
in thousands
2,000
1,500
1,000
500
0
685
856
1,102
1,594
2,088
1,910
July 1990
Jan. 1991
July 1991
Jan. 1992
July 1992
Jan. 1993
Source: Bureau of Labor Statistics



The decline in real family income is reflected in the growing number of Americans who are applying for and receiving food stamps as a supplement to their incomes. There are currently 26.6 million Americans, or 10.4% of the population, who are receiving food stamps. This is the largest percentage of the population receiving food stamps since the program began in 1964 — exceeding the previous record of 9.6% at the end of the last recession in 1982.

FEAR OF STALLING

The recent round of positive economic signs of renewed growth are as welcome as they are overdue. Yet they may not prove to be enough to keep the recovery going.

This recovery has already stalled twice before — once in the fall of 1991 and again in the summer of 1992. As the chart on this page shows, the Commerce Department's index of coincident economic indicators, which is designed to track movements in the current state of the economy, shows how the economic downturn has gone through a triple dip.

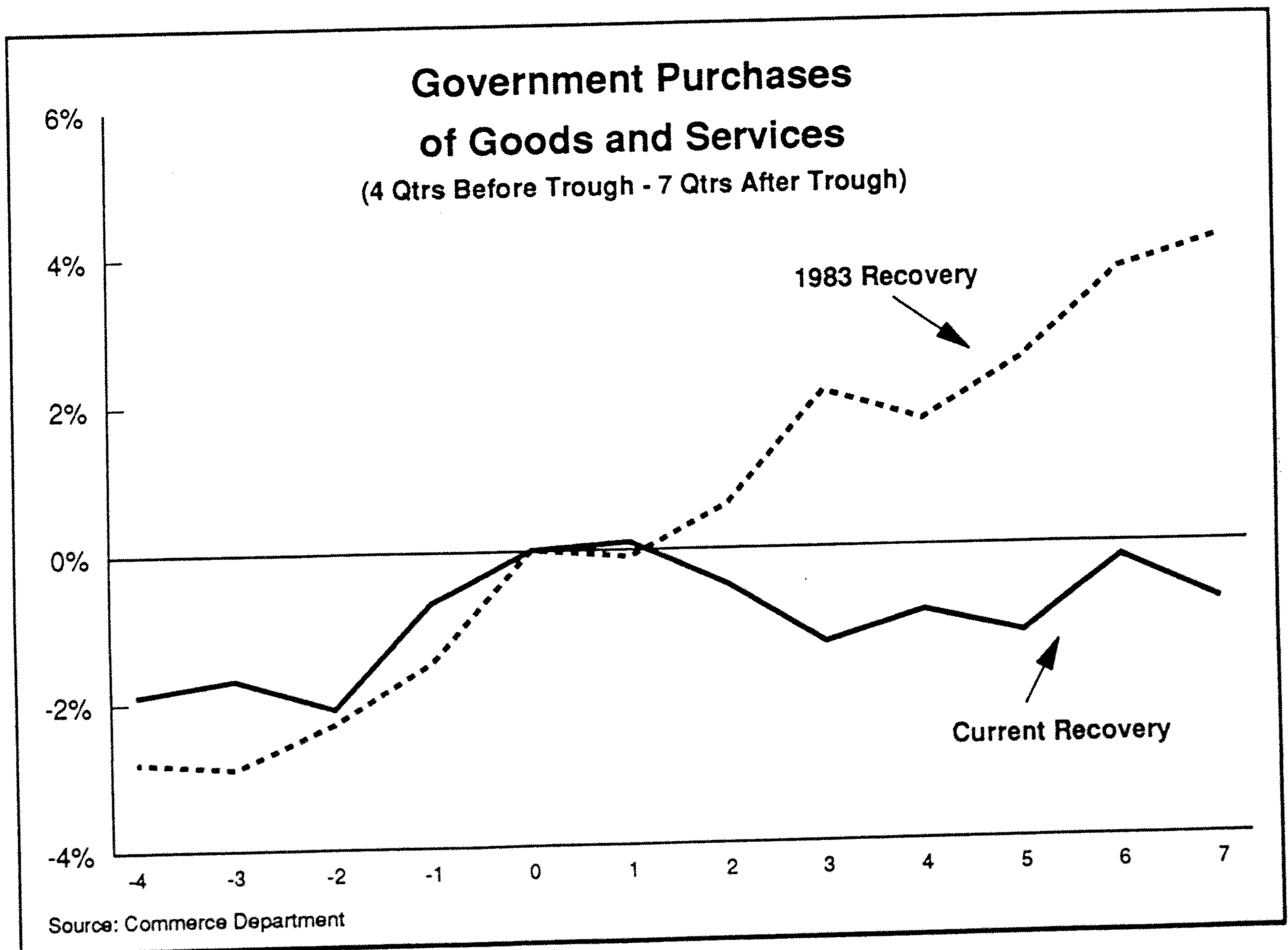
There are a number of reasons to worry about the future strength and sustainability of the current recovery

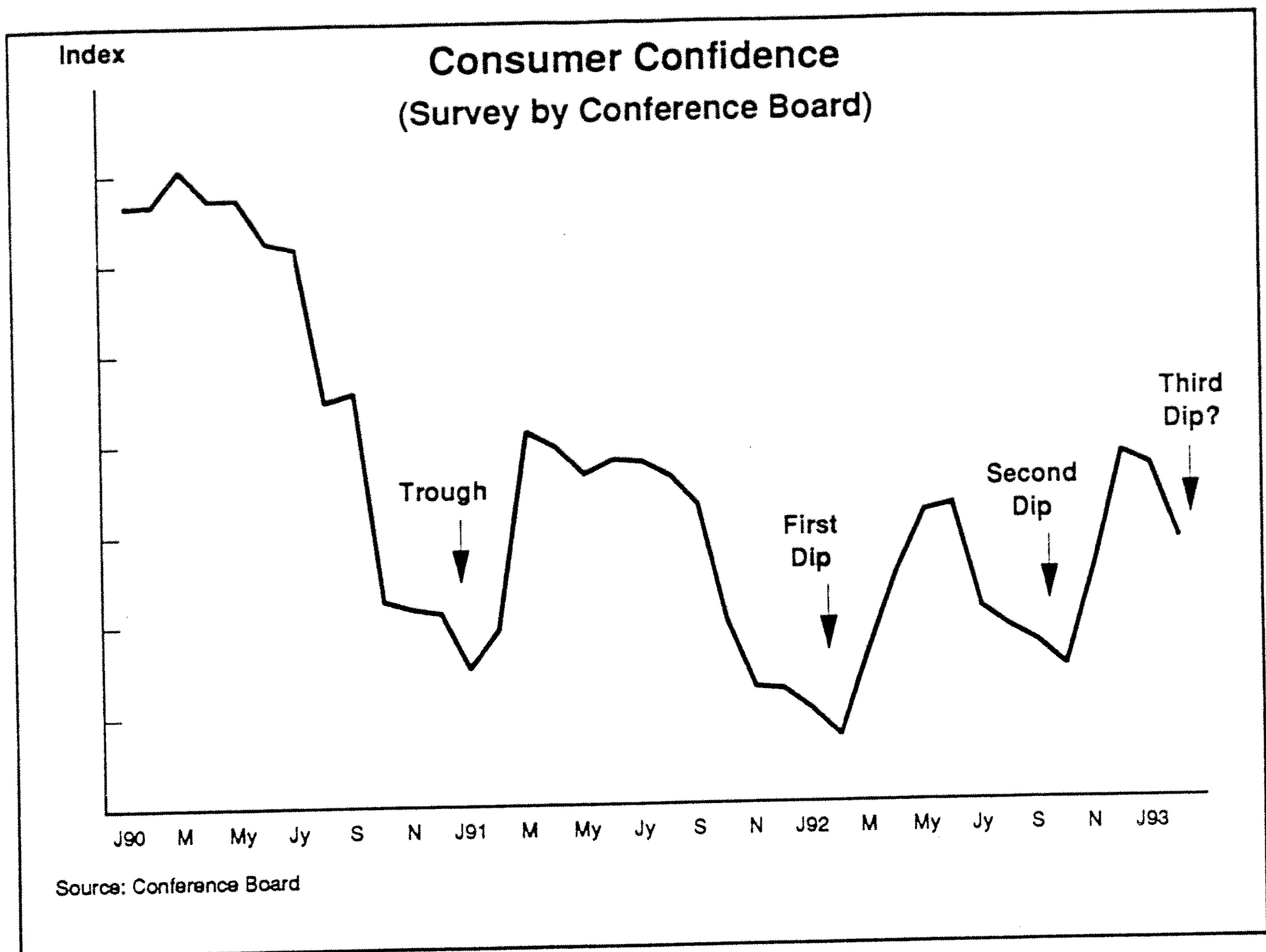
First, commercial bank lenders continue to be hestitant to provide businesses and individuals the credit needed to spark economic growth. The chairman of the Federal Reserve has testified that it is unlikely that this trend will be fully

reversed until these institutions can free themselves of the large numbers of non-performing loans which are mostly associated with the excess supply of commercial real estate. Demand for commercial space is not likely to absorb the excess supply until the latter part of this decade. Banks are therefore unlikely to clean up their books on the loans that financed this construction for several years to come.

Secondly, construction has provided a major share of the new jobs and purchases that have sparked all post-war recoveries. The massive over building of commercial real estate means that the commercial component of the construction industry will be of very little help at all. The residential component will also be much weaker than normal. Inventories of unsold new housing remain at very high levels and changes in demographics point toward markedly softer levels of demand than existed in previous recoveries.

Thirdly, overseas sales will be a major drag on growth here at home. The improvement in the nation's trade deficit which occurred between 1986 and 1991 has reversed. Trade in goods and services, which dropped to annual deficit levels of about $18 billion in the early part of 1991, have jumped to a deficit level of nearly $50 billion by late 1992. The International Monetary Fund forecasts growth for all industrialized economies in 1993 will hit only 2%, which means demand for U.S. exports will continue to be weak. In addition, an increase in imports is likely to accompany any increase in U.S. economic activity and drain dollars from the U.S. economy.





Fourth, because of a desire to reverse the serious fiscal imbalances of the 1980s, the federal government will be placing a serious drag on the early stages of a recovery for the first time in recent decades. During the Reagan Admininstration for instance, government purchases of goods and services grew by 4.1% during the seven quarters following the trough of the 1982 recession. As the chart on the previous page shows, government purchases have fallen since the beginning of this recovery and are scheduled to fall further under the Clinton Budget even if the stimulus package is adopted.[2]

Fifth, consumer demand cannot be sustained indefinitely solely on the basis of increased confidence.

A major source for the stronger economic growth in the latter part of 1992 was the boost in consumer confidence. As the chart on this page shows, consumer expectations about the economy, which had dipped twice before in the recovery, turned decidedly optimistic in the fall of 1992. Clinton began to succeed in his efforts to convince the American public that a Democratic government could successfully rekindle economic growth by putting together an effective fiscal policy. Chris Probyn, forecaster at DRI/McGraw Hill, puts it very clearly, "The spur of confidence was partly psychological. A lot of it was based on the assumption that effective government policies would be put in place."

Thus, with Clinton running steadily ahead in the polls, the major surveys of consumer and

business confidence showed that optimism grew remarkably beginning in October and remained high in the post-election period.

Consumers became more confident about their economic conditions and started to increase their spending. As a result, in the latter part of 1992, consumer spending grew rapidly, significantly outstripping personal income. Many Americans dipped into savings or added to their indebtedness to sustain their spending, particularly during the holiday season.

But there are reasons to believe that very strong consumer spending will not sustain this growth in 1993. One reason that consumer spending may not be as robust in early 1993 as it was in late 1992 is the Bush Administration's changes in tax withholding. These changes shifted after-tax income into 1992 (thereby boosting consumer spending) and will reduce the tax refunds that would come in the first two quarters of 1993.

Further, and more importantly, in the past few weeks, as the chart on the previous page demonstrates, surveys of consumer confidence show slight declines. One of the explanations for this drop is that there has not been the kind of substantial improvement in employment or incomes that would support continued growth in consumer spending. That is, the pace of economic growth will have to be vigorous enough to raise wages or create substantial numbers of new jobs simply to continue the current pace of consumer spending. Indeed, consumer spending, after adjusting for inflation, actually dropped by 0.1% in January.

Based on these concerns, most forecasters now expect the pace of growth during the first quarters of 1993 to be substantially below the levels experianced in late 1992.

CONCLUSION

Past recoveries have been characterized by very strong levels of growth in the first several years following the recession trough. This growth has resulted in rapid increases in total employment, substantial gains in personal and family income, and in overall pace of activity that allows both businesses and households to quickly regain most of the ground lost from the preceding period of contraction.

In sharp contrast, the current recovery has sputtered along and twice stalled. Even the recovery's better performance in the latter part of 1992 was built on weak foundations—with some of the contributing factors not likely to recur in the early months of 1993.

While we have become accustomed in recent decades to recessions which are neither as long nor as severe as those we suffered in earlier times and recoveries which restore most of the lost ground quickly, there is no rule that guarantees those types of recoveries. We are now clearly faced with substantially different kinds of economic problems than we faced in the past, and it may well take much longer to resolve them.

If the economy were to stall again, it would have numerous consequences. Recession weary households would be placed in an extremely stressful position given the lack of opportunity they have been given to recover from the pounding taken during the past 30 months. Government itself would become a major victim suffering from both a dramatic downturn in revenues and increased claims for entitlement benefits, Federal budget deficits would be pushed to new all time highs. If growth over the next twelve months were to turn even slightly negative, government revenue collections would drop by about $35 billion.

The best available evidence indicates that this recovery continues to break the mold and disapoint those who hope that a coordinated government effort to restore growth will not be necessary.

NOTES

[1] The four most recent recessions prior to this one were: the 11-month recession beginning in December 1969 and ending in November 1970; the 16-month recession beginning in November 1973 and ending in March 1975; the 6-month recession beginning in January 1980 and ending in July 1980; and the 16-month recession beginning in July 1981 and ending in November 1982. Only the four most recent business cycles are studied because certain monthly data (such as retail sales) are only available back through those four cycles.

[2] The federal component of government purchases should continue to decline. Despite the economic stimulus package, real discretionary spending under the Clinton plan will fall in each of the next five fiscal years. Measured in 1993 dollars, spending will fall from $548 billion in 1993, to $535 billion in 1994, and finally to $490 billion in FY 1998 — a 10.6% drop over five years.