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The 2008 Economic Crisis Ten Years On: *In Retrospect, Context, and Prospect*

"Some Observations on the Structure of the Labor Market after the Great Recession"

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Abstract

This (short) paper takes as its starting point the (short) seminal article by Edward C. Prescott entitled 'Some Observations on the Great Depression'.[2] Prescott finds for the United States in the 1930s (from 1929 to 1939) that there is a 20% decrease in yearly hours worked per adult from the pre-Depression 1929 "steady state" and that there are (difficult to identify with certainty) structural changes in the labor markets related to government policy interventions occurring during the 1930s causing this change, whose effects lasted until at least 1949, almost 10 years after the end of the Depression. Our paper proposes that in our current era, post-Great Recession, post-Financial Crisis of 2008, there also have been institutional interventions which have resulted in structural changes in labor markets. These (also difficult to identify with certainty) institutional changes have led to a decrease in the Labor Force Participation Rate and have increased underemployment since the financial crisis of 10 years ago, social phenomena which are not captured in the headline employment data we see today. We compare and contrast the economic conditions as found in Prescott (1999) for the Great Depression with the economy today and find many similarities, as well as less significant differences.

Keywords: Great Recession, Great Depression, Labor Markets, Structural Change, Unemployment

JEL Codes: E24, H12, I3, J21

[1] I state that I have no conflicts of interest regarding this research.

[2] Federal Reserve Bank of Minneapolis Quarterly Review 23 (1), 25-31, Winter 1999.

"Some Observations on the Structure of the Labor Market after the Great Recession"

I am led, as Cole and Ohanian are, to the view that there must have been a fundamental change in labor market institutions and industrial policies that lowered steady-state, or normal, [labor] market hours.
-Edward C. Prescott (1999)

I. Introduction, Scope and Methodological Approach

What makes the Great Depression great in the historical memory, is that unemployment averages around 15% (or three times that which has become accepted as the 'natural rate' of unemployment of 5%) during the 1930s[3]. It was not until the pre-WWII conscription of 1940, the first and only peace-time draft in US history, that unemployment drops ending the 10- year Depression. Prescott's (1999) paper is about this 1930s period and its after-effects on the US economy.

Our current paper differs from this approach as, first off, the Great Recession as a result of the 2008 financial crisis, lasts only 18 months (December 2007 – June 2009[4]), so our concern here is the last 10 years since our recent crises, not an evaluation of a prolonged depression. What is similar is that in both cases we cannot blame a deflationary central bank policy, in that in the last half of the 1930s, "There was no deflation. There was a large increase in the money supply and a corresponding drop in the interest rate, just as the demand-for-money relation predicts" (Prescott 19999, 26), and recently, for example, the Federal Reserve targets the discount rate at less than one percent for an unprecedented seven years (December 2008 – November 2015)[5,6].

[3] Weber 2009, 14.

[4] http://www.nber.org/cycles.html

[5] https://fred.stlouisfed.org/series/INTDSRUSM193N

[6] In addition, although not part of Prescott's (1999) analysis, we find a similar expansionist fiscal policy in both periods.

Fiscal Data ($ Billions): US Government Outlays and Deficits and US GDP

	Outlays	Deficit	Defect %/outlays	GDP	Outlay%/GDP	Deficit%/GDP
1935	6.4	2.8	43.8%	986	0.6%	0.3%
2012	3537	1087	30.7%	15605	22.7%	7.0%

source: whitehouse.gov, thebalance.com, calculations by author

Taking mid-points during each episode, we find that deficit spending as a percentage of the economy in each period is deficit-stimulus oriented (a robust deficit spending of more than 30% of government outlays in each case). Furthermore, government intervention (outlays as a percentage of GDP) is greater in our recent period, meaning that we would expect institutional changes due to interventionist policy to be even greater today than in the 1930s. We

Another difference between our current research and that of Prescott's (1999) is that we use the Labor Force Participation Rate and a measure of underemployment to show the (destructive) structural changes in the labor market whereas Prescott uses "Yearly Market Hours Worked per Adult"[7], data which is not readily available to us, and, data which is not part of today's headline story which we are trying to critique. Where our two papers are similar is that we both use measurements of structural labor market changes due to crisis and subsequent intervention.[8] In the next section we indicate why we believe there has been structural change in the labor market since the 2008 Financial Crisis, and we conclude by summarizing our findings.

II. The Headlines versus Reality

We find today, post-Great Recession, that President Trump is taking credit for the lowest unemployment level since 2000. Here is his tweeter feed of May 4, 2018:

Illustration 1: Donald J. Trump Tweeter Feed[9]

Donald J. Trump

can take period beginning and ending points and find the same results. Thus, in both instances, we cannot say that decreased labor market activity is due to lack of Keynesian monetary and fiscal intervention.

[7] Yearly labor hours worked in 1929 are 1170, in 1939 are 920, in 1949 are 949, 1034 in 1959 and 1030 in 1979 (Prescott 1999, 28). In other words, by 1979 labor hours worked are still below pre-Depression levels, although by 1949 labor hours surpass those of 1939.

[8] Robert Higgs (1987) calls unpredictable discretionary government intervention into the economy "regime uncertainty" and finds that this uncertainty reduces long-term entrepreneurial investment, a reduction in investment results in decreased economic growth, which leads to a decrease in the demand for labor. The form and content of this intervention is beyond the scope of this paper just as it is for Prescott (1999). However, both papers show that there are structural changes historically, and do not attempt to identify (if this is even possible) all the interventions which create these structural changes. See Higgs (1987) for interventions during the 1930s which change the structure of labor markets and Beckworth, editor (2012) for interventions leading to toady's labor market changes.

[9] Available:
https://twitter.com/realDonaldTrump/status/992395376039727104?ref_src=twsrc%5Etfw%7Ctwcamp%5Etweetembed%7Ctwterm%5E992395376039727104&ref_url=https%3A%2F%2Fwww.washingtonpost.com%2Fnews%2Fwonk%2Fwp%2F2018%2F05%2F04%2Funemployment-is-headed-for-historic-lows-economists-say%2F

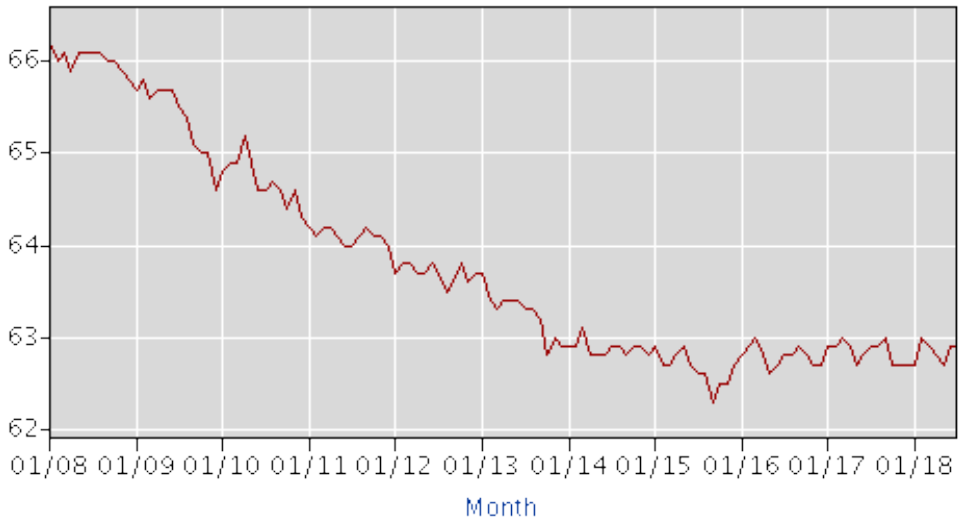
Follow
@realDonaldTrump

JUST OUT: 3.9% Unemployment. 4% is Broken! In the meantime, WITCH HUNT!

6:27 AM - 4 May 2018

However, what is not in the headlines are the structural changes underlying this official unemployment figure. Today we are experiencing a low, and continually flat, Labor Force Participation Rate.

Graph 1: Labor Force Participation Rate (source: BLS.gov[10])



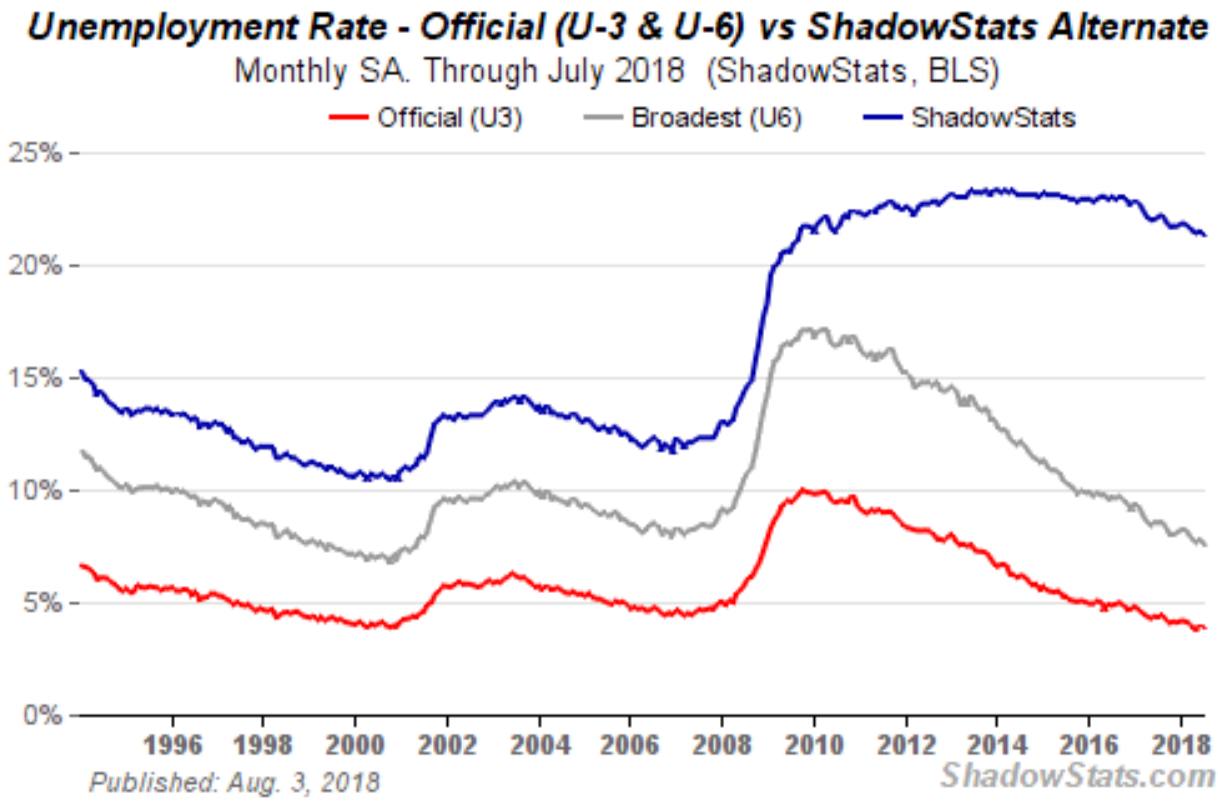
We can see from Graph 1 that the LFPR has hovered around 63% for the last four years (decreasing since the 2008 Financial Crisis from 66%). If we add those who have dropped out of the labor force (3% of the workforce) to the above-mentioned 3.9% officially-reported unemployment, the result is a 6.9% unemployment rate, nothing to tweet about when we consider the accepted 'natural' rate of unemployment to be 5%. This lower than historic LFPR over the last four years is one structural change in today's labor market resulting from the financial crisis of ten years ago. It of course remains to be seen if this structural change will be as

[10] https://data.bls.gov/timeseries/LNS11300000. Data through July 2018.

long-lasting as the decreased labor supply found in Prescott (1999) as a result of the labor market and other interventions during the Great Depression.

However, this is not the end of the story. When we take into consideration both the decrease in the LFPR, and other idiosyncrasies in the official unemployment statistics, we find that unemployment may be on a much higher structural plain than reported in the headlines.

Graph 2: ShadowStats Unemployment Measure[11]



We find from Graph 2 that there might be much larger structural changes to the labor market than just those of a change in the LFPR. The official (U3) statistic tracks our headline unemployment rate. When we add-in workers who have been discouraged for one-year and those working part-time instead of full-time due to economic (not personal) reasons (U6) we find a measure slightly above the official unemployment plus the decrease in the LFPR (which to remind is around 6.9%).

Further, we should examine the ShadowStats measure of unemployment, which we can see has remained above 20% since after the official recovery from the 2008 Financial Crisis. The ShadowStats alternative measure is U6 plus those workers who have been discouraged for more

[11] Available: http://www.shadowstats.com/alternate_data/unemployment-charts. Data through July 2018.

than one year. We can see using this broadest measure of unemployment (which is not comparable with unemployment figures calculated during the Great Depression due to accounting changes for official unemployment measures made in 1994) that there is a clear structural break with the 2008 Financial Crisis 'recovery' which has given us prolonged unemployment approaching, or even surpassing, the structural unemployment resulting from the Great Depression.

III. Conclusion

Following the work of Prescott (1999) for the Great Depression we have examined the changes in the labor market since the Great Recession and have found that there may be clear and persistent changes ("structural" changes) in the supply and demand for labor since the 2008 Financial Crisis. It is too early to tell if these changes will be as long-lasting as those which occurred in the 1930s, however, it is clear that there has been structural change. This lower labor market activity may also help explain the lower than historic levels of economic growth since the official end of the Great Recession in June 2009. The ShadowStats measure of consistent unemployment of around 23% since the recent crisis roughly correlates with the 20% decrease in labor hours worked during and after the Great Depression as found by Prescott.

The Keynesians had it all wrong. In the Great Depression, employment was not low because investment was low. Employment and investment were low because labor market institutions and industrial policies changed in a way that lowered normal employment.

-Edward C. Prescott (1999)

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