EPI Issue Brief

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WHY PEOPLE ARE SO DISSATISFIED WITH TODAY'S ECONOMY

by Lee Price

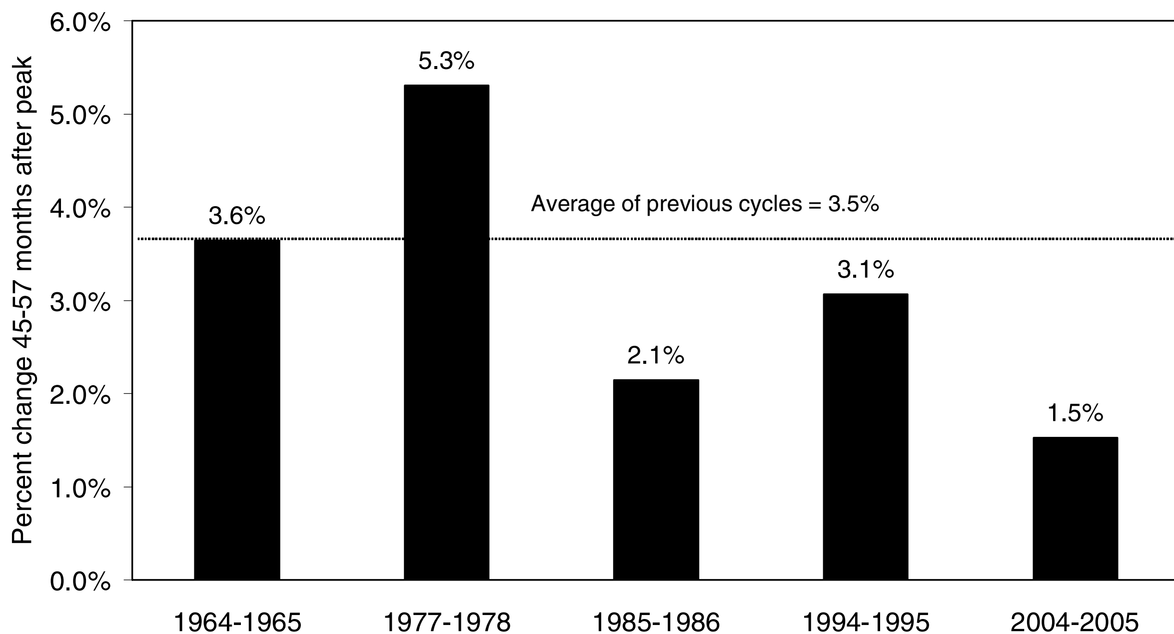
In recent weeks, incumbent politicians have bragged about growth in gross domestic product, jobs, and pay and touted declines in unemployment. Yet a January 12 Gallup poll found that 55% of Americans rate the economy as only "fair" or "poor," and that 52% believe the economy is getting worse. It will not come as a surprise to these Americans that the Commerce Department reported today that, in the fourth quarter of 2005, GDP grew by a tepid 1.1% and the wage and salary growth rate was 1.7%.

The following set of questions and answers provides insight into the public's dissatisfaction with the economy despite the seemingly positive numbers that often get the most attention.

Jobs

President Bush has noted that 2 million jobs were created over the course of 2005 and that we have added 4.6 million jobs since the decline in jobs ended in May 2003. Doesn't that mean the labor market is getting back to normal?

Recent job gains lag far behind historical norms. Last year's 2 million new jobs represented a gain of 1.5%, a sluggish growth rate by historical standards (**Figure A**). In fact, it is less than half of the average growth rate of 3.5% for the same stage of previous business cycles that lasted as long. At that pace, we would have created 4.6 million jobs last year. If jobs had grown last year at the pace of even the slowest of the prior cycles—2.1% in the 1980s—we would have added 2.8 million jobs. Over the last half century, the only 12-month spans with job growth as low as 1.5% were those that actually included recession months, occurred just before a recession, or were during the "jobless recovery" of 1992 and early 1993.



Unemployment

According to President Bush, today's 4.9% unemployment rate is below the average rate of the 1970s, 1980s, and 1990s. Doesn't that mean we have a tight labor market?

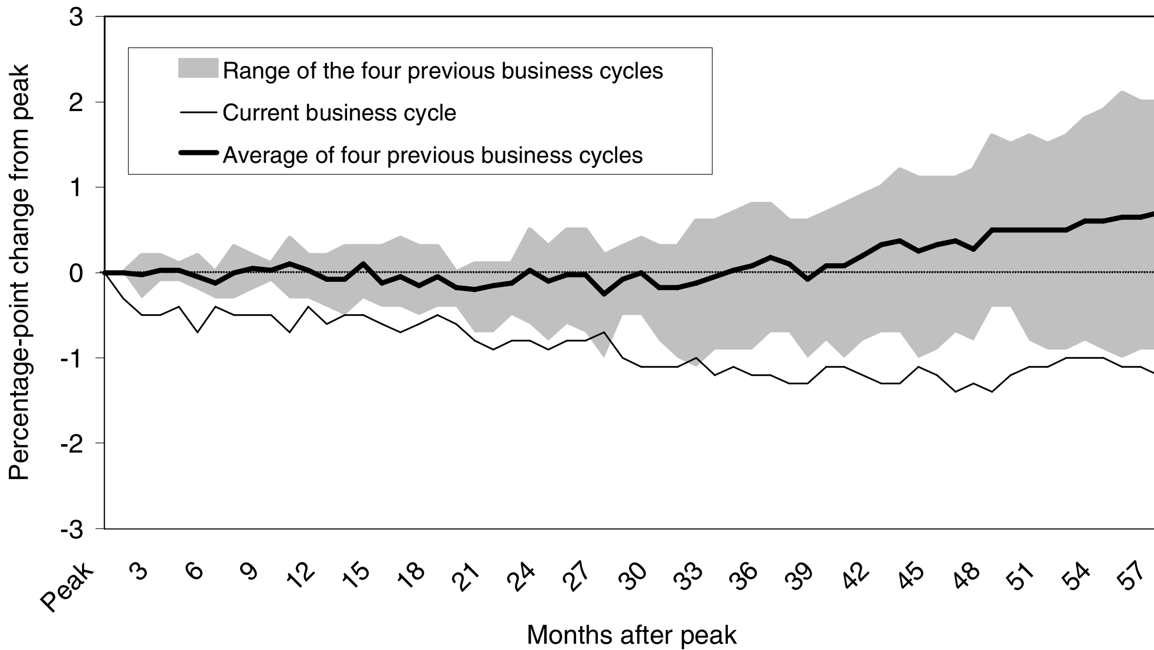
Unfortunately, no, because the unemployment rate under today's circumstances is misleading as a gauge of tightness in the labor market. The unprecedented 26-month decline in jobs (from March 2001 to May 2003) followed by sluggish job growth ever since has caused many people simply to withdraw from the labor force. Only those who are actively looking for work are included in the calculations of the unemployment rate. However, the employment rate (i.e., the ratio of employed workers to the country's working-age population) provides a better gauge of tightness in the labor market for the 227 million people now of working age. The employment rate has declined from 64.3% in March 2001 to 62.8% in December 2005. If the employment rate had recovered to its March 2001 level, an additional 3.4 million people would be employed today. What's more, if the rate had increased by the average 0.6 point gain of previous cycles, 4.7 million more people would have jobs today (**Figure B**).

Wages

Last month, Treasury Secretary John Snow noted that real (inflation-adjusted) wages had risen 1.1% since March 2001 in contrast to the 2.1% decline in wages over a comparable period of the 1990s business cycle. Aren't wages doing pretty well?

FIGURE B

Employment rate also lags all past recoveries



Source: Author's analysis of Bureau of Labor Statistics data.

The slack in the labor market has taken a toll on pay gains. While the Treasury data are accurate, they give the misleading impression that wages are doing well in this cycle. In fact, real wages fell by 0.5% over the last 12 months after falling 0.7% the previous 12 months. Because of the momentum of real wage growth from the tight labor market of the late 1990s, real wages actually continued to grow during the recession that began in March and ended in November 2001. Since then, however, they have fallen slightly (**Figure C**).

The decline in inflation-adjusted pay has been the largest for lower and middle-income employees. For example, workers at the 20th percentile of the income scale suffered a 0.8% decline in real pay. Only the highest wage employees enjoyed pay gains that outpaced inflation—those in the 95th percentile of wages had gains last year of 0.8% (**Figure D**).

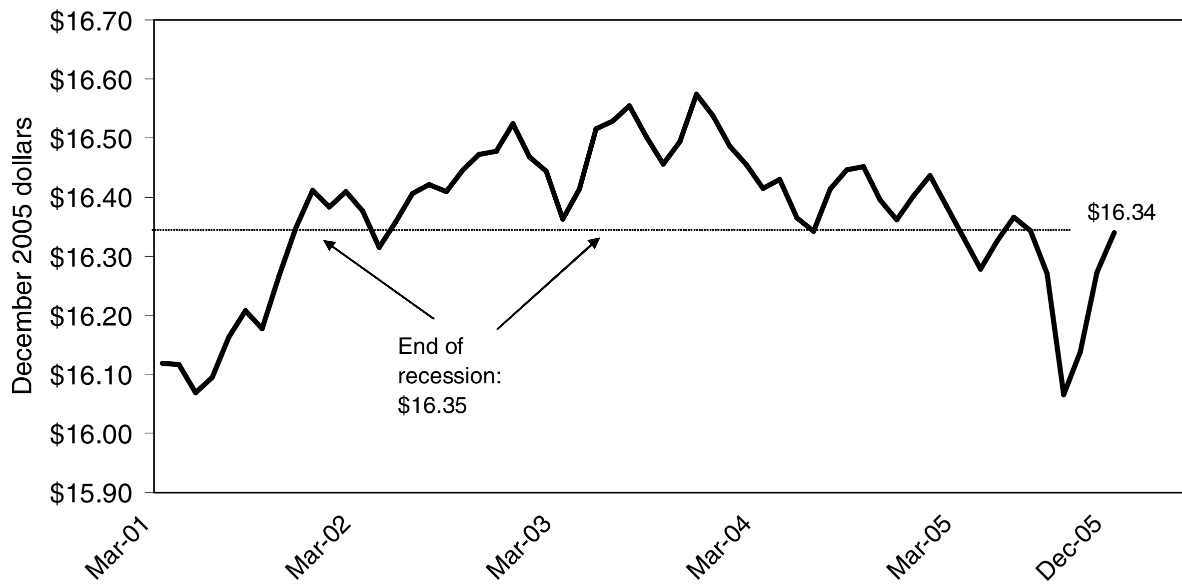
Tax cuts and jobs

Haven't the tax cuts passed since 2001 been vital to job creation?

No. Federal spending, not tax cuts, are responsible for the jobs that have been created.
If tax cuts have created jobs at all since 2001, it will have happened in the private sector. Assuming that job growth in 2006 matches the Bush Administration's projections, the economy will have added about 2.0 million jobs to the private sector from FY2001 through FY2006. But how many of these two million jobs actually can be attributed to tax cuts and how many to increased government spending—particularly increased defense spending—in this period?

FIGURE C

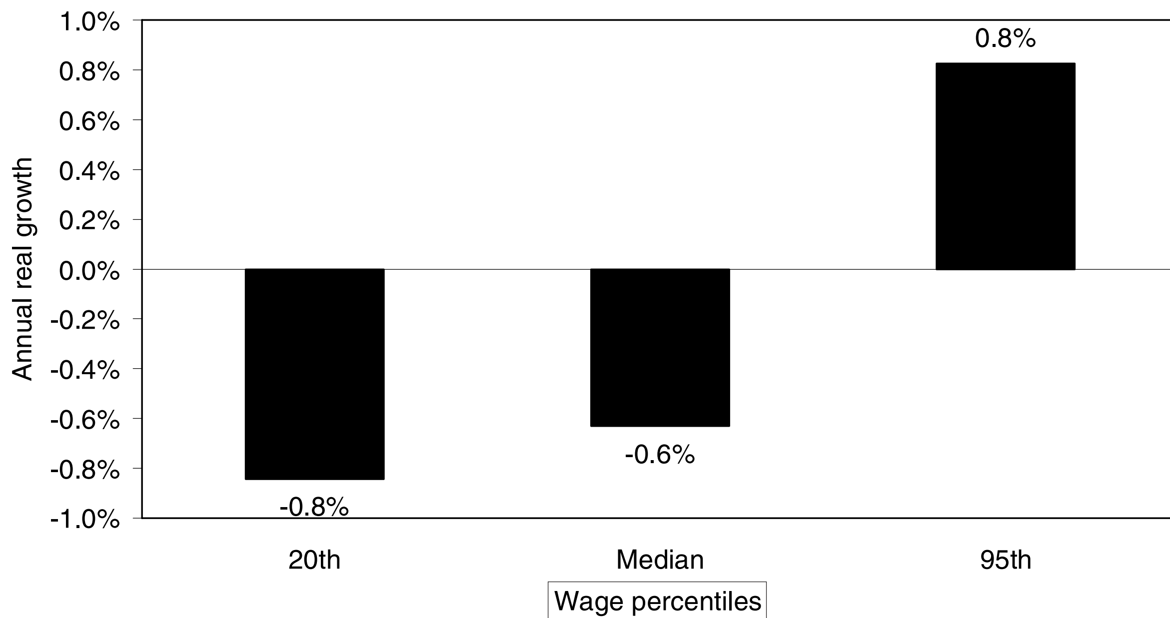
Real average hourly earnings of production workers, March 2001-December 2005



Source: Bureau of Labor Statistics.

FIGURE D

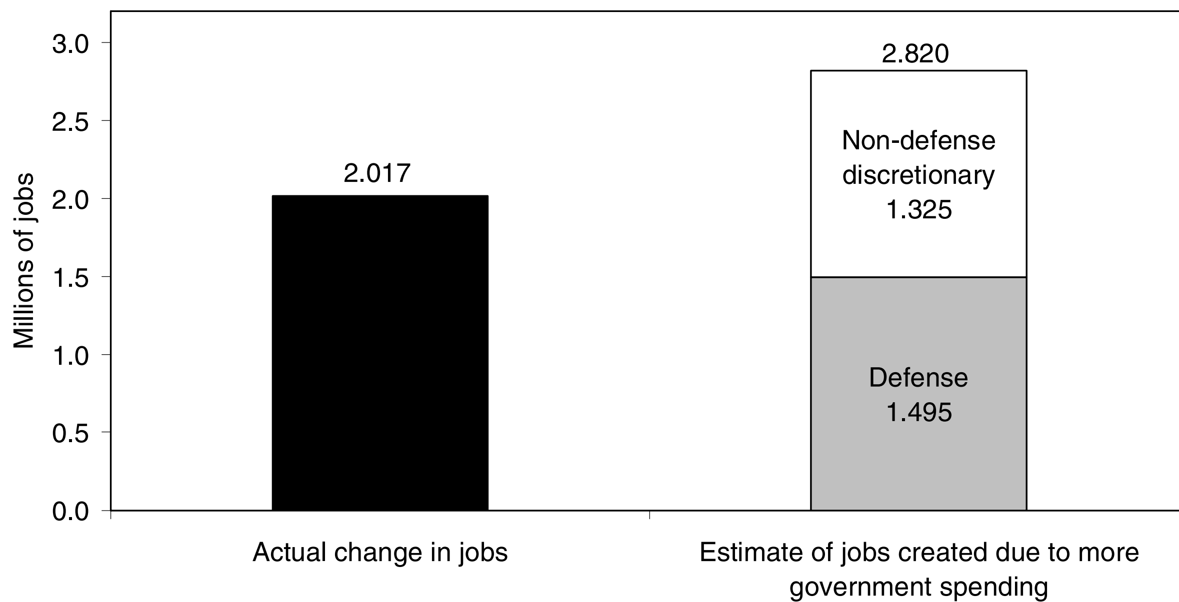
Real hourly wage changes, by percentile, 2003-2005



Sources: Author's analysis of CPS data.

FIGURE E

Sources of private sector job growth from 2001-2006*



* Job growth is projected by using the 12-month growth rate from December 2004 to December 2005.

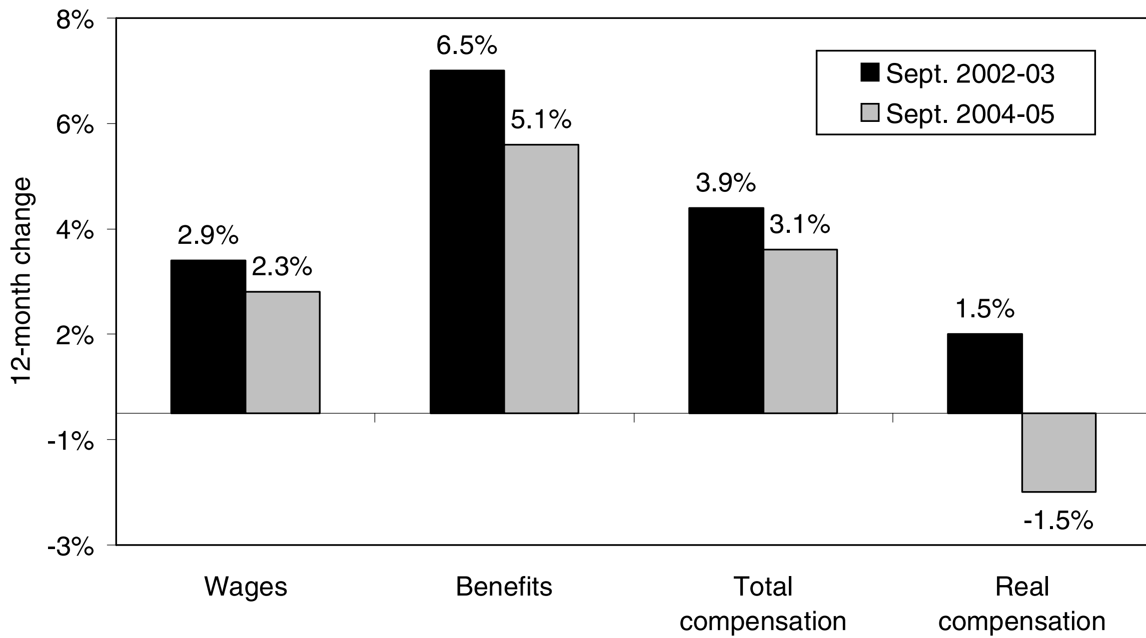
Source: Author's analysis of CRS, Defense Department, and OMB data.

Based on Defense Department estimates of the number of private-sector jobs created by its own spending, we project that additional defense spending will account for a 1.495 million gain in private sector jobs between FY2001 and FY2006. Furthermore, increases in non-defense *discretionary* spending since 2001 will have added yet another 1.325 million jobs in the private sector, for a total of 2.82 million jobs created by increased government spending. Increased *mandatory* government spending—which is not even included in these estimates or **Figure E**—would account for even more job creation. The mere fact that the projected job growth resulting from *increased defense and other government spending* exceeds the actual number of jobs projected to be added to the economy through 2006 clearly indicates that the tax cuts hardly seem plausible as the engine of the modest job growth in the economy since 2001.

Declining wage gains

Don't rising health care costs explain why wages have not done well?

No, labor market slack has caused both pay and employer benefit costs to rise more slowly. Data on employers wage and benefit costs show that over the last year, wage and salary income per hour rose by 2.3%, the slowest year-over-year rate on record. That compares to a gain of 2.9% two years earlier. Over the most recent year, benefit costs (including employer-paid health insurance) rose 5.1%, down from 6.5%



two years earlier (**Figure F**). As a result, growth in total compensation slowed from 3.9% to 3.1%. Because of the acceleration in inflation over that period, inflation-adjusted compensation declined by 1.5% over the last year in contrast to a 1.5% gain two years earlier. That fact, plus the fact that increases in profits are running multiple times the increase in employer health care costs, makes clear that the squeeze on wages is coming from profits and not from health care costs.

Research assistance by David Ratner.