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# EPI Issue Brief

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## **JOBLESS RECOVERY CATCHES UP WITH WAGES, STIFLES GROWTH**

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Though its endpoint has not been made official, the recession that began in March 2001 is generally agreed to have ended late that same year, as real gross domestic product began to grow again in the fourth quarter of 2001. Unfortunately, the growth that has occurred has been too slow to prevent unemployment from climbing and payrolls from contracting; the U.S. economy remains ensconced in a jobless recovery. Still, a number of unique trends helped to raise the growth of real aggregate personal income, and thus consumption, in this downturn relative to past recessions. These trends have helped to maintain the positive—albeit slow—growth we have experienced thus far.

This analysis focuses on how various periods of recession have affected the foundations of income growth: wages, taxes, and transfers. While other factors played a role in supporting consumption growth—for example, mortgage refinancing pumped billions of dollars into household incomes over the last few years—these three components of income growth warrant a close examination because of the role they have played thus far and the considerably lesser role they are likely to play in the near term.

This examination of the components responsible for the growth of after-tax income reveals the following:

- Inflation-adjusted disposable personal income (real DPI) grew 6.2% in this downturn versus 4.0% over an average of comparable periods in the last four downturns.
- While the growth of aggregate wage income added 0.6% to the 6.2% growth in real DPI, this is only about half the average contribution over the four most recent recessions. This difference is heightened in share terms, as wage growth explained 9% of DPI's growth in this downturn compared to an average of 27% over the past four.

- Because of the progressive U.S. tax system, the recent drop in capital gains and upper incomes has caused aggregate tax payments to fall faster than incomes, thereby offsetting the particularly weak wage income growth. Though taxes have, historically, added less than 1% to real DPI growth, in this downturn the decline in tax payments added 3.5% to the growth of DPI.
- After rising steeply through the late 1990s, the combination of slower wage growth and faster inflation has led to real declines in the earnings of the typical worker in each of the past four quarters. This is the first time since 1990 that real earnings have seen such a continuous decline.
- Given what is widely expected in the near term—sustained high unemployment, weak job growth, and stagnant real wages—wage growth will not be sufficient to support the consumption growth needed to fuel a vigorous recovery.

This analysis suggests that any “job stimulus” plan or tax reductions should focus on boosting jobs in 2003. The Bush Administration’s plan clearly fails on this account, as it provides very little stimulus in 2003, devotes nearly all the lost revenues to years in the distant future, and concentrates resources on the exclusion of dividends from taxes—an effort widely acknowledged to have little effect on jobs, especially in the near term.

### **What’s been driving after-tax income growth, and can it be sustained?**

As shown in **Figure A**, the growth in inflation-adjusted, after-tax income (also called disposable personal income, or real DPI) in this downturn surpassed the average of the past four downturns. (Note that this part of the analysis compares the two-year period from 2001q1 to 2003q1 to the first eight quarters of downturns/recoveries in past business cycles.)

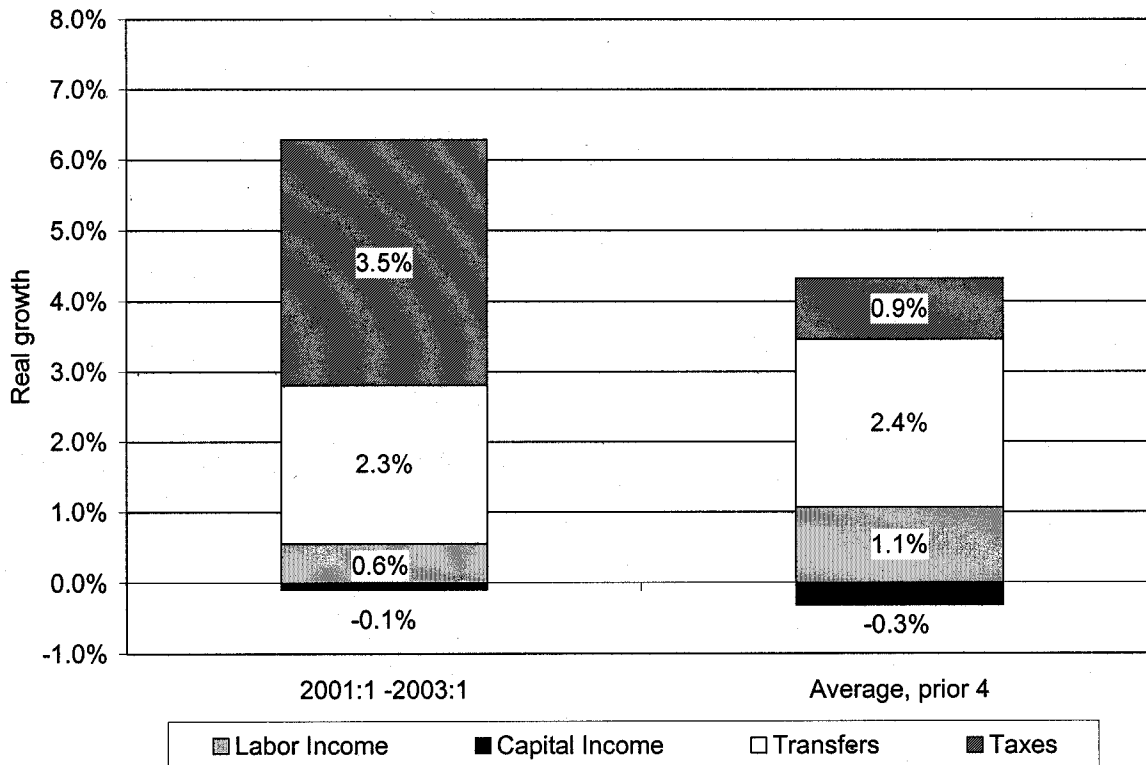
Each stacked bar in **Figure A** contains the four components of DPI growth: capital income, labor income (wages and benefits), transfers, and taxes. Real aggregate wage growth contributed 0.6% to DPI’s growth in this downturn, well below the 1.1% average for the past four recessions. This is surprising given both the faster growth in productivity and lower inflation over the most recent period (prices only began accelerating in the last few quarters), which might have been expected to fuel more real wage growth. A countervailing factor, however, has been the sharp employment losses over this downturn, which have lowered the nation’s wage and salary income, as fewer workers draw paychecks and others work fewer hours. In share terms—the percent of DPI’s growth explained by labor income—wages contributed 9% in this downturn versus 27% in prior downturns (0.6%/6.2% compared to 1.1%/4.0%).

Capital income, primarily interest and dividends, played a minor negative role in DPI’s growth in both this recession and prior ones. The calculations in **Figure A**, however, follow the government’s practice of ignoring income from capital gains (though revenues from capital gains taxes are included). Since the bursting of the asset bubble led to large capital losses, including trends in capital gains leads to a -0.9% contribution from capital income in this downturn versus a smaller negative contribution of -0.4% averaged over the past four downturns (see **Appendix Table 1**).

The other significant difference is taxes. Given the progressive nature of the U.S. federal tax code, tax revenues decline faster than incomes in a downturn (leading to higher after-tax income), but this effect was

**FIGURE A**

**Growth in real disposable income, by component, 2001q1-2003q1 and average of four prior downturns**



Source: Authors' analysis of National Income and Product Accounts.

particularly significant this time around. In prior periods, falling tax payments contributed 0.9% to real DPI growth, but over this most recent recession, payments added 3.5%. Note that most of the decline in tax payments is due to income and asset losses among wealthier taxpayers, not to the tax cuts in 2001. The Congressional Budget Office (CBO) reports that tax payments fell 14% in 2002, and 71% of this decline was due to income and capital losses.<sup>1</sup> Thus, lower tax liabilities more than offset the drag on DPI growth caused by the historically small wage contribution.

This finding is particularly germane when considering what sources of growth might be tapped in the near term to jumpstart the weak economy. Wage growth among workers, as shown below, is likely to continue to slow as higher unemployment leads to less wage pressure. Transfers, such as unemployment insurance (UI) payments, made a contribution similar to that of past downturns, but the most recent UI extension is scheduled to end at the end of May 2003 and the administration appears unlikely to enact another one. Most importantly, while large tax cuts are, in all likelihood, forthcoming, they are not structured in such a way as to deliver the same type of boost to DPI.

There are a few reasons why these tax cuts are not likely to quickly provide the needed income boost. First, whatever the magnitude of the administration's tax plan, it provides little stimulus this year: just \$41 billion, or

less than 2% of its 10-year total (and less than 0.5% of the overall economy). Even assuming dubious supply-side growth effects, CBO estimates that the plan would generate about 400,000 jobs in 2003, less than the number lost during just February and March of this year.

This lack of impact stems from the fact that high-end tax cuts such as the dividend exclusion fail to boost demand in the short term. Also, the plan is heavily “back loaded”—tax cuts in 2005 and beyond will not lower unemployment this year or next.

Without a truly stimulative fiscal boost, it is unlikely that unemployment will fall anytime soon. The Blue Chip Consensus, a popular private forecasting service, predicts unemployment to average 5.9% this year and 5.8% for the first half of next year, before falling to 5.5% in the last quarter of 2004. This level of unemployment, in turn, creates a wage problem due to the lack of pressure in the labor market. Persistently high unemployment is already taking a toll on wage growth, and, given the lack of fiscal stimulus, there is little in the system to offset this burgeoning wage problem.

## Recent earnings trends

Each quarter, the Bureau of Labor Statistics (BLS) publishes the median weekly earnings of full-time workers. After stagnating across much of the 1980s and early 1990s, these earnings grew sharply in the late 1990s, when the tight labor market led employers to bid up wages for middle- and low-wage workers. Lately, however, that unemployment effect has been working in reverse, with a weak labor market leading to slower wage growth. At the same time, inflation, which has been quite tame over the recession, has grown more quickly due to faster growth of energy prices.

As shown in the next two figures, these two trends have led to persistent real wage losses for the median earner over the past year. **Figure B** shows the real value of median weekly earnings from the first quarter of 1998 to the first quarter of 2003. Median earnings grew fairly consistently over the last years of the economic boom, and even through 2001, as the momentum of the formerly tight labor market coupled with decelerating prices kept real wages on the rise. But these favorable trends appear to have reversed by last year, and the series falls steadily over the last four quarters.

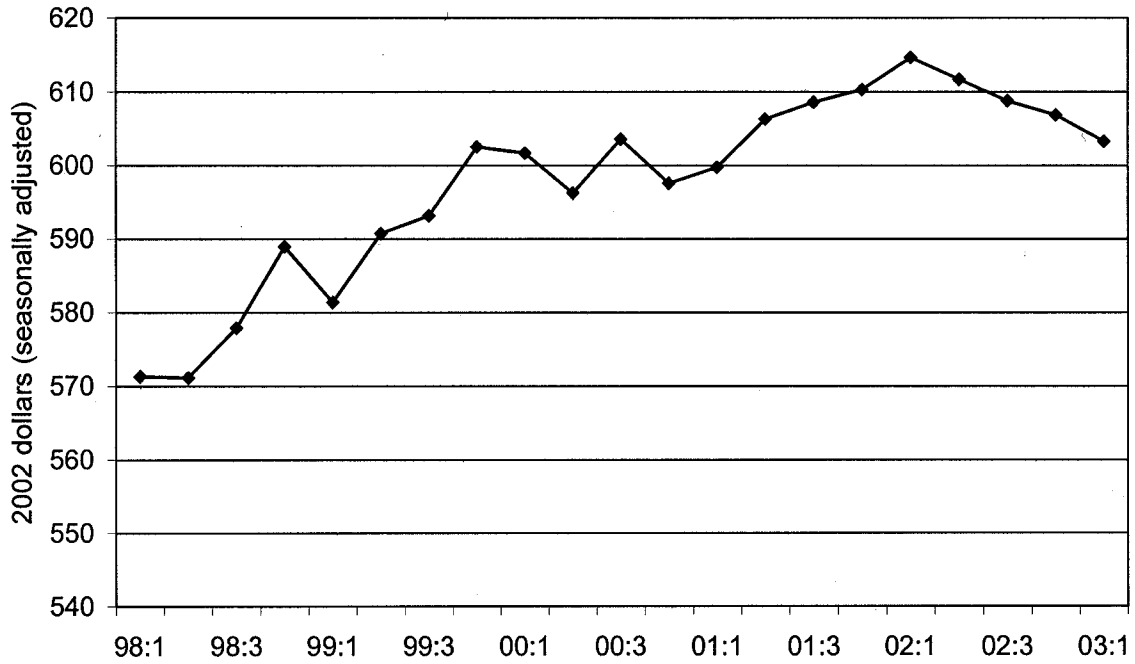
**Figure C** shows how this result stems from both slower earnings and faster inflation by tracking both year-over-year nominal earnings growth and price growth. The deceleration of year-over-year earnings growth clearly begins in 2002q1, and continues through the most recent quarter (2003q1). At the same time, after growing more slowly from mid-2001 through mid-2002, inflation is growing faster now. Together, slowing nominal wage growth and faster inflation are leading to real losses at the median.

**Figure D** shows the reversal of real wage gains throughout the earnings distribution. The sample again refers to full-time workers, but only those 25 years and older, since this is a more reliable age sample when dealing with very high and low earnings levels. Even as the recession was underway, the earnings of each group grew in real terms over 2001, from 1% among the lowest wage adult workers, to 3% among the highest earners. Last year, however, wage losses were pervasive, and were actually greater at the top of the earnings scale, perhaps driven by weakness in white-collar sectors such as financial services and information technology.

It should be noted that declines in the earnings of job holders are not unique to this BLS series of usual full-time workers. The widely observed hourly earnings of production, non-supervisory workers grew 3.1% from

**FIGURE B**

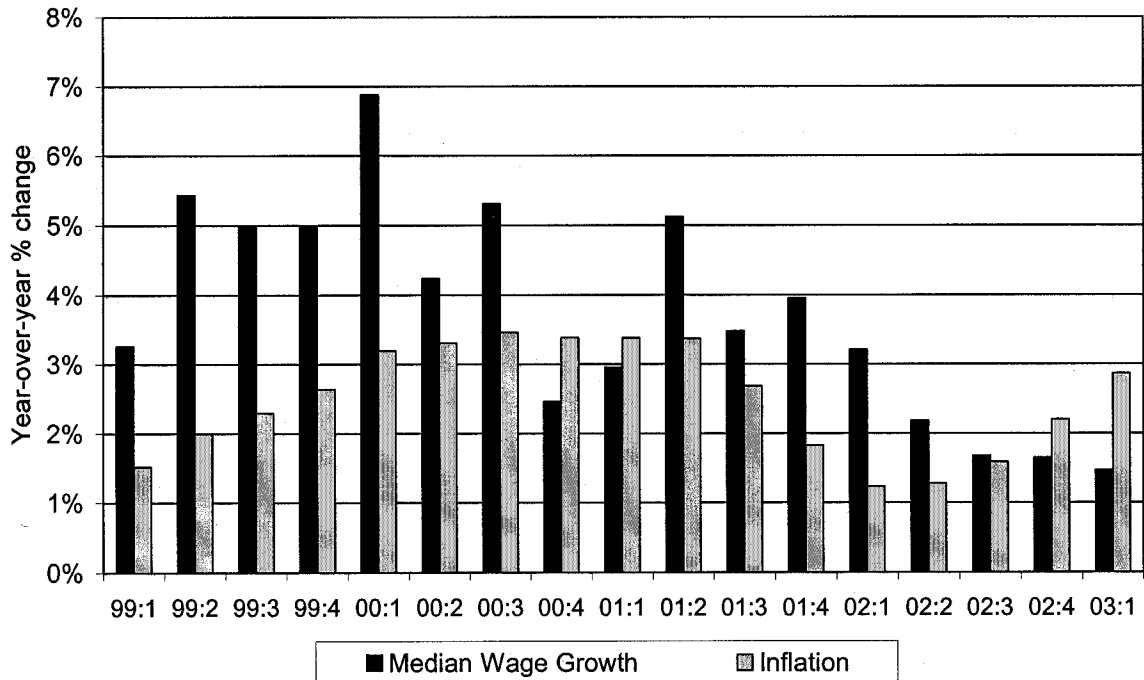
**Real median earnings, 1999q1-2003q1**



Source: Authors' analysis of BLS data.

**FIGURE C**

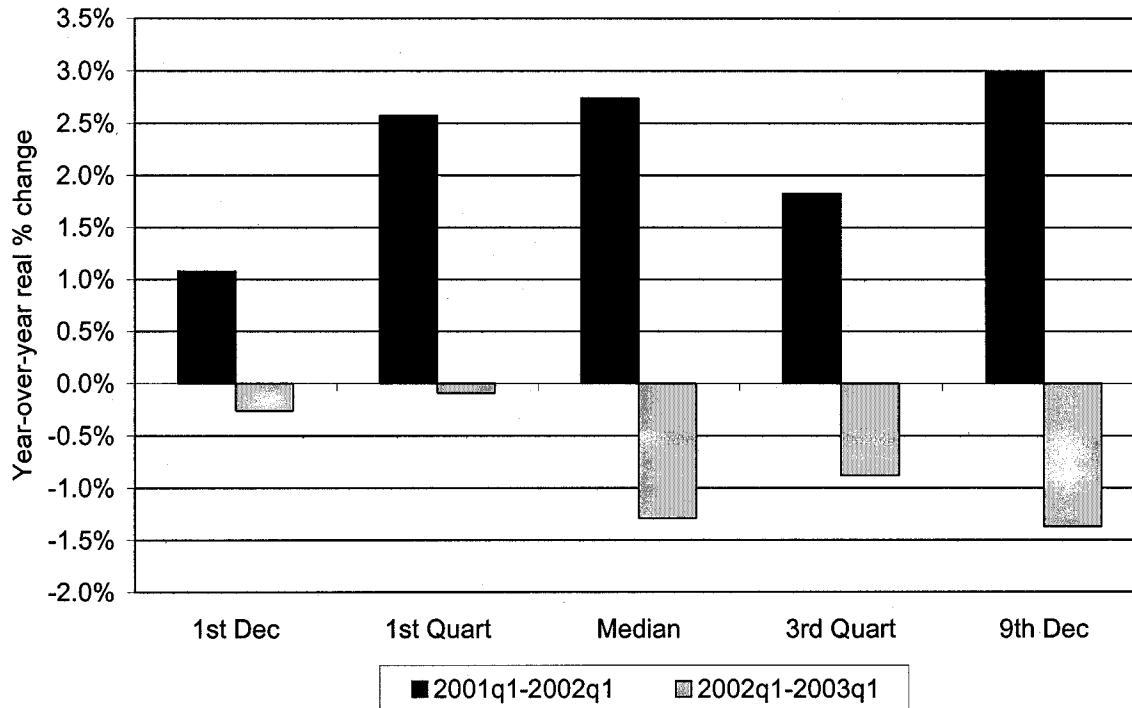
**Growth in nominal median weekly earnings and inflation, 1999q1-2003q1**



Source: Authors' analysis of BLS data.

FIGURE D

Real weekly earnings changes by percentile, 2001-2003



Source: Authors' analysis of BLS data.

2002q1 to 2003q1, 0.2% ahead of inflation (over the previous year, this series grew 2.3% in real terms). Finally, the most recent data from the employment cost index show nominal private sector wages and salaries growing 3.0% from 2002q1 to 2003q1, compared to 3.5% and 3.8% in the previous two years. Clearly, high unemployment has caught up to earnings growth.

## Conclusion

Though economic growth is currently too slow to reverse the negative trends in the labor market, a number of factors have helped to boost personal income in this downturn relative to past ones. Income and asset losses have lowered tax payments relative to past downturns, and this has helped to raise real DPI, which has in turn fueled the positive, albeit low, consumption spending that has persisted through the downturn and weak recovery. At the same time, less employment has predictably translated into less wage-based income growth in this period relative to earlier downturns, and higher unemployment has let much of the beneficial pressure out of the full employment labor market of the late 1990s.

Thus far, falling tax liabilities have helped to offset the lack of wage growth. But while a large tax cut is likely on the horizon, its structure will prevent it from reversing the negative conditions in the current labor market. In this sense, policy makers are wasting an important opportunity to pass legislation that would be more likely to generate the job and income growth needed to trigger a more vigorous recovery. Much more effective

approaches to quickly stimulating the economy and the labor market have been introduced and should be pursued. (See the stimulus section of the EPI web site for a discussion of the various options—<http://www.epinet.org/subjectpages/stimulus.html>.)

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**APPENDIX TABLE 1**  
**Contributions to the growth of real disposable personal income**

	Labor Income	Capital Income	Transfers	Taxes	Total
1969:4-1971:4	3.1%	1.2%	3.0%	1.0%	8.4%
1973:4-1975:4	-1.0	-1.8%	3.1	0.6	0.9
1981:3-1983:3	1.1	0.5	0.8	1.6	4.0
1990:3-1992:3	1.1	-1.2	2.7	0.3	2.8
<i>Average of the above</i>	1.1	-0.3	2.4%	0.9	4.0
2001:1 -2003:1	0.6	-0.1	2.3	3.5	6.2
<b>Adding capital gains/losses</b>					
1969:4-1971:4	3.0%	0.5%	2.8%	1.0%	7.3%
1973:4-1975:4	-1.0	-2.5	2.9	0.5	-0.1
1981:3-1983:3	1.0	1.7	0.8	1.5	5.1
1990:3-1992:3	1.1	-1.3	2.6	0.3	2.6
<i>Average of the above</i>	1.0	-0.4	2.3	0.8	3.7
2001:1 -2003:1	0.5	-0.9	2.2	3.3	5.1

Source: Authors' analysis of NIPA data; capital gains data are from CBO; average annual value used for each relevant quarter. Nominal values are deflated using PCE chained deflator.

## Endnote

1. Congressional Budget Office. *The Budget and Economic Outlook: Fiscal Years 2004-2013*. January 2003. <http://www.cbo.gov/showdoc.cfm?index=4032&sequence=2>.