

“Some Observations on the Structure of the Labor Market after the Great Recession”

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**Abstract**

This work takes as its starting point the seminal article by Edward C. Prescott (1999) entitled ‘Some Observations on the Great Depression’.<sup>2</sup> 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-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 any certainty) institutional changes have led to a decrease in the Labor Force Participation Rate and therefore 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

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<sup>2</sup> *Federal Reserve Bank of Minneapolis Quarterly Review* 23 (1), 25-31, Winter 1999.

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*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<sup>3</sup>. It was not until the pre-WWII conscription of 1940, the first and only peace-time draft in US history, that unemployment mandatorily 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<sup>4</sup>), 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 1999, 26), and, for example, the Federal Reserve targets the discount rate at less than one percent for an unprecedented seven years (December 2008 – November 2015)<sup>5,6</sup>.

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<sup>3</sup> Weber 2009, 14.

<sup>4</sup> <http://www.nber.org/cycles.html>

<sup>5</sup> <https://fred.stlouisfed.org/series/INTDSRUSM193N>

<sup>6</sup> Although fiscal is not part of Prescott’s (1999) analysis, we find relative expansionist fiscal policy in both periods, although not to the same degree, with fiscal-expansionism much more part of the later period as a percentage of the economy.

<b>Fiscal Data (\$ Billions): US Government Outlays and Deficits and US GDP</b>						
	<u>Outlays</u>	<u>Deficit</u>	<u>Deficit % / outlays</u>	<u>GDP</u>	<u>Outlay%/GDP</u>	<u>Deficit%/GDP</u>
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).

Another difference between our current research and that of Prescott's (1999) is that we use the Labor Force Participation Rate as a measure of underemployment to show the (destructive) structural changes in the labor market whereas Prescott uses "Yearly Market Hours Worked per Adult"<sup>7</sup>, 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.<sup>8</sup> 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.

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Furthermore, as stated government intervention (outlays as a percentage of GDP) is greater in our recent period, meaning that we might expect institutional changes due to interventionist policy to be even greater today than in the 1930s. We 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 monetary and fiscal intervention.

<sup>7</sup> 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. Measurement techniques can tell a lot of a story.

<sup>8</sup> 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 as it is for Prescott (1999). However, both researches 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, (2012), for example, of interventions leading to today's labor market changes.

## II. The Headlines versus Reality

We find today, post-Great Recession, that President Trump is taking credit<sup>9</sup> for the lowest unemployment level since 2000. Here is his tweeter feed of May 4, 2018.

Illustration 1: Donald J. Trump Tweeter Feed<sup>10</sup>



**Donald J. Trump**

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More

**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 mostly continually flat, Labor Force Participation Rate, meaning we should take rates of unemployment to be around 2 or 3% higher than popularly reported and as-if measured prior to the 2008 and onward interventions.<sup>11</sup>

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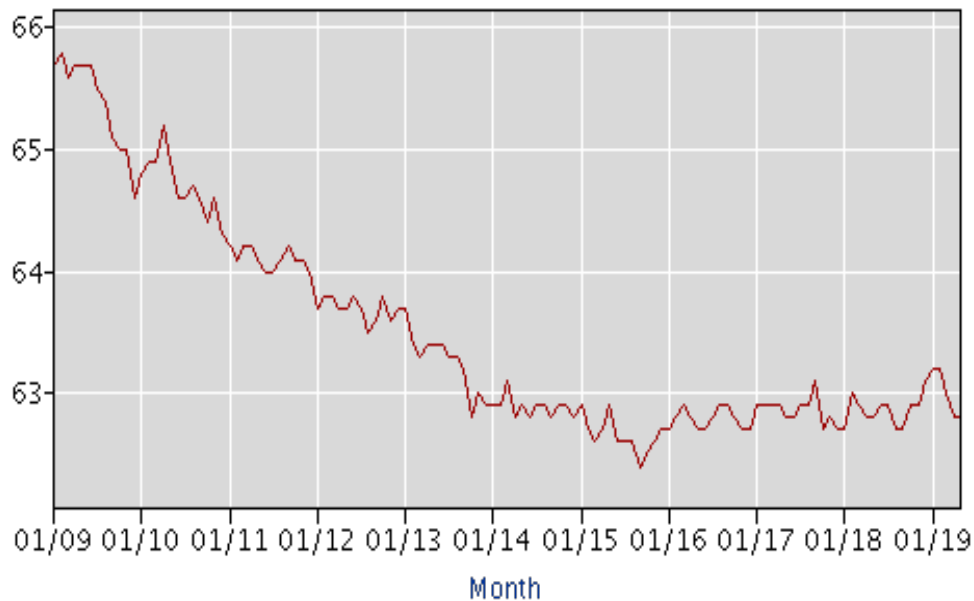
<sup>9</sup> See Levy and Peart 2017 on some of the adverse-selection problems under constitutional democracy when we turn discretionary (and unilateral) decision-making over to others (experts, technocrats, politicians) in activist policy interventions rather than having robust public conversations about important issues of public concern around often expert-driven state intervention.

<sup>10</sup> Available:

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

<sup>11</sup> There seems to be a recent short-term uptake in the labor force participation rate, but still perhaps not enough to signify that a structural change has not occurred since the 2008 crisis. There are also of course technological evolutions which are changing the industrial structures of the last 10 years. This ‘gig’ or ‘new’ economy activity might not all be captured in official statistics and may be overstating the reduction in LFPR. This is another potential structural change, perhaps in this case, a positive change. Again, data sourcing and presentation can tell alot of the story.

Graph 1: Labor Force Participation Rate (source: BLS.gov<sup>12</sup>)



We can see from Graph 1 that the LFPR has been around 63% for the last five years (decreasing since the 2008 Financial Crisis from around 66%). If we add those who have dropped out of the labor force we have a different picture than an easily justified self-congratulatory-greatness, in that, as stated, real unemployment is around 2 or 3% above that officially-reported due to those leaving the labor force for ‘structural’ reasons. Though we might hypothesize, although of course too early to tell with any comfortable (robust) certainty, *that after a 10-year structural change*, we might have the possibility towards experiencing a longer-term reversion to a higher than recently historical LFPR as officially-measured.

### 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.

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<sup>12</sup> <https://data.bls.gov/timeseries/LNS11300000>. Data through June 2019.

This lower labor market activity might also help explain the lower than historic levels of economic growth since the official end of the Great Recession in June 2009 as has been measured in official statistics (which do not include ‘new economy’ activity to any significant degree). ShadowStats.com measures 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. Why these changes have occurred is beyond the scope of this chapter. We will leave this analysis for a later day and hopefully, perhaps, to others for their contributions.

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