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# The Depression: If Only Things Were That Good

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UNDERNEATH the misery of [the Great Depression](#), the United States economy was quietly making enormous strides during the 1930s. Television and nylon stockings were invented. Refrigerators and washing machines turned into mass-market products. Railroads became faster and roads smoother and wider. As the economic historian [Alexander J. Field has said](#), the 1930s constituted “the most technologically progressive decade of the century.”

Economists often distinguish between cyclical trends and secular trends — which is to say, between short-term fluctuations and long-term changes in the basic structure of the economy. No decade points to the difference quite like the 1930s: cyclically, the worst decade of the 20th century, and yet, secularly, one of the best.

It would clearly be nice if we could take some comfort from this bit of history. If anything, though, the lesson of the 1930s may be the opposite one. The most worrisome aspect about our current slump is that it combines obvious short-term problems — from the financial crisis — with less obvious long-term problems. Those long-term problems include a decade-long slowdown in new-business

formation, the stagnation of educational gains and the rapid growth of industries with mixed blessings, including finance and health care.

Together, these problems raise the possibility that the United States is not merely suffering through a normal, if severe, downturn. Instead, it may have entered a phase in which high unemployment is the norm.

On Friday, the Labor Department reported that **job growth was mediocre** in September and that unemployment remained at 9.1 percent. In a recent survey by the **Federal Reserve Bank of Philadelphia**, forecasters said the rate was not likely to fall below 7 percent until at least 2015. After that, they predicted, it would rarely fall below 6 percent, even in good times.

Not so long ago, 6 percent was considered a disappointingly high unemployment rate. From 1995 to 2007, the jobless rate exceeded 6 percent for only a single five-month period in 2003 — and it never topped 7 percent.

“We’ve got a double-whammy effect,” says John C. Haltiwanger, an economics professor at the University of Maryland. The cyclical crisis has come on top of the secular one, and the two are now feeding off each other.

In the most likely case, the United States has fallen into a period somewhat similar to the one that Europe has endured for parts of the last generation; it is rich but struggling. A high unemployment rate will feed fears of national decline. The political scene may be tumultuous, as it already is. Many people will find themselves shut out of the work force.

Almost 6.5 million people have been officially unemployed for at least six months, and another few million have dropped out of the labor force — that is, they are no longer looking for work — since 2008. These hard-core unemployed highlight the nexus between long-term and short-term economic problems. Most lost their jobs because of the **recession**. But many will remain without work long after the economy begins growing again.

Indeed, they will themselves become a force weighing on the economy. Fairly or not, employers **will be reluctant to hire them**. Many with borderline health problems will end up in the **federal disability program**, which has become a shadow welfare program that most beneficiaries never leave.

For now, the main cause of the economic funk remains the financial crisis. The bursting of a generation-long, debt-enabled consumer bubble has left households rebuilding their balance sheets and businesses wary of hiring until they are confident that consumer spending will pick up. Even now, sales of many big-ticket items — houses, cars, appliances, many services — **remain far below** their pre-crisis peaks.

Although the details of every financial crisis differ, the broad patterns are similar. The typical crisis leads to almost a decade of elevated unemployment, according to **oft-cited academic research** by Carmen M. Reinhart and Kenneth S. Rogoff. Ms. Reinhart and Mr. Rogoff date the recent crisis from the summer of 2007, which would mean our economy was not even halfway through its decade of high unemployment.

Of course, making dark forecasts about the American economy, especially after a recession, can be dangerous. In just the last 50 years, doomsayers claimed that the United States was falling behind the Soviet Union, Japan and Germany, only to be proved wrong each time.

This country continues to have advantages that no other country, including China, does: the world's best venture-capital network, a well-established rule of law, a culture that celebrates risk taking, an unmatched appeal to immigrants. These strengths often give rise to the next great industry, even when the strengths are less salient than the country's problems.

THAT'S part of what happened in the 1930s. It's also happened in the 1990s, when many people were worrying about a jobless recovery and economic decline. At a 1992 conference Bill Clinton convened shortly after his election to talk about the economy, participants recall, no one mentioned the Internet.

Still, the reasons for concern today are serious. Even before the financial crisis began, the American

economy was not healthy. Job growth was so weak during the economic expansion from 2001 to 2007 that employment failed to keep pace with the growing population, and the share of working adults declined. For the average person with a job, income growth barely exceeded inflation.

The closest thing to a unified explanation for these problems is a mirror image of what made the 1930s so important. Then, the United States was vastly increasing its productive capacity, as Mr. Field argued in his recent book, "A Great Leap Forward." Partly because the Depression was eliminating inefficiencies but mostly because of the emergence of new technologies, the economy was adding muscle and shedding fat. Those changes, combined with the vast industrialization for World War II, made possible the postwar boom.

In recent years, on the other hand, the economy has not done an especially good job of building its productive capacity. Yes, innovations like the iPad and Twitter have altered daily life. And, yes, companies have figured out how to produce just as many goods and services with fewer workers. But the country has not developed any major new industries that employ large and growing numbers of workers.

There is no contemporary version of the 1870s railroads, the 1920s auto industry or even the 1990s Internet sector. Total economic output over the last decade, as measured by the gross domestic product, has grown more slowly than in any 10-year period during the 1950s, '60s, '70s, '80s or '90s.

Perhaps the most important reason, beyond the financial crisis, is the overall skill level of the work force. The United States is the **only rich country** in the world that has not substantially increased the share of young adults with the equivalent of a bachelor's degree over the past three decades. Some less technical measures of human capital, like the percentage of children living with two parents, have deteriorated. The country has also chosen not to welcome many scientists and entrepreneurs who would like to move here.

The relationship between skills and economic success is not an exact one, yet it is certainly strong enough to notice, and not just in the reams of peer-reviewed studies on the subject. Australia, New

Zealand, Canada and much of Northern Europe have made considerable educational progress since the 1980s, for instance. Their unemployment rates, which were once higher than ours, are now lower. Within this country, the 50 most educated metropolitan areas have an average jobless rate of 7.3 percent, according to Moody's Analytics; in the 50 least educated, the average rate is 11.4 percent.

Despite the [media's focus](#) on those college graduates who are struggling, it's not much of an exaggeration to say that people with a four-year degree — who have an unemployment rate of just 4.3 percent — are barely experiencing an economic downturn.

Economic downturns do often send people streaming back to school, and this one is no exception. So there is a chance that it will lead to a surge in skill formation. Yet it seems unlikely to do nearly as much on that score as the Great Depression, which helped make high school universal. High school, of course, is free. Today's educational frontier, college, is not. In fact, it has become more expensive lately, as state cutbacks have led to tuition increases.

Beyond education, the American economy seems to be suffering from a misallocation of resources. Some of this is beyond our control. China's artificially low currency has nudged us toward consuming too much and producing too little. But much of the misallocation is homegrown.

In particular, three giant industries — finance, health care and housing — now include large amounts of unproductive capacity. Housing may have shrunk, but it is still a bigger, more subsidized sector in this country than in many others.

Health care is far larger, with the United States spending at least 50 percent more per person on medical care than any other country, without getting vastly better results. (Some aspects of our care, like certain cancer treatments, are better, while others, like medical error rates, are worse.) The contrast suggests that a significant portion of medical spending is wasted, be it on approaches that do not make people healthier or on insurance-company bureaucracy.

In finance, trading volumes have boomed in recent decades, yet it is unclear how much all the activity

has lifted living standards. Paul A. Volcker, the former Fed chairman, has mischievously said that the only useful recent financial innovation was the automated teller machine. Critics like Mr. Volcker argue that much of modern finance amounts to arbitrage, in which technology and globalization have allowed traders to profit from being the first to notice small price differences.

IN the process, Wall Street has captured a growing share of the world's economic pie — thereby increasing inequality — without doing much to expand the pie. It may even have shrunk the pie, given that a new [International Monetary Fund analysis](#) found that higher inequality leads to slower economic growth.

The common question with these industries is whether they are using resources that could do more economic good elsewhere. “The health care problem is very similar to the finance problem,” says Lawrence F. Katz, a Harvard economist, “in that incredibly talented people are wasting their talent on something that is essentially a zero-sum game.”

In the short term, finance, health care and housing provide jobs, as their lobbyists are quick to point out. But it is hard to see how the jobs of the future will spring from unnecessary back surgery and garden-variety arbitrage. They differ from the growth engines of the past, which delivered fundamental value — faster transportation or new knowledge — and let other industries then build off those advances.

The United States has long overcome its less dynamic industries by replacing them with more dynamic ones. The decline of the horse and buggy, difficult as it may have been for people in the business, created no macroeconomic problems. The trouble today is that those new industries don't seem to be arriving very quickly.

The rate at which new companies are created has been falling for most of the last decade. So has the pace at which existing companies add positions. “The current problem is not that we have tons of layoffs,” Mr. Katz says. “It's that we don't have much hiring.”

If history repeats itself, this situation will eventually turn around. Maybe some American scientist in a laboratory somewhere is about to make a breakthrough. Maybe an entrepreneur is on the verge of creating a great new product. Maybe the recent health care and financial-regulation laws will squeeze the bloat.

For now, the evidence for such optimism remains scant. And the economy remains millions of jobs away from being even moderately healthy.



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