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The Dark Side of the Nation's Improving Cyclical Performance

Cyclical indicators showed substantial improvement in 1993, but real output growth weakened, reflecting a sharp deterioration in the underlying long-term growth of output and productivity. It is too early to tell whether this deterioration was permanent, as some analysts suggest, or transitory. In particular, unemployment fell from 7.3 percent of the civilian labor force in the fourth quarter of 1992 to 6.5 percent in the fourth quarter of 1993; employment expanded percent, much faster than the 1.2 percent growth in the labor force. Over the same period, the industrial capacity utilization rate rose from 80.4 percent to 82.3 percent, the same as the rate that prevailed at the business cycle peak before the 1990-91 recession. Real gross domestic product (GDP) rose at a 2.8 percent rate, however, relatively weak compared with the cyclical gains in employment.

A rule of thumb relates each percentage point reduction in the unemployment rate to about a 2 percent decline in the gap between the nation's actual and capacity GDP. Thus, last year's decline in the unemployment rate suggests that real GDP rose 1.6 percentage points faster than capacity. This, in turn, implies that capacity GDP rose 1.2 percent. Consequently, with the labor force growing 1.2 percent, real GDP per worker, on a cyclically adjusted basis, was unchanged in 1993.

The 1993 productivity experience contrasts sharply with that in 1991 and 1992. Over the eight quarters from the end of 1990 to the end of 1992, the nation's output expanded at a 2 percent rate. Employment expanded at only a 0.2 percent rate over the same period, well below the 0.9 percent rate of increase of the civilian labor force; the unemployment rate rose 1.3 percentage points. Based on the rule of thumb above, the implied annual growth rate of capacity output was about 3.3 percent over this period, 2.4 percentage points faster than the growth rate of the civilian labor force. Thus, such a measure of adjusted real GDP per worker rose at about a 2.4 percent rate over these two years.

Business sector output per hour, a more accurate measure of actual productivity, rose at a 2.9 percent rate from the end of 1990 to the end of 1992. This improvement came after nearly five years of stagnant productivity and appeared to presage a period of strong real income and employment growth. In the first three quarters of 1993, however, this measure slowed to a 0.6 percent rate. Thus, the recent performance raises the specter that the nation has reentered a period of slow capacity, productivity and real income growth.

Some analysts argue that the recent increase in taxes on capital income and prospects for further tax increases are responsible for losses in productivity and capacity output. The significance of this conclusion for developments in 1993, however, is unclear. For example, unusual factors—severe winter storms, floods in the Midwest and drought in the Southeast—temporarily reduced productivity. It remains to be seen whether productivity will rebound sufficiently in 1994 to prove the 1993 experience was temporary. If not, such a permanent loss in growth would reignite concern about the prospects for improvements in the U.S. standard of living.

—John A. Tatom

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