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Economy Falling Years Behind Full Speed

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As the recession grinds on, more and more of the nation's means of production — its workers, its factories, its retail outlets, its freight lines, its bank lending, even its new inventions — are being mothballed.

This idled capacity, like baseball players after a winter off, takes time to bring back into robust use. So even if the recession miraculously ended tomorrow, economists estimate that at least three years would pass before full employment returned and output rose enough for the economy to operate at full throttle.

While stock market investors have embraced tentative signs of improvement in the mortgage market and elsewhere, even a sharp pickup in demand for products and services will take considerable time to play out.

The mathematics are daunting. The shortfall is running at more than $1 trillion in annual sales and other transactions. Only once since the Great Depression has there been such a severe loss of output — in the 1981-82 recession — and after that downturn, it was seven years before the economy regained the lost production.

Recovery from the current recession could be similarly sluggish. New occupants have to be found for empty stores. Factory owners who are hesitant to ramp up production will wait until they are sure of demand. Hiring the right people for an operation will take time. And imports, entering the country in ever greater quantities, will slow any expansion by siphoning sales from domestic producers.

Then there is the growth rate itself. In the six years of recovery from the 2001 recession to the current one, the economy grew at an average annual rate of only 2.5 percent, adjusted for inflation. If that growth rate were to resume, just $350 billion a year would be added back, requiring three years to restore the $1 trillion in lost capacity. But getting the economy to grow at all after so much output has been lost, and so many jobs, is no easy task.

“Excess capacity, once entrenched, perpetuates itself, and that is what is happening now,” said James Crotty, an economist at the University of Massachusetts, Amherst. “Companies cannot hire workers to make more goods and provide more services until their sales go up. But people can’t buy goods and services until they are hired — so the excess capacity just sits there.”

It shows up everywhere. Lawyers are booking fewer hours. Retail space goes begging. Tourism is down. So is cellphone use, airline bookings, freight traffic and household borrowing, which is less than half what it was on the eve of the recession, the Federal Reserve reports.

With orders dwindling, manufacturers are using less than 68 percent of the nation’s factory capacity, the lowest level since records were first kept in 1948. And while entrepreneurs are as inventive as ever, they may not be able to get venture capitalists to bankroll their creations.

“We and others are funding start-ups as slowly as possible, or not at all,” said Howard Anderson, a founding partner of Battery Ventures in Waltham, Mass., and a senior lecturer at the Massachusetts Institute of Technology.

He cites as an example a hand-held device, similar in shape to an iPod, that restaurant diners would use to order food and drink electronically. Waiters would bring the orders, but not take them.

“The prototype just sits there,” Mr. Anderson said, “and maybe the inventors will get funding to produce and market their device — and maybe their company never gets born.”

If there is an upside, it is the absence of inflationary pressure. With so much excess capacity rattling around, shortages do not develop that would push up prices. Indeed, interest rates are kept low to encourage more borrowing and spending. Neither is happening. Instead, demand continues to shrink and idle capacity to build up.

The Obama administration, like the Roosevelt administration 75 years ago, is trying to break this logjam through government spending, using it in effect as a substitute for consumers who are jobless or short of credit. The spending is also a substitute for companies that hesitate to extend themselves or see no profit in doing so.

But the president's solution, the recently enacted stimulus package, spreads $787 billion over two years. So even if every dollar of spending restored a dollar of output, President Obama would be nearing the end of his first term before output approached the level achieved just before the start of the recession in December 2007.

Or so says Robert J. Gordon, an economist at Northwestern University who specializes in tracking the gap between actual output and potential output, a k a full capacity. The Roosevelt economy also languished well below full capacity, Mr. Gordon said, until the summer of 1940, when France fell to Hitler's armies.

From then until the attack on Pearl Harbor, 18 months later, a galvanized administration more than doubled federal outlays — soon accounting for $1 of every $4 spent in the country — and the United States entered the war with its economy operating almost at full capacity.

(Government currently accounts for $1 of every $5 spent, barely more than in 2007, and most of that spending is at the state and local levels, the opposite of 1940-41, when federal outlays shot up.)

"What you had was a revolution in the labor force," Mr. Gordon said. "Women poured into jobs in droves, often replacing men, and every factory went to three shifts."

By V-J Day in 1945, the economy, propelled by war spending, was operating beyond what the experts thought of as full capacity, demonstrating the "squishiness" of the concept, as Mr. Gordon put it. Just the swing from one to three shifts alters capacity, he said, and so does the more intensive use of floor space.

Capacity stretched again in the 1950s and '60s, to feed demand created by the wars in Korea and Vietnam, and then again in the late 1990s, propelled by the dot-com boom. And there were downdrafts as recessions sapped demand, but none as punishing as the current one.

Sixteen months into this recession, the economy is operating at 7 percent below its potential capacity, the Congressional Budget Office reported last month. If that were to continue, today's $14 trillion economy would be a $13 trillion economy by this time next year.

Labor is contributing hugely to the shortfall. More than 24 million men and women, or 15.6 percent of the labor force, are either hunting for work or working fewer hours than they would like to work, or are too discouraged to seek work, although they would take jobs if offered them, the Bureau of Labor Statistics reports.

The ranks of this "underutilized" group — the bureau's label — are up by 10 million since early last year. Generating work for so many people would take several years, even if the nation's employers stopped shedding more than 600,000 jobs a month, as they have done since December, and began hiring robustly.

"We have rarely been in this deep a hole," said Nigel Gault, chief domestic economist for IHS Global Insight.

His concern is that nearly every nation — not just the United States — is suffering from idle capacity as the recession that started in America grips Europe and Asia. Struggling for sales in a marketplace swamped with goods and services, companies are cutting prices and shutting down operations, trying to keep supply in line with dwindling demand.

The cutback is particularly severe in the auto industry, which had the capacity, going into the recession, to make nearly twice as many cars in the United States as are now being sold here. Indeed, some of the factories being closed are unlikely to ever reopen.

“Eventually, once this recession is over, we will fill up capacity,” Mr. Gault said. “Not only that, capacity itself will inevitably expand as the labor force grows and innovation kicks in. But the new capacity won’t be as great as it would have been if we had not gone through this terrible experience.”