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AFR Briefing Paper

COST OF THE CRISIS

The cumulative economic damage caused by the financial crisis and Great Recession (updated to May 2013)

The financial crisis of 2007-09 caused deep and lasting harm. Millions of Americans lost jobs or homes; many more millions suffered sharp declines in property values, retirement savings, income, household wealth, and over-all prosperity. Not since the Great Depression has the United States or the world experienced such a dramatic erosion of wealth.

The crisis triggered the nation's longest recession since World War Two, from which the economy is recovering at a painfully slow pace – a pattern in line with past financial meltdowns both here and around the world. Even today, unemployment remains **close to 8 percent**, up from a pre-crisis rate of **5 percent**, representing a net increase of more than **five million** people. Meanwhile, the average duration of unemployment has **more than doubled**, from **16.4 weeks** at the end of 2007 to **38 weeks**, according to the Bureau of Labor Statistics.

While there is no way to put a dollar figure on all the costs, this document reviews the dimensions where such an exercise is meaningful.

JOBS & INCOMES

- During or immediately following the recession, which officially ran from December 2007 through June 2009, **8.8 million Americans (**roughly **1 in 20 full-time workers**) lost their jobs. By contrast, the nation lost just 2.8 million jobs in the 1981-82 recession, according to the Associated Press.

- Between April 2008 and October 2009, the unemployment rate doubled from **5** to **10** percent, its highest level (adjusting for demographic shifts in the workforce) since the 1930s, according to the Bureau of Labor Statistics.

- Three years later, unemployment remains **above 8 percent.** That figure represents some **12.5 million** Americans who want jobs and can't find them. **About 5.2 million** (**40 percent)** of the unemployed have been out of work for more than six months. Economic Policy Institute analysis of BLS data.

- If you add discouraged and under-employed workers, the figure is sharply higher: **23.1 million** Americans, or **14.7 percent,** as of August 2012. This broader measure, known as U-6, peaked at **17.2 percent** in October 2009. BLS.

- According to the latest Census Bureau data, median family income after inflation fell by **8 percent** between 2007 and 2011, to a level of $50,054.

- As a share of all unemployed Americans, the long-term unemployed - those looking for work for more than 6 months – remained above 40 percent for nearly 3 years, from December 2009 until November 2012. See General Accounting Office a report, January 2013.

POVERTY

- From a pre-recession level of **12.5 percent**, the proportion of Americans living in poverty has increased to **15 percent**, the Census Bureau reports.

- Roughly **46.2 million** Americans (**1/6th** of the adult population) are officially considered poor today, up from **37.3 million** in 2007, according to the Census Bureau.

HOUSING

- Between January 2007 and early 2012, roughly **4 million families** lost their homes to foreclosure, according to The New York Times and Realty Trac,

- Many million more families are destined to follow in their wake. Between **3.5 and 4 million** borrowers are already over 60 days past due on their loans, says Laurie Goodman of Amherst Securities. Another **four-plus million** either have a shaky payment record or owe more than the current value of their homes. That adds up to **more than seven million** homeowners facing the threat of foreclosure and eventual liquidation.

- Home values have dropped **33.7 percent** since the crisis began. As the 2012 Economic Report of the President observes, that is a sharper decline than the nation experienced during the Great Depression.

- The median value of Americans' stake in their homes fell by **42 percent** between 2007 and 2010, to $55,000, according to Federal Reserve data.

- Lost household wealth due to declining home values alone comes to **$7 trillion,** according to the Economic Report of the President.

- The homeownership rate, which peaked at **69.2 percent** in June 2004, fell to **65.6 percent** in the first half of 2012. A Bloomberg story, based on Census Bureau figures, points out that this was the lowest homeownership rate in fifteen years.

HOUSEHOLD WEALTH

- Between 2007 and 2010, household wealth dropped nearly 39 percent, or about $49,100 per family, according to the Federal Reserve, putting Americans roughly on par where with they had been in 1992. The Fed notes that most of this loss was due to falling house prices (p. 20). Because pre-crisis housing prices were inflated, this was arguably not a real decline in net worth. Nevertheless, home prices fell nearly "29 percent between their peak in April 2006 and the end of the recession in June 2009. This decline [in home prices] followed a 10-year period of significant home price growth, with the price index more than doubling between April 1996 and 2006."

- By the end of 2011, Federal Reserve data put total household wealth at **$58.5 trillion**, down from **$67 trillion** before the crisis.

- Between 2005 and 2011, total household wealth declined by about $9.1 trillion (in constant 2011 dollars). Due to the rapid decline in housing prices between 2006 and 2007, American homeowners wound up collectively holding more mortgage debt than equity in their homes. This was the first time since the collection of such data began in 1945 that total national home equity fell below total national mortgage debt. Four years after the decline, in December 2011, total mortgage debt exceeded total home equity by $3.7 trillion (p. 21 of GAO report). According to Figure 7, the percentage of loans in foreclosure increased rapidly from about 1 percent in 2007 to over 4 percent in 2010. Private investments also decreased household wealth. The aggregate value of corporate equities held in retirement funds dropped by over a third between 2007 and 2008, and began recovering in 2009.

DISPROPORTIONATE IMPACT ON COMMUNITIES OF COLOR

- The decline in household wealth was even more precipitous for minority families, because home values typically constitute a larger fraction of their assets. From 1995 through the middle of the last decade, minority homeownership gains outpaced white homeownership gains. Since the housing bubble began to break in 2005, homeownership has fallen among all groups, but more steeply among minorities, according to Pew. Between 2007 and 2011, the homeownership rate for African Americans dropped from **47.7 percent** to **45.1 percent;** for

Hispanics/Latinos, the rate fell from **48.5 percent** to **46.6 percent.**

- The typical Latino family lost **two-thirds** of its household wealth between 2005 and 2009, while African Americans families lost **more than half**, mostly due to declining home values. The Pew study also shows record-high disparities between the household wealth of non-Hispanic whites and that of blacks and Hispanics as a result of the crisis.

HEALTH AND EDUCATIONAL ACHIEVEMENT

- Prolonged unemployment is a devastating experience. Men who get laid off before retirement age experience a significant increase in mortality – a spike of **50-100 percent** in the years immediately following job loss, according to a 2011 study by economists Daniel Sullivan and Till von Wachter. Their children, as reporter Binyamin Applebaum noted in the New York Times recently, eat less well, do less well in school, and earn less over their lifetimes. And the longer the unemployment lasts, "the deeper the damage appears to be."

DIMINISHED ECONOMIC OUTPUT

- As the Congressional Budget Office noted in late 2011, "A large portion of the economic and human cost of the recession and slow recovery remains ahead." Between 2008 and 2012, the U.S. economy produced an estimated **$2.6 trillion** less than it was on track toward producing before the crisis. By 2018, when output is projected to climb back to its potential, the shortfall in economic output will have reached an estimated **$5.7 trillion**.

- Economists have estimated that more than **$6 trillion** in additional economic damage was avoided by economic stimulus measures, Federal Reserve actions, and other Federal government responses.

- Past experience with financial crises suggests that their impacts on economic growth are long-lasting, and that some of the losses are never fully recouped. By the time the story of this crisis has played out, Andrew Haldane of the Bank of England projects a cumulative loss of **$60 trillion** in global economic output.

- The Great Recession lasted for about 18 months, from December 2007 to June 2009. During that interval, "U.S. real gross domestic product (GDP) fell from $13.3 trillion to $12.7 trillion (in 2005 dollars), or by nearly 5 percent." GDP did not climb back to its pre-recession level until the third quarter of 2011.

- That 5% decline, however, does not represent the full loss of output, since, without the financial crisis, GDP could have been expected to grow during the same period. The GAO report cites a January 2012 estimate by the

Congressional Budget Office (CBO), putting the cumulative difference between actual GDP and potential GDP at $5.7 trillion by 2018, when the economy is expected to have worked back to its pre-crisis rate of growth (GAO report, p. 15).

- As the GAO report goes on to note, the International Monetary Fund (IMF) has analyzed the results of banking crises over time from around the world, finding a median 23 percent loss of output in trend-level GDP, compared to an estimated 31 percent loss of output in the case of the 2007-09 crisis (p. 16). Other researchers, projecting very long-term effects, have estimated the cumulative output losses of some past financial crises at 100 percent or more; based on that yardstick, the losses in output from the 2007-09 crisis could exceed $13 trillion in the United States alone (p. 17).

GOVERNMENT SPENDING AND REVENUE LOSSES

- Total budgetary impact of diminished tax revenues and higher outlays for unemployment insurance, food stamps, other safety-net programs, and debt service: $3.5 trillion between 2009 and 2018, according to the CBPP.

- Combined cost per U.S. household of government spending *and* diminished home and stock values: **$108,000,** according to Pew.

- The Great Recession caused federal government spending to rise sharply while tax revenues declined. From the end of 2007 to the end of 2010, the federal government increased spending on unemployment and other safety-net and stimulus programs, along with federal assistance to the financial sector increased the federal debt held by the public from about 36 percent of GDP to roughly 62 percent (GAO report, p. 26). High levels of publicly held debt can lead to the "crowding out" of private investments and increased interest payments by the government, both of which may cause a decrease in investment and slower long-term economic growth.

- In a February 2013 paper, the Center on Budget and Policy Priorities looks at the impact on state budgets, concluding: "The recession of 2007-09 sharply reduced state revenues, causing budget shortfalls totaling well over half a trillion dollars. Revenues have improved lately but remain about 6 percent below where they were five years ago, even as the number of people needing state services has grown. In addition, states need to replenish reserve funds diminished in the recession, such as 'rainy day' budget reserves, pension funds for state workers, and unemployment trust funds."