'Great Recession' Will Redefine Full Employment as Jobs Vanish

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By Matthew Benjamin and Rich Miller

May 4 (Bloomberg) -- Post-recession America may be saddled with high unemployment even after good times finally return.

Hundreds of thousands of jobs have vanished forever in industries such as auto manufacturing and financial services. Millions of people who were fired or laid off will find it harder to get hired again and for years may have to accept lower earnings than they enjoyed before the slump.

This restructuring -- in what former Federal Reserve Chairman Paul Volcker calls "the Great Recession" -- is causing some economists to reconsider what might be the "natural" rate of unemployment: a level that neither accelerates nor decelerates inflation. This state of equilibrium is often described as "full" employment.

Fallout from the recession implies a "markedly higher" natural rate of unemployment, says Edmund Phelps, a professor at Columbia University in New York and winner of the 2006 Nobel Prize in economics. "It was 5.5 percent; maybe it will be 6.5 percent, maybe 7 percent."

That has implications for policy makers as well as workers. The Obama administration and the Federal Reserve are counting on the jobless rate to fall to a medium-term equilibrium of about 5 percent as the economy recovers. A natural rate significantly above that would drive up the annual budget deficit -- which will top $1 trillion for the first time this year -- by reducing tax revenue and pushing up spending on unemployment benefits.

A higher rate would also require the Fed to make a choice: Accept an economy with more Americans permanently out of work, or try to boost employment at the risk of heating up inflation.

Unemployment Report

The government may report May 8 that the jobless rate jumped to 8.9 percent in April, the highest since 1983, from 8.5 percent in March, according to economists surveyed by Bloomberg.

Laurence Ball, an economics professor at Johns Hopkins University in Baltimore, says unemployment may peak at 10 percent, and "it will be a long time before we see 5 percent" again.

The more time workers spend without a job, the less attractive they become to potential employers, Ball says. That in itself helps keep the unemployment rate elevated.

"If you're unemployed" for an extended period, "you're not keeping up with new technology," he says. "You become discouraged and you change your lifestyle."

A burst of productivity growth starting in the mid 1990s helped lower the natural rate of unemployment to around 5 percent from 6 percent, as profit-flush companies took on more workers. Now the fear is that will be reversed as industries downsize.

Permanent Layoffs

Already, almost a quarter of the unemployed have been out of work for 27 weeks or longer, the highest proportion since 1983. Permanent layoffs -- for workers who don't expect to ever regain the same job -- hit a record 51.5 percent in March. Mass layoffs, those that affect 50 or more people, rose to a record 2,933, comprising almost 300,000 lost positions.

"We're shedding jobs in industries in a significant way, and we're not going to see those same industries be the source of job creation," Bruce Kasman, chief economist at JPMorgan Chase & Co. in New York, said in an April 21 interview. "We're going to be living in a world in which we're going to be feeling that the normal on the unemployment rate is above 6 percent."

About 27 percent of automotive-manufacturing jobs --roughly 257,000 -- have been cut during the recession as carmakers trimmed operations.

GM Job Cuts

General Motors Corp., the largest U.S. automaker, has set a target of reducing 47,000 positions worldwide this year. The company also aims to eliminate about 2,600 of its 6,200 U.S. dealerships by 2010, a move the National Automobile Dealers Association estimates will cost as many as 137,000 jobs. GM wants to sell or eliminate its Pontiac, Saturn, Hummer and Saab brands.

Chrysler LLC filed for bankruptcy protection on April 30 to streamline its operations in a reorganization that includes Italy's Fiat SpA as a partner. Since being spun off from Germany's Daimler AG in August 2007, Chrysler has fired about 32,000 workers.

Half of the auto-industry jobs being cut "are gone for good," says Sean McAlinden, chief economist at the Center for Automotive Research in Ann Arbor, Michigan. He predicts that older displaced workers will retire, while younger ones will migrate to industries such as health care where wages are lower. "Autoworkers don't readjust well," McAlinden says.

Financial Services

Employment in the financial sector -- which has seen the demise of investment banks Bear Stearns Cos. and Lehman Brothers Holdings Inc. -- has contracted by 4.5 percent, or 376,000, with more losses to come.

Zurich-based UBS AG, the biggest Swiss bank, last week confirmed plans to cut 2,000 positions in its U.S. wealth- management unit.

"Some sectors of the economy seem to have clearly gotten well overbuilt," says Orley Ashenfelter, an economist at Princeton University in New Jersey and former Labor Department official. "Financial services is an extreme example."

In the publishing industry, which is suffering from falling advertising and a migration of readers to the Internet, employment is down almost 8 percent since the recession began in December 2007, according to the Bureau of Labor Statistics.

Daily average circulation for 395 newspapers fell 7.1 percent to 34.4 million in the six-month period through March, the Audit Bureau of Circulations said last week. Five publishers -- including Tribune Co., parent company of the Los Angeles Times and Chicago Tribune -- sought bankruptcy protection, and printed versions of the Seattle Post-Intelligencer and Denver's Rocky Mountain News were halted. New York Times Co. has threatened to close the Boston Globe, which was founded in 1872.

'Considerably Lower Pay'

"Most of the publishing job cuts we've seen are probably going to be permanent," says John Morton, a media-industry analyst and president of Morton Research Inc. in Silver Spring, Maryland. Workers displaced from large metropolitan dailies will wind up at community papers and other places "with considerably lower pay than they're used to," he says.

Layoffs now taking place are similar to those in the 1981- 1982 recession, when unemployment peaked at 10.8 percent and 2.8 million jobs disappeared, leaving industries such as durable-goods manufacturing permanently smaller. Some 14 percent of durable-goods positions vanished in that slump, and the sector never regained the employment level of June 1981.

Earnings Hit

People who lost stable work in the early 1980s sustained large and long-lasting earnings reductions, according to research by economists Till von Wachter of Columbia University, Jae Song of the Social Security Administration and Joyce Manchester of the Congressional Budget Office. A typical 40- year-old man who became unemployed at the time went on to suffer a 20 percent loss in lifetime earnings, they found.

The income hit is all the greater when displaced workers have to start over in new careers because their old employers were in sectors that have shrunk.

"People losing their jobs now in permanently downsizing industries have to be aware that they're particularly at risk of pretty large losses" to lifetime wages, says von Wachter, who briefed staff at the Fed and the European Central Bank last month on the effects of mass layoffs.

"People tend to think that when you come out of a recession you get the labor market you had when you entered it," says Lawrence Mishel, president of the Economic Policy Institute in Washington. "This time you may get something quite different."

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