Deregulation, Bailouts and Job Loss: The Century's Second Supply-Side Slump

by Gregory DeFreitas

The past 10 days will be remembered as the time the U.S. government discarded a half-century of rules to save American financial capitalism from collapse. On the Richter scale of government activism, the government's recent actions don't (yet) register at FDR levels. They are shrouded in technicalities and buried in a pile of new acronyms. But something big just happened. It happened without an explicit vote by Congress. And, though the Treasury hasn't cut any checks for housing or Wall Street rescues, billions of dollars of taxpayer money were put at risk. A Republican administration, not eager to be viewed as the second coming of the Hoover administration, showed it no longer believes the market can sort out the mess.[1]

If this front-page analysis by the *Wall Street Journal* on March 27th appeared overdramatic to some, concern over the economy's direction only intensified one week later when the government released its latest employment figures. The national economy lost 80,000 jobs in March, the worst decline in five years. It marked the third straight month of severe declines, totaling 232,000 fewer jobs in the year's first quarter. The unemployment rate shot up to 5.1% in March from 4.8% the month before. That large an increase has only been recorded in the past during postwar recessions. Then, just days later, it was revealed that a "prolonged and severe economic downturn could not be ruled out," in the opinion of the Federal Reserve Board's last leadership meeting.[2]

The country is already in recession, according to two-thirds of Americans questioned nationwide in the CBS News/New York Times public opinion survey in late March. A majority said that they were very concerned or somewhat concerned that they or another household member might be out of work or looking for a job in the next 12 months. One of every five "personally has friends or relatives who have filed for bankruptcy or have had a foreclosure during the past year." And four out of five felt that "things in this country have pretty seriously gotten off on the wrong track."[3]

Signs of the slump's highly unequal impacts abound. Job losses have so far been concentrated among lower-income, non-college-educated workers and racial/ethnic minorities. In the 12-month period ending in March, the jobless rate jumped from 6.9% to 8.2% among high school dropouts and from 4.1% to 5.1% among high school graduates with no college. Latino workers' unemployment has risen from 5.2% last March to 6.9% in March 2008, over twice as large a percentage point increase as that of the current white (4.5%) and African American (9%) rates. Unemployment's reach has been spreading beyond manufacturing and construction into a wider set of industries. The rate among college graduates has been rising, though much more slowly than that of the less-educated, and by March was still just 2.1%.

More and more of the unemployed have been jobless a half-year or more: the long-term unemployment rate has risen to 16.7%, far higher than on the eve of the last recession in March 2001 (11.1%). For some years now, an average of just two-fifths of the unemployed have managed to obtain unemployment benefits. Stiffer eligibility requirements and resistance by employers have cut average recipiency rates far below the levels common prior to the 1980s. Yet the White House and its Congressional allies defeated a Senate proposal to include in the tax rebate bill a 13-week extension of benefits to the long-term unemployed once they exhaust the standard 26 weeks of benefits.

Those still employed have seen little increase in their average wages, after adjustment for inflation, since 2001. What belated real wage growth there has been ended last summer: for all of 2007, the average real weekly wage fell 0.9%.[4] In February, rising costs for food, energy and health care pushed up wholesale price inflation by the steepest amount in a quarter century, and overall consumer prices were 4% higher than a year ago. Squeezed by prices increasing faster than their paychecks, the typical American family's median income failed to keep up with the rising cost of living last year.[5] With unemployment and foreclosures rising at a time of wage decline, more families are slipping into the ranks of the poor and near-poor. One clear indication is the sharp rise in people applying for food stamps. By December, the number of food stamp recipients broke previous records in 14 states. The Congressional Budget Office projects the number to rise to 28 million nationwide this year – more than at any time in the food stamp program's entire 48-year history.[6] And the soaring prices of bread, rice, dairy, and other staple foods, here and abroad, are forcing more and more working class people to seek help from overstretched food banks for the first time.

But the highest-income groups continue to pull away from the poor and the middle class. A new report on 200 companies with revenues of $6.5 billion or more found that average compensation for their chief executives rose to $11.7 million last year. CEOs with as little as two years on the job enjoyed, on average, a 5% pay raise in 2007, thanks to "discretionary bonuses" not linked to their company's performance.[7] One among many examples drawing shareholder and employee ire is struggling Ford Motor Co. Ford lost $2.7 billion in 2007, and last fall it demanded and won major wage and pension sacrifices from its unionized workers. Yet Ford paid its top five executives $60.7 million in compensation last year. CEO Alan Mulally alone received $21.7 million.

New York's Slowdown

The New York Metropolitan Area recovered more slowly from the 2001 recession than most of the nation and year-end economic statistics have raised some hope that it might now take longer than other areas to fall into recession. The pace of production in New York City, as measured by Gross City Product (GCP), began slowing in the spring of 2007, declined to 2.5% growth in the July–September third quarter, then ended the year with fourth-quarter GCP growth of just 1.1%. Still, this was nearly twice the national growth rate (0.6%) in the fourth quarter.

Job growth in New York was also stronger than the national rate last year: the city added 53,400 net new jobs in the 12 months through last December, 1.4% higher than in December 2006. Nationwide, job growth over the same period was a slower 0.9% (Table 1).[8]

However, early in 2007, several high-profile layoffs began raising concerns about a coming slowdown. One was Manhattan-based Citigroup's announcement that it planned to slash 10,000 to 12,000 jobs worldwide in 2007. Another 14,000 positions would be cut through attrition or relocation of employees from New York, London and Hong Kong to low-cost cities here and abroad. As the credit crunch worsened in mid-summer, job growth appeared to peak in financial services and some other key sectors like leisure and hospitality. At year's end, financial turmoil was clearly threatening more Wall Street income and employment losses. In the first week of 2008, Citigroup and Merrill Lynch both announced that each had run up losses of almost $10 billion from October through December. Now Goldman Sachs Group and Lehman Brothers each appear set to cut at least 5% of their employees. Far deeper layoffs are expected at Bear Stearns: half or more of its 14,000 employees could lose their jobs in the wake of its emergency takeover by J.P. Morgan Chase.[9]

Within the city, every borough experienced higher official jobless rates. The largest increase was in the Bronx, where unemployment rose from 5.5% to 6.9% over the 12 months through December 2007. Brooklyn's rate increased only slightly less to 5.6%, about one percentage point higher than the rate in Manhattan, Queens and Staten Island. The number of people unemployed last year also increased citywide (by 44,700) and in every borough. The fact that, at the same time, the number counted as employed was little changed indicates that more job seekers were entering or reentering the labor force, but failing to find jobs.

In contrast, while Long Island also recorded more residents officially counted as unemployed (+8,900) during 2007, the total number of employed persons actually fell far more (-16,800). The difference is attributable to the fact that 7,900 dropped out of the active labor force – whether out of discouragement with their job search prospects or other reasons. Since labor force dropouts are not included in the official unemployment count, the local unemployment rate rose less than it would have otherwise. It still increased over the 12 months, though only from 3.2% to 3.9%.

Which sectors accounted for New York City's job growth last year? As Figure 1 shows, just over half of net new jobs were concentrated in service industries. Within this diverse supersector, three subsectors created disproportionate shares of the 28,800 new positions: professional and business services (+15,400 new jobs), health care (+9,700) and leisure/hospitality (+5,700). Among professional and business services, growth was strongest in accounting, advertising, computers and legal services. The main such service experiencing shrinkage was employment services (-1,500), commonly among the first victims of economic slowdowns. Of the new health care jobs, home health care, specialty hospitals, nursing and residential care facilities, and individual and family services each experienced increases of 2% or more.

Leisure and hospitality job growth was driven by hotels, motels, restaurants and bars, now employing a total of nearly 232,000 workers. The weak U.S. dollar and a relatively mild winter helped the city set another tourism record: over 46 million visited in 2007, up 5.7% from the year before and up 31.5% from 2001. Foreign visitors numbered an estimated 8.5 million, an increase of over one million since 2006 and nearly a 50% increase since 2001. International tourists typically spend more per person than domestic visitors on the city's hotels, restaurants, entertainment, and clothing purchases.

Tourism also helped the city avoid as severe a softening of retail trade as that elsewhere in the country. Clothing and clothing accessories saw most of the employment benefits. Another impact was felt by airline and related transport service jobs, which increased by 2,100 over the 12 months through December. Rising demand for such workers at JFK and LaGuardia airports in Queens may help explain the surprisingly rapid jump in that county's average weekly wage early last year. According to the US Bureau of Labor Statistics' survey of all the large counties in the country, Queens placed second highest in quarterly wage growth between the April–June period 2006 and the same quarter a year later.[10] The borough's 12.7% average wage rise was twice as fast as that in Manhattan. But Manhattan's average wage of $1,540 was still the highest in the country and over 70% above that of Queens ($886). Moreover, midsummer 2007 was a turning point toward weaker job and wage growth. Newly released county wage trends between the July–September quarters of 2006 and 2007 show that Queens' wage growth fell sharply to 4.1%, as did its ranking among US counties (117th).[11]

The fact that construction employment grew by 5,800 (+4.8%) is largely attributable to continued strength in the commercial market, as well as unusually warm fourth-quarter weather. Both Manhattan's commercial office occupancy rate and the average asking rent per square foot were among the highest in the country last year. In contrast, Manhattan's high-priced residential real estate market has experienced, by one large broker's estimate, a 34% drop in sales in the 12 months through March 2008. Over this same period, new building permits have dropped some 40% and foreclosures have soared by nearly 66%.[12] Commercial construction faces mounting threats to two major long-planned projects: the $14 billion reconstruction of a new Madison Square Garden-Penn Station complex and the $4 billion Atlantic Yards project in downtown Brooklyn.

Motion picture and video jobs grew by 2,200 last year and telecommunications added 1,400 new hires. But radio and TV broadcasting employment was down by 900. This reflected in part the writers' strike that began November 5th and lasted until mid-February 2008.

Of the other big expanding industries, finance, insurance and real estate (FIRE) added 10,500 positions, nearly all in securities brokerages, investment houses, and insurance firms. In contrast, commercial bank jobs fell by 1,000. Record Wall Street bonuses helped to boost the city's personal income tax revenue (a close proxy for income growth) by 12.3% last year.[13]

Manufacturing jobs continued a long-running decline, as the city lost another 6,000 (-5.7%) over the past year. Total manufacturing employment dipped below 100,000 – one-tenth its size in 1950 when New York City was still the manufacturing capital of the nation.

The services supersector was an even more dominant source of job growth on Long Island than in the city. It added 7,500 net new jobs, enough to more than compensate for stagnation or declines of other industries. Still, the net addition of 4,100 new jobs on Long Island was only a 0.3% improvement, well below the New York City or national rates. Health care led the region's new hiring, followed by professional and business services and leisure and hospitality services. Educational service employment ended the year unchnaged. Like the city, Long Island also experienced sizable manufacturing layoffs last year, losing 2,600 net jobs. Despite these continuing losses, the Island is still home to 83,500 manufacturing jobs. If these continue to fall at a slower pace than the city's, the day is not far off when suburb and city will have equivalent, shrunken manufacturing workforces. The other sector to contract markedly was finance, insurance and real estate. In contrast to FIRE's expansion downtown, Long Island lost 2,300 jobs in all parts of the sector.

Even if the current downturn does not involve a Wall Street crash or a deep local recession, the Independent Budget Office now forecasts that negligible job growth in New York City this year will be accompanied by widening municipal budget gaps. As city residents lose jobs and wages, their consumer spending will fall, dragging down with it income tax and sales tax revenues. The resultant budget shortfalls are estimated to be: -$3.1 billion in fast-approaching fiscal year 2009, -$4.6 billion in 2010, and -$6.3 billion the following year.[14]

To meet the annual requirement to balance the city budget, Mayor Michael Bloomberg has proposed cutting subsidies for public libraries, meals for the elderly, summer jobs for youth and tutors at the City University of New York. He has asked for nearly 4% cuts in schools and in nearly all city agencies. Other painful possibilities suggested for large-scale savings include rolling back his $1 billion property tax reduction.

Government's Role

Why is the economy suffering its second major slump of the still-young 21st century and what should be done about it? Answers to this question are bound to be hotly contested in an election year, especially when the stakes are so high and the electorate is as polarized as it is today.

Policymakers have followed two main approaches so far: 1) Federal Reserve monetary policies to increase loans to major banks; and 2) direct economic stimulus payments to households. A wide variety of proposals are also being suggested aid distressed mortgage borrowers and lenders, but as yet no concrete action has been taken on them.

Monetary Policy. The Federal Reserve has been rushing with untidy haste to stem a wider crisis in the financial system. For the first time, the country's central bank deviated from its main focus on commercial deposit-taking banks to lend billions to investment banks. In mid-March it joined with US Treasury Secretary Henry Paulson (former CEO of rival investment bank Goldman Sachs) to force the country's fifth-largest investment bank, Bear Stearns, to accept a bargain-basement buyout by JP Morgan Chase. To sweeten the deal for Chase, the Fed agreed to absorb any losses on up to $29 billion in Bear Stearns' portfolio. Bear's employees, holders of nearly a third of their employer's stock, were left with heavy pension losses and little job security.

Despite the fact that investment banks are free of all the restrictions or disclosure requirements of commercial banks, the Fed has also just given them access to the same cheap loans that it offers commercial banks.

Investment banks are now being allowed to borrow at the Fed's heavily government-subsidized discount rate, currently just 2.5%. In other words, the Fed has, with few if any strings attached, gifted wealthy investment banks far cheaper credit than millions of anxious middle-class households are being offered. According to the Wall Street Journal, the banks are now "clamoring" to take advantage of the Fed's generosity. Lehman Brothers has repackaged $2.8 billion in unsold loans (a so-called collateralized loan obligation, or CLO) to obtain a low-interest Fed loan. It was thus "able to turn loans that had been mostly shunned by investors for months into cash it could use to finance its business."[15]

What are the big banks being asked to sacrifice in return for these federal benefits? Treasury Secretary Henry Paulson, himself a long-time Wall Street banker, recently unveiled sweeping proposals that would supposedly give federal regulators new authority over the entire financial system, not just banks and insurance companies but also other entities like hedge funds and private equity funds, now operating virtually without regulation. Critics, including state bank regulators and at least one former Republican chairman of the Securities and Exchange Commission, immediately challenged the proposal as further pro-bank deregulation disguised as get-tough regulation. Instead of strengthening current government oversight and enforcement, the White House proposal bows to long-held Wall Street demands to replace specific government rules with target "principles" that financial institutions would be given greater leeway in interpreting and enforcing.[16]

Such proposals to concentrate more power in the Federal Reserve have drawn new attention to the Fed's role in causing the credit crisis. Alan Greenspan, Fed chairman for 18 years until 2006, is now being widely criticized for encouraging the speculative credit frenzy of recent years by holding interest rates low and taking a laissez-faire approach to bank oversight. While Greenspan now says he "doesn't regret a single decision," even some of his former close Fed colleagues think he should, including Stanford University economist John Taylor. The Treasury Department's top international authority from 2001 to 2005 and a former Fed staff member under Greenspan, Taylor told Congress in February testimony that: "rates were kept too low for too long, overheating housing prices and setting the stage for a bust."[17]

Public opinion now places most of the blame on the government and bankers. When asked in a late March national poll, "Who do you think is mostly to blame for the home mortgage crisis?" 40% of respondents blamed regulators, while 28% blamed lenders. Only 14% thought borrowers were mostly responsible. When asked what government should do about the crisis, less than one-third of those surveyed felt that the federal government should aid banks or mortgage companies.

Economic Stimulus. In mid-March the $168 billion Economic Stimulus Act was signed into law, the hasty result of a bipartisan Congressional effort. The federal government will send all income tax filers (even those who owe no taxes) up to $600 for individuals or $1200 for joint filers. Payments are phased out for individuals with incomes over $75,000 and for joint filers with over $150,000 incomes. The law also adds new investment depreciation tax breaks for businesses.

In announcing the annual *Economic Report of the President* on February 11th, President Bush optimistically characterized the current situation as "uncertainties" in the "short term" that the new law would remedy:

> "This report indicates that our economy is structurally sound for the long term, and that we're dealing with uncertainties in the short term. And therefore, what should we do about it? Well, I'm so pleased that the Congress and the administration worked closely together to pass a robust pro-growth package to deal with the uncertainty. That package is about $160 billion-plus. What that means is, it means that money will be going directly to America -- workers and families and individuals. It also means that there is incentives for American businesses." [18]

Similarly, the President's Council of Economic Advisers (CEA) in their latest annual report described the economy as only entering "a period of rebalancing." They predict that 2008 will enjoy stable unemployment at 4.8% and moderate inflation at 2.9%.[19] The report staunchly defends the massive 2001–2003 tax cuts which the administration still wants to make permanent. In rejecting criticisms of these tax cuts' regressive tilt to high-income tax benefits and the accompanying surge in government deficits, the CEA embodies the "Supply-Side View" dominant in Republican administrations since 1980. Essentially this theory promises that "tax cuts pay for themselves;" that is, cutting tax rates automatically spurs such huge increases in production, jobs and income that the resulting boost to income tax revenues is enough to replenish the original revenue loss from rate cuts. Thus, then-House Republican leader Tom Delay defended the 2001–2003 tax cuts in unapologetically ideological terms:

> "We, as a matter of philosophy, understand that when you cut taxes the economy grows, and revenues to the government grow. The whole notion that you have to cut spending in order to cut taxes negates that philosophy, and so I'm not interested in something that would negate our philosophy."[20]

In that spirit, the major income tax cuts were labeled the "Economic Growth and Tax Reconciliation Act of 2001" and the "Jobs & Growth Act of 2003." However, both Congress's Joint Committee on Taxation and its Congressional Budget Office conducted tests of the supply-side "revenue feedbacks" of the 2001-03 tax cuts. Their conclusion – that the tax cuts would clearly *not* pay for themselves – are reflected in the CBO's projections of huge 10-year deficit increases through 2014.

For most Americans the last economic expansion ended before they regained their losses from the 2001 recession. Although that recession was declared officially over after just eight months, employment continued to fall for 30 months in a row. Job totals only crept back to pre-recession levels in early 2005 – the slowest job rebound of any U.S. recovery in the past half-century -- and would have taken even longer without the stimulus of heavy government spending. The average workweek was not restored to the pre-recession norm until January 2006 and the unemployment rate never fell back to the 3.9% rate in late 2000.[21] In fact, in comparing the current recovery to all others since World War II, corporate profits are the only major indicator enjoying above-average growth. The period since 2002 has lagged a full percentage point behind the average annual postwar rate of output growth.[22] Investment has been growing at one-half the average of earlier recoveries and job growth at one-fourth the average rate. In sharp contrast, corporate profits have jumped twice as fast of late as in comparable business cycles.

In this 75th anniversary year of the birth of President Franklin Roosevelt's New Deal, renewed calls have been heard in some quarters for restoring genuine government regulation of financial services and shifting more government resources from rising military expenditures to anti-recessionary measures. The "$3 trillion war" is clearly viewed as far too costly by many Americans.[23] When asked in late March how much the war in Iraq has contributed to US economic problems, two-thirds answered: "A lot."[24] The prospects for such alternative views in rebalancing economic strategy away from its largely supply-side focus will depend heavily on events in the political as well as economic world in coming months.

Table 1
Number of Nonfarm Jobs (in thousands) by Place of Work: 2000–2007

	Dec. 2007	Dec.2006	Dec. 2000	% Change	
				2000–2007	2006–2007
U.S.	139,229.0	137,959.0	133,308.0	4.4%	0.9%
NY State	8,841.4	8,772.4	8,830.9	0.1	0.8
New York City	3,798.1	3,744.7	3,814.2	-0.4	1.4
Long Island	1,282.0	1,277.9	1,254.5	2.2	0.3

Table 2 source: Establishment data (not seasonally adjusted) from US Dept. of Labor & NY State Dept. of Labor.
Note: the data reflect regular revisions made by Dept. of Labor.

Table 2
Civilian Labor Force, Employment & Unemployment:
New York City, Long Island & All U.S., Dec. 2006–Dec. 2007
(in thousands, not seasonally adjusted)

	Labor Force		Employed		Unemployed		Unemp. Rate	
AREA	Dec. 2007	Dec. 2006	Dec. 2007	Dec. 2006	Dec. 2007	Dec. 2006	Dec. 2007	Dec. 2006
U.S.	153705.0	152572.0	146334.0	146081.0	7371.0	6491.0	4.8%	4.3%
NYC	3849.1	3807.6	3650.7	3653.9	198.4	153.7	5.2	4.0
Brooklyn	1083.2	1070.9	1023.0	1023.9	60.2	47.0	5.6	4.4
Bronx	513.3	506.3	477.8	478.3	35.5	28.0	6.9	5.5
Manhattan	914.8	905.9	873.6	874.4	41.2	31.5	4.5	3.5
Queens	1103.3	1092.6	1052.7	1053.7	50.6	38.9	4.6	3.6
Staten Island	234.4	231.9	223.5	223.7	10.9	8.2	4.6	3.5
Long Island.	1477.8	1485.7	1421.5	1438.3	56.3	47.4	3.8	3.2
Nassau Co.	694.3	698.1	668.7	676.6	25.6	21.5	3.7	3.1
Suffolk Co.	783.6	787.6	752.8	761.7	30.8	25.9	3.9	3.3

Table 3 source: CPS household survey data from NY State Department of Labor, 2008. Note: the data reflect regular revisions made by Dept. of Labor.

Figure 1
NYC Job Growth by Industry: Dec. 2006– Dec. 2007
(in thousands of jobs, and percent change)

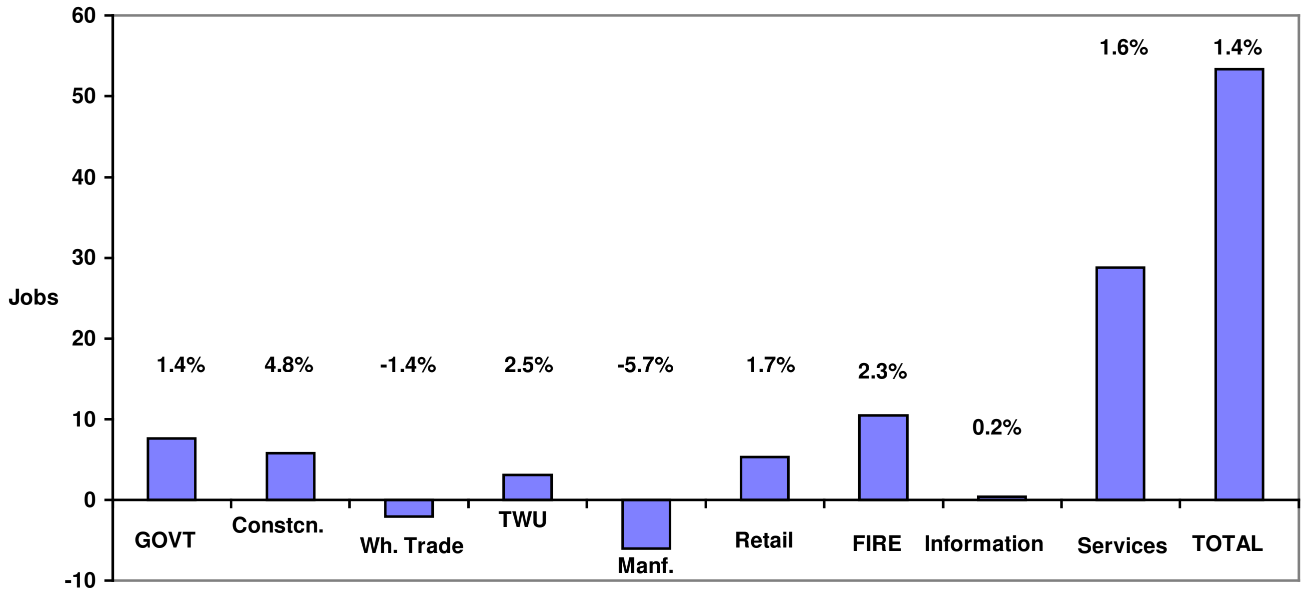
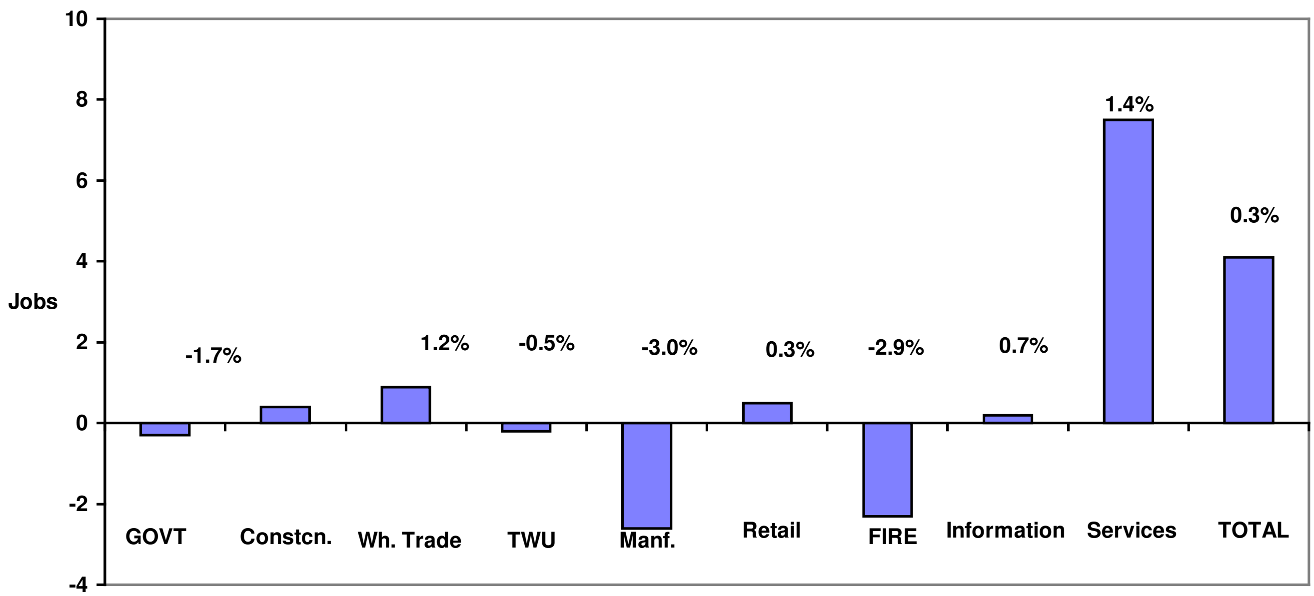


Figure 2
Long Island Job Growth by Industry: Dec. 2006– Dec. 2007
(in thousands of jobs, and percent change)



Source: NYS Dept. of Labor: nonfarm payroll job data from CES establishment survey in Nassau & Suffolk counties. Year-to-year changes, not seasonally adjusted. Note: FIRE = Finance, Insurance & Real Estate; TW U= Transport, Warehousing & Utilities

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