Economix

Explaining the Science of Everyday Life

January 28, 2010, *12:30 pm*

The Growing Underclass: Jobs Gone Forever

By CATHERINE RAMPELL

Associated Press

Last night, President Obama talked about the need to put people back to work, calling job growth the "No. 1 focus in 2010."

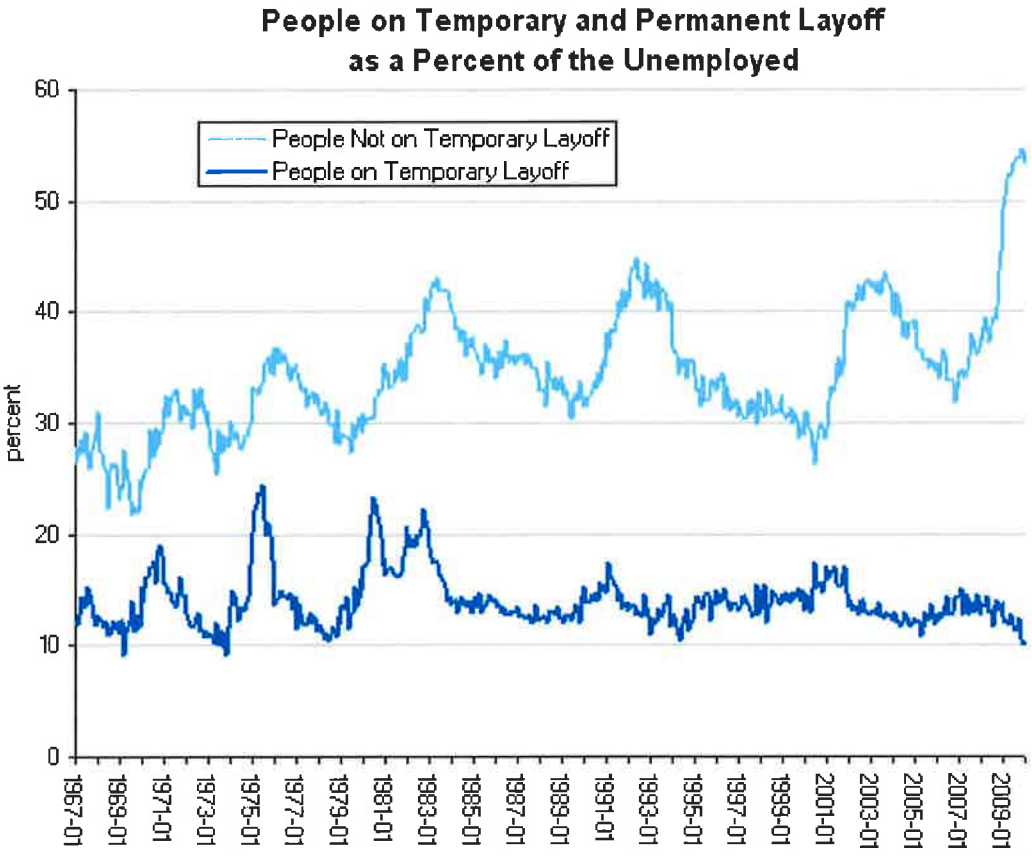
But one major obstacle to that goal — and one that has so far gone mostly unacknowledged — is that many of the jobs slashed during this recession are not coming back.

Lots of the bloodletting we've seen in the labor market has probably been permanent, not just cyclical. Many employers have taken Rahm Emanuel's famed advice — never waste a crisis — to heart, and have used this recession as an excuse to make layoffs that they would have eventually done anyway. Some economists refer to this as the "cleansing effect" of recessions.

As a recent Congressional Budget Office report put it, "Recessions often accelerate the demise or shrinkage of less efficient and less profitable firms, especially those in declining industries and sectors."

Think glassmaking. Or clerical work. Or, for that matter, newspapers.

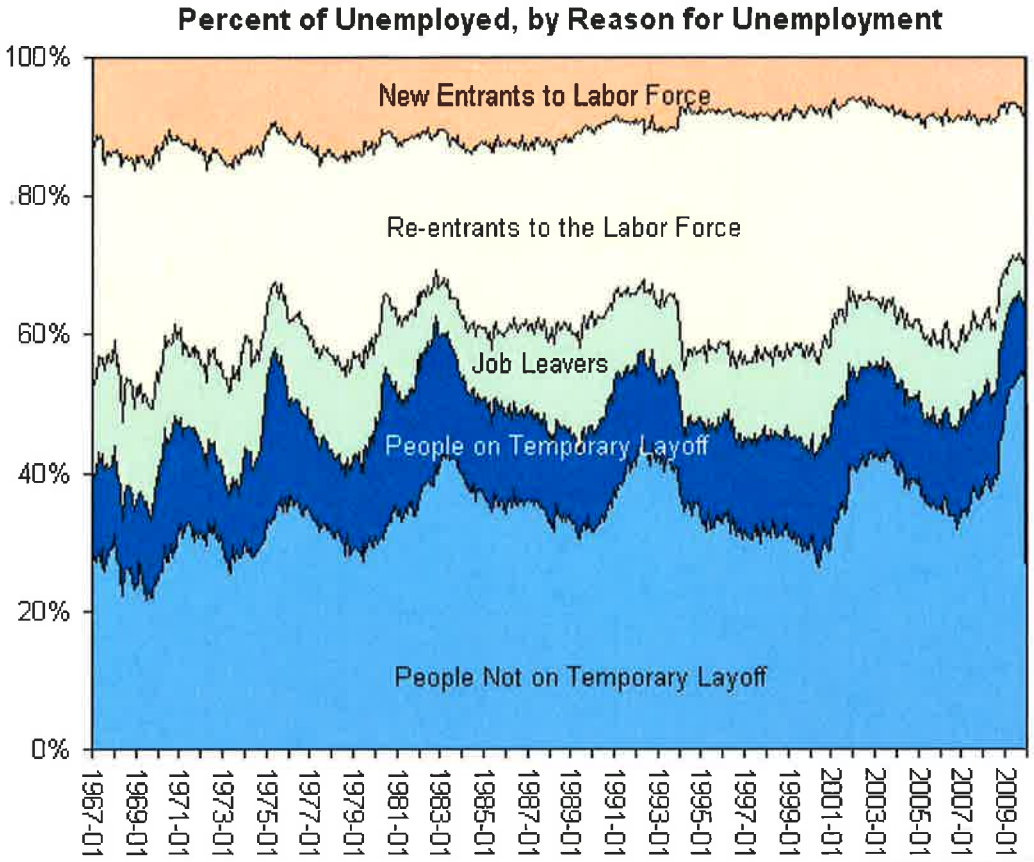
Over all, the share of unemployed workers whose previous job has been permanently lost tends to rise during recessions, and the share of the unemployed who are just on temporary layoff falls. You can see both trends in the chart below.



Source: Bureau of Labor Statistics

In this recession, though, the shift from temporary layoffs to permanent job loss has been especially pronounced. In fact, the share of the unemployed who lost their jobs permanently is at its highest level since at least 1967, the first year for which the Labor Department has these numbers available.

Here's another way to look at these trends, by what share of the unemployed are represented by each of the five categories of unemployed workers (that is, people who don't have jobs yet because they're new entrants to the labor market; re-entrants to the labor market; people who left their jobs; people who are on temporary layoff; and people who lost their jobs permanently).



Source: Bureau of Labor Statistics

The big ocean of blue represents the portion of the unemployed who have lost their jobs, with the lighter blue section showing those whose jobs are gone permanently.

There are multiple ways to explain why permanent job-losers represent a higher share of the unemployed this time around. Maybe, as others have suggested, many of the jobs gained in the boom years were built on phantom wealth. Or maybe the culprit is a corollary of Moore's Law, the idea of exponential advances in technology over time. That might suggest that innovation and automation displace more and more workers by the time each recession rolls around.

Whatever the underlying cause, the result is disconcerting: compared with previous recessions, many more of the employment gains in this recovery will have to come from *new* jobs.

That is much easier said than done.

Workers whose entire occupations — not just the previous payroll positions they held — are disappearing (think: auto workers) will need to start over and find a new career path. But the new skills they will need take a long time to acquire.

What's more, in addition to obtaining new degrees or training, some workers may need to move to new places in order to start a different career. But sharp declines in housing prices, plus high loan-to-value ratios on many mortgages before the downturn, will make that transition harder. Homeowners who are "underwater" — that is, who owe more in mortgage payments than their house is actually worth — may not be able to sell their house for enough money to enable them to buy a home in a new area.

All of which is to say that many of the Americans who are already out of work are likely to stay in that miserable state for a long, long time. And the longer they stay unemployed, the harder it will be for them to transition back into the work force, further adding to America's growing underclass.

The administration is likely to have a big labor (and class) problem on its hands, and one that won't be solved merely by an increase in the gross domestic product.

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Explaining the Science of Everyday Life

December 2, 2010, *3:34 pm*

Will Today's Unemployed Become Tomorrow's Unemployable?

By CATHERINE RAMPELL

Lots of smart economists and policy makers have been debating whether the problems in the job market are primarily cyclical (that is, temporary, and related to slack demand) or primarily structural (that is, reflecting a deeper problem in the economy, such as a tougher mismatch between the skills employers want and the skills workers have).

But this discussion largely misses an important point: Cyclical unemployment can *become* structural unemployment because perfectly good workers become less employable the longer they are out of work.

Economists have long known this to be the case, and have documented that the likelihood of finding a job falls drastically the longer a person has been unemployed. The following chart, from a 2008 paper by the University of Chicago's Robert Shimer, shows the percentage of each group of workers with various durations of unemployment who found work in the coming month:

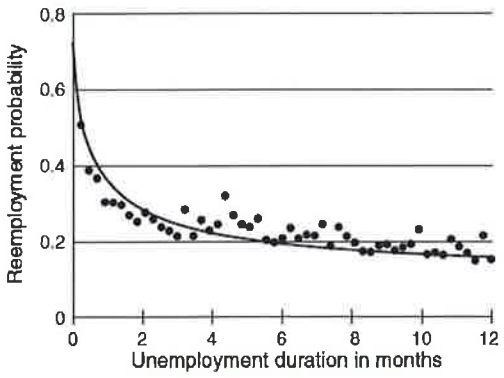


FIGURE 1

Notes: The dots show the empirical probability of being employed at the next survey as a function of unemployment duration, F_τ, for job losers and job leavers. The line shows the theoretical reemployment probability $F(\tau)$ as a function of duration for $\mu = 0.6\sigma$.

Robert Shimer, "The Probability of Finding a Job,"
American Economic Review: Papers & Proceedings 2008, 98:2, 268–273.

Professor Shimer averaged job-finding data from the Bureau of Labor Statistics from January 1976 to October 2007, looking at only people who either lost or left jobs before becoming unemployed (that is, excluding people who were new entrants or re-entrants to the labor force).

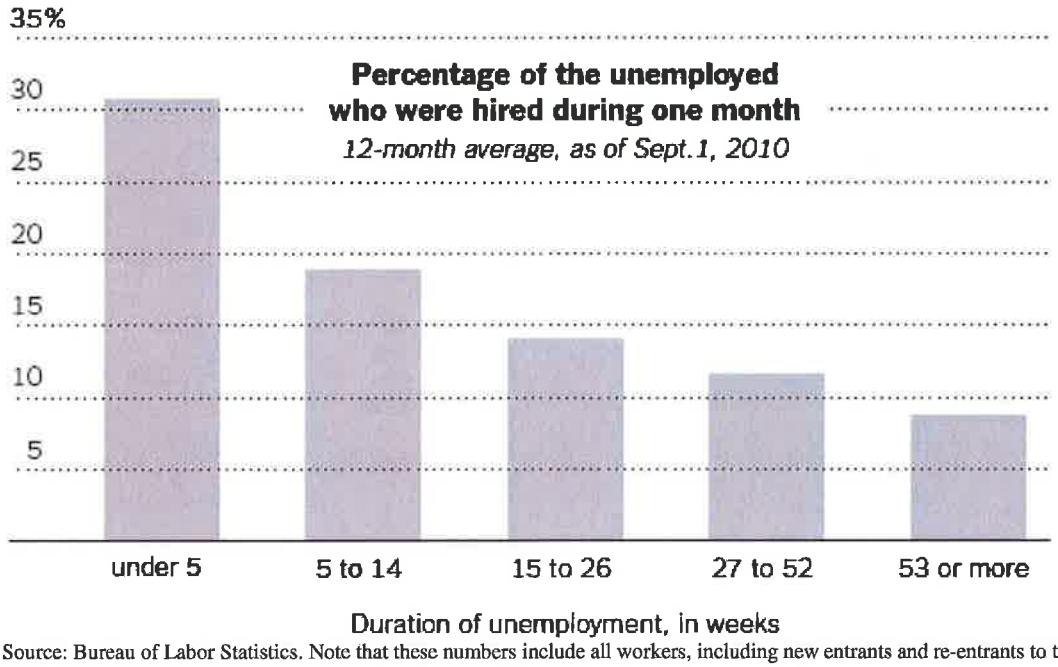
The horizontal axis shows how long someone has been unemployed, and the vertical axis shows the likelihood that the person will find a job in the next month. Professor Shimer found that 51 percent of workers who had been unemployed for one week obtained work in the following month, but the share declined sharply after that.

"For workers with duration less than six months, the job finding probability averages 31 percent," he writes. "It falls to 19 percent during the next six months and just 14 percent for workers who have been unemployed for over a year."

In other words, in recent decades, a person out of work for a week was nearly four times as likely to find a job the next month as a counterpart who'd been out of work for a year.

Professor Shimer's data are all prior to the recession. But the Labor Department, at the request of The New York Times, provided more recent numbers. The re-employment data by week are pretty noisy, but the general trend — if you group the workers into slightly broader categories of duration — is the same:

As people are unemployed longer, their chances of finding a new job get smaller:



Source: Bureau of Labor Statistics. Note that these numbers include all workers, including new entrants and re-entrants to the labor force. Professor Shimer's data refer only to job-losers and job-leavers.

The exact reasons why the long-term unemployed have more trouble finding work — a fact that is true throughout the business cycle, and not just during tough economies — are hard to disentangle.

To be sure, there might be some differences between the types of workers who are short-term unemployed and those who are long-term unemployed. The better workers are more likely to get hired faster, leaving a pool of less qualified workers as the ones who disproportionately make it to long-term unemployment in the first place.

But the experience of unemployment itself also seems to damage workers' prospects.

First of all, employers will look at a yawning gap in a worker's resume and wonder why no one else would take this applicant. It's the "lemon" issue that also applies to housing and used cars: The fact that a person has been unemployed for so long (or that, say, a house has been on the market so long) is a signal that something is defective, even if the defect is not obvious to the naked eye.

Employers may also worry that jobless people have gotten out of the habit of working, which appears to be a valid concern. Unemployed people spend more time sleeping and watching television, for example, than their employed counterparts, and may have trouble readjusting to the rigors of a more structured schedule after spending so much time out of the office. Unemployed people are also more likely to be depressed and to suffer from low self-respect, characteristics that may make them interview poorly.

Other types of skills may atrophy — especially if the long-term unemployed worked in particularly dynamic industries like high-tech — and their Rolodexes become dated.

Of course, when the economy is booming and the supply of workers is extremely tight, employers are less picky, and to some extent the marketability issues will fade.

But the other effects of long-term unemployment may be more permanently scarring. This is a phenomenon Europe appeared to go through starting in the 1980s, as an entire class of workers became very difficult to put back to gainful employment.

"After a while, a lot of European countries just got used to having 8 or 9 percent unemployment, where they just said, 'Hey, that's about good enough,' " said Gary Burtless, a senior fellow at the Brookings Institution.

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Explaining the Science of Everyday Life

February 18, 2010, *2:03 pm*

Inflation Won't Solve Our Debt Problems

By CATHERINE RAMPELL

Lately I have seen a few suggestions, here and there, that the United States should consider inflating its way out of its rising debt burden.

The country essentially inflated its way out of much of its debt during the Great Depression, and again in the 1970s, according to Harvard's Kenneth S. Rogoff. But as anyone who remembers the 1970s can attest, inflation can be painful. It's no fun to get your paycheck and then find out that you cannot buy as many groceries or as much gasoline as you did the week before because prices have gone up so much.

The more powerful argument against inflating away debt is that it will not work, says Alan Auerbach, an economics professor at the University of California, Berkeley.

Why? Because so much of our long-term spending obligations are indexed to inflation. In other words, the debts will rise along with inflation, so they won't "feel" any smaller. Here is how Professor Auerbach explained it in an e-mail message (links added are mine):

> Sudden inflation can only inflate away the debt that is (1) not indexed, the way TIPS are; and (2) not very short term (i.e., not T-bills), so that the interest rates cannot be reset to much higher rates that would compensate for inflation. Also, there is no net gain to inflating away debt held within the government (e.g., the Social Security trust fund, etc.). So, as of the end of November (data from the Treasury Web site; probably can be updated through December now), that left about $5.4 trillion worth of debt that could be made to disappear with a sudden, rapid inflation.
>
> But most of our long-term imbalance, which Bill Gale and I have estimated at $53-$126 trillion (in our paper published in Tax Notes in October), depending on how far out one looks, comes from exploding entitlement programs, which are either explicitly indexed to inflation — Social Security — or implicitly indexed (Medicare and Medicaid) because they provide services that will also grow in cost with inflation. So the best

> we could do, using the lower estimate of the long-term gap (a 75-year number) would be to eliminate 5.4 of 53 trillion, or about 10 percent.

In other words, even if the government printed a lot more money and lowered the purchasing power of the dollar, 90 percent of the country's debt problem would survive.

So what are the other strategies for bringing down the country's long-term deficits?

The one countries always hope for is **growth**.

If the economy grows quickly enough, tax revenues can rise faster than spending. This helps explain why the country had budget surpluses in the late 1990s and early 2000s. A booming economy — greased by the stock bubble, of course — helped push tax revenues even higher than the government had expected they would be.

But the grow-your-way-out-of-debt option is usually too rosy, especially during a recession.

A country loaded with debt can try to simply **tighten its belt**, by raising tax revenues and/or slashing spending. But there are major political obstacles for these policy initiatives because they are so painful, at least in the short-run.

Finally, a country can **restructure its debt or default**, which is generally considered the worst-case. Just as a person defaulting on a loan can mar his ability to borrow in the future or even get a job, a country defaulting on its debt obligations will have trouble getting other nations and investors to trust it in the future, too.

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December 14, 2010, *9:22 am*

'Spider-Man' Economics: Recouping That Initial Investment

By CATHERINE RAMPELL

A still from a video posted on the Facebook page for "Spider-Man: Turn Off the Dark."

"Spider-Man: Turn Off the Dark" has made headlines as the most expensive musical in Broadway history. At $65 million, it had an initial budget that is more than twice as big as that of the previous record holder, "Shrek the Musical." The new show even rivals the cost of many major Hollywood films — which, given that they can be distributed cheaply worldwide, have a much bigger potential audience than this live show can ever hope for.

So how long will it take "Spider-Man" to recoup its original investment?

When a colleague asked me this question after seeing the show this weekend, I could not resist a chance to meld my two great loves: economics and theater. After calling a few theater producers to get a better handle on the arithmetic, I've put together the following back-of-the-envelope calculation.

Running Costs: Besides the upfront investment, it costs money to keep the show running every week. Actors, musicians, stagehands, rent and electricity bills must be paid, and

other maintenance costs crop up. Let's assume that it costs about $1 million a week to put up the show, a ballpark figure that several theater producers suggested given the size of the cast, crew and orchestra.

Ticket Sales: The Foxwoods Theater, which is housing "Spider-Man," seats 1,932. How many of those seats sell, and at what price, can vary greatly from week to week.

The average paid ticket over the last couple of weeks has been around $97. But right now the show is still in previews, and as a result many of the seats are discounted. The average ticket price when the show opens will likely be higher, assuming the show does well. Still, these prices will vary from week to week, depending on factors like how many premium-price tickets are sold.

Under a best-case scenario, ticket prices might be about as high as they are for blockbusters like "The Lion King" (whose director, Julie Taymor, is also helming "Spider-Man") and "Wicked."

Over the last year, the average tickets sold to "The Lion King" and "Wicked" have gone for $111.86 and $111.19, respectively, according to the Broadway League. (The average prices last year were slightly lower.) Let's assume, then, that if "Spider-Man" is a hit, it can bring in an average of about $111 a ticket for every performance.

Not every seat gets sold every week, either. According to the Broadway League, over the last year, 94.71 percent of available seats were sold for "The Lion King," and 98.96 percent of seats were sold for "Wicked," both exceptionally high rates. Again using these hits as models for our best-case scenario, let's assume "Spider-Man" sells 96 percent of its seats each week.

($111 a seat) x (1,932 seats in the theater) x (96 percent of seats filled) x (8 shows a week) = $1,646,991

Weekly Profits: That's what producers call the "gross gross." We should knock about 10 percent off this number, though, to account for the 4.5 percent that is automatically scraped off and given to pension plans, and another 5 percent or so that goes toward credit card charges, theater party charges and other miscellaneous discounts.

So that leaves us with ($1,646,991) x (90 percent) = $1,482,292.22 a week.

That figure minus the weekly running costs of the show ($1 million) comes to $482,292.22 a week. A good rule of thumb is that about 35 percent of that amount will go toward royalties and the like. The show's actual profit, then, will be about 65 percent of the difference between running costs and ticket sales.

That comes to (482,292.22) x (65 percent) = $313,489.80 a week.

The Verdict: Again, the total upfront cost of the show was $65 million. At the weekly profit rate above, it will take ($65,000,000) / ($313,489.80 a week) = 207.3 weeks = about **4 years before the show even begins to make up its initial investment.**

Again, this is just a rough estimate that excludes any merchandising sales (which can be very lucrative for hit shows), and these are under the most optimistic of circumstances. Many have argued that the hits "The Lion King" and "Wicked" are good comparisons for this show because they both had existing franchises behind them (the Disney animated film and "The Wizard of Oz," respectively), and thus built-in fan bases. Both were also large-scale, design-heavy, megamusicals with big budgets.

But there have been other hyped musicals built on popular franchises, designed by superstar creative teams, and buoyed by generous budgets that fared less than well. " Disney's The Little Mermaid" ran for about a year and a half. " Shrek the Musical" ran for just over a year. And "The Capeman," the Paul Simon musical backed by $11 million in 1997 (which would be about $15 million in today's dollars), ran for only two months.

For a similar exercise, see this post on how many hot dogs it would take to pay the rent at New York's most expensive hot dog stand.

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Explaining the Science of Everyday Life

April 19, 2010, *11:02 am*

Want a Higher G.P.A.? Go to a Private College

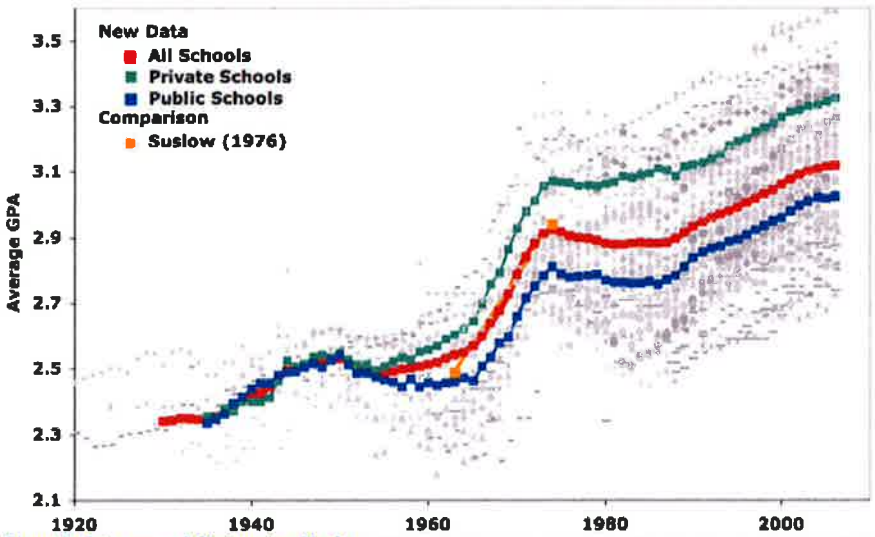
By CATHERINE RAMPELL

Over the last 50 years, college grade-point averages have risen about 0.1 points per decade, with private schools fueling the most grade inflation, a recent study finds.

The study, by Stuart Rojstaczer and Christopher Healy, uses historical data from 80 four-year colleges and universities. It finds that G.P.A.'s have risen from a national average of 2.52 in the 1950s to about 3.11 by the middle of the last decade.

For the first half of the 20th century, grading at private schools and public schools rose more or less in tandem. But starting in the 1950s, grading at public and private schools began to diverge. Students at private schools started receiving significantly higher grades than those received by their equally-qualified peers — based on SAT scores and other measures — at public schools.

In other words, both categories of schools inflated their grades, but private schools inflated their grades more. The chart below shows average G.P.A.'s from 1930 to 2006. Gray dots represent individual schools' average G.P.A's. The blue and green lines represent the average G.P.A. for each school type — public or private — over time:



Stuart Rojstaczer and Christopher Healy Average G.P.A. over the time period 1930-2006 as a function of school type. Gray dots represent individual data points. Colored squares represent the average G.P.A. for each school type over time.

Based on contemporary grading data the authors collected from 160 schools, the average G.P.A. at private colleges and universities today is 3.3. At public schools, it is 3.0.

The authors suggest that these laxer grading standards may help explain why private school students are over-represented in top medical, business and law schools and certain Ph.D. programs: Admissions officers are fooled by private school students' especially inflated grades.

Additionally, the study found, science departments today grade on average 0.4 points lower than humanities departments, and 0.2 points lower than social science departments. Such harsher grading for the sciences appears to have existed for at least 40 years, and perhaps much longer.

Relatively lower grades in the sciences discourage American students from studying such disciplines, the authors argue.

"Partly because of our current ad hoc grading system, it is not surprising that the U.S. has to rely heavily upon foreign-born graduate students for technical fields of research and upon foreign-born employees in its technology firms," they write.

These overall trends, if not the specific numbers, are no surprise to anyone who has followed debates about grade inflation. But so long as schools believe that granting higher grades gives alumni an advantage, there will be little or no incentive to impose stricter grading standards unilaterally.

You can find a database of G.P.A.'s by school over the last few years (or in some cases, the last few decades) here.