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# REGULATORY UNCERTAINTY

## A phony explanation for our jobs problem

BY LAWRENCE MISHEL

Job creation has finally returned as a front and center priority in Washington. The prescription for spurring job creation, however, depends on the diagnosis of the underlying problem. Policymakers are currently invoking two very different explanations for the jobs crisis. The more persuasive explanation is that the demand for goods and services is depressed because of the collapse of the housing and stock market bubbles—the financial crisis—that has led to both a deleveraging (paying off debts) of households and a cratering of the construction sector. The initial shock of the bubble's burst then cascaded into non-construction business investment that dried up as customers disappeared. Finally, all of this led to state and local governments cutting back services and jobs as tax revenues plunged.

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**EPI BLOG: More on why regulatory uncertainty is a phony explanation**

There is a competing story, widely told by Republican politicians and business trade associations, which claims that business investment and hiring is being held back by uncertainty over future regulations and taxation. As Maine Senator Susan Collins said in introducing her bill to put a moratorium on all new regulations: "Businesses, our nation's job creators and the engine of any lasting economic growth, have been saying for some time that the lack of jobs is largely due to a climate of uncertainty, most notably the uncertainty and cost created by new federal regulations" (Kasperowicz 2011).  Her view has been repeated by others, including House Majority Leader Eric Cantor (2011) and the Chamber of Commerce (Donohue 2011).

An examination of current economic trends, and especially what employers are *doing* in terms of hiring and investment, debunks this story about regulatory uncertainty as the cause of our dismal job growth. An examination of what employers and their economists are *saying* again and again in private surveys (cited later in this paper) makes it clear that what businesses actually identify as their primary set of challenges does not fit this story either. In other words, what the heavily politicized trade associations in Washington are saying does not correspond to the real challenges facing both large and small businesses, even as they themselves perceive them.

## What is the flawed reasoning behind the "uncertainty" argument?

What is the logic behind the "uncertainty" argument for our poor job growth? Based on numerous media reports, we know that firms *have substantial cash on hand to invest* (Monga, Mattiloi, and Chasan 2011), but that they are not using it for new hires or investments. We also know that firms are making a third more profit than they did before the recession (Eisenbrey et al. 2011), so they are not being held back by current profitability or the ability to finance investments. There is no mention of any demand-side problems in the rhetoric coming from House leaders, so presumably they believe that businesses have ample customers.

Given all of this, the story must be—according to conservative policymakers—that employment growth is sluggish because firms are turning down, and will continue to turn down, opportunities to make goods and services that are profitable today (current sales are *very* profitable) because they fear regulations will not allow these sales opportunities to be as profitable in the future and they fear making the longer-term commitment of hiring permanent workers.

Actually, it's not really "uncertainty" about these potential rules and regulations that is the complaint; the regulatory process is moving along, and the rules are becoming final and therefore certain. But the House Republicans and various business groups are actually trying to delay the rules, prolonging the sense of uncertainty. The bottom line is an old conservative story: that regulation will raise costs and make future business opportunities to sell goods and services insufficiently profitable. The new twist is that these fears are suppressing current investments and hiring, and are thus a major cause of our unemployment problem.

The underlying assumption that regulations inhibit job growth is questionable, of course. EPI's Isaac Shapiro and John Irons have reviewed the available evidence on this and found that, taken in their entirety, neither studies on the economy as a whole or ones on particular sectors support the view that regulations cause substantial job losses. Following are excerpts from Shapiro and Irons (2011):

> *The most common general studies are of environmental regulations, and these have consistently failed to find significant negative employment effects. Moreover, studies suggesting that regulations have broad negative effects on the economy offer little persuasive evidence.*
>
> *Some well-executed studies have found that certain regulations led to job losses in particular areas, but most studies of various industries suggest that regulations had either a close to neutral or small positive effect on employment levels.*

It is worth mentioning that this "regulatory uncertainty" argument requires its proponents to have a particularly peculiar form of amnesia, given that the worldwide economic collapse we are now experiencing is due to a failure to sufficiently regulate financial markets.

## What do economic trends and employer decisions indicate? The demand-side explanation

Instead of uncertainty about regulations, there is strong evidence that the absence of job creation reflects the continued unwinding of the financial collapse and the corresponding lack of demand. Firm investments and hiring are lower because they have ample capacity to produce the goods and services they are selling to a shrunken market, while firms are deleveraging at the same time. One can easily document (using National Income and Products Accounts (NIPA) Table 1.4.6 on GDP and mixing with population information from NIPA Table 2.1) that the final per person demand for domestically produced goods and service in the spring of 2011 (second quarter) was still 0.7 percent lower than it was before the recession, i.e., the last quarter of 2007 (U.S. Bureau of Economic Analysis 2011a and 2011b). Assuming that demand per person would have grown, absent the downturn, at a 1.5 percent rate for three-and-a-half years (a rate 20 percent lower than that of the 1979-2007 period), we find ourselves with demand 8.5 percent lower than we would expect.

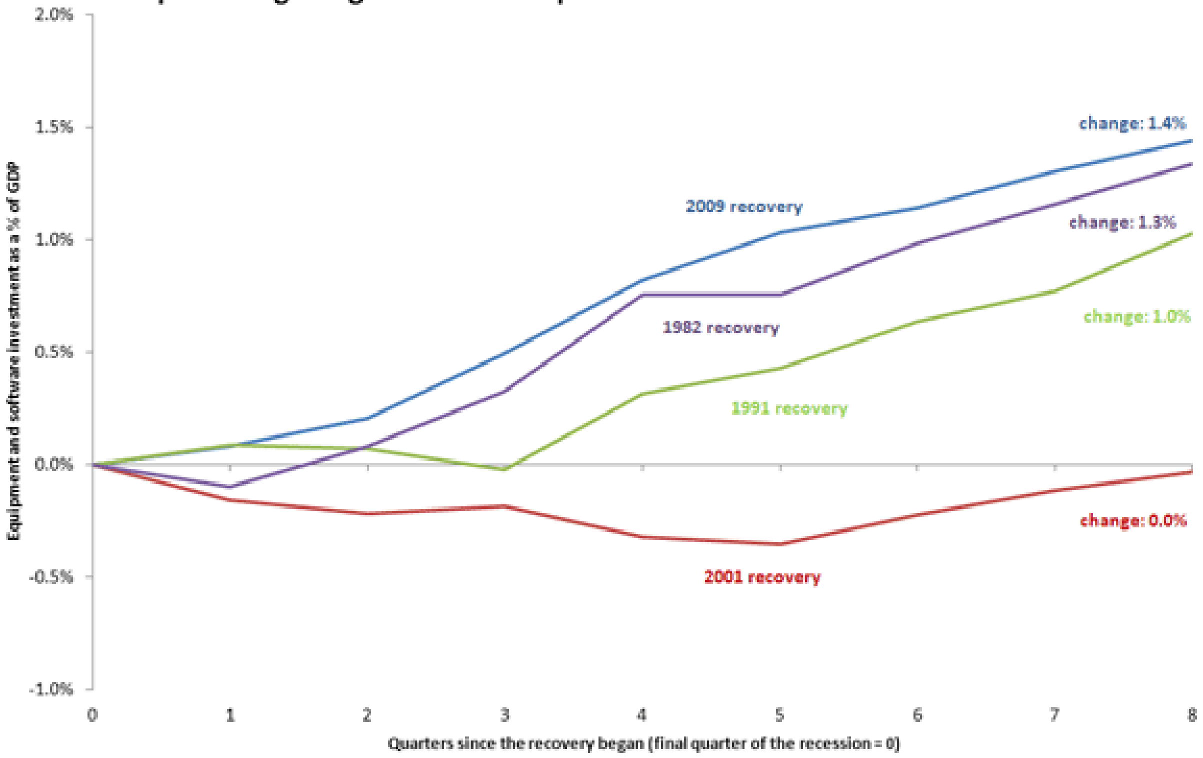
The optimal response to shrunken demand when interest rates are as low as they can go and households and firms are still not spending is for government to step in to augment demand. The Obama administration's recent jobs plan follows this logic, though it would be even better if it had more investment, fewer tax cuts—especially for businesses already overflowing with cash—and had set up a direct government hiring program. More on these actions can be found in proposals from Rep. Jan Schakowsky (2011) and William Darity (2010).

## Investment and hiring trends inconsistent with "uncertainty" story

A simple review of investment and employment trends—what businesses are actually doing— reveals that employers are not behaving according to the narrative described in the uncertainty story: Employment and investment trends are what one would expect (or better) given the trends in the overall growth of the economy (i.e., the actual growth or shrinkage of gross domestic product).

Let us start by comparing investment, specifically investment in equipment and software, in the first two years (which is where we are now) of each of the last four recoveries. **Figure A** does so by examining the changes in the investment (equipment and software) share of GDP from the beginning of each recovery. The data show that investment has increased more in this recovery than in the prior two recoveries and roughly the same as that of the 1980s recovery. It is interesting to note that there was no growth in investments (as a share of GDP) in the George W. Bush recovery. That means that this recovery, with Obama regulations pending, is far more investment-led than the recovery under the *deregulatory* Bush administration. So, investment does not look like it is being held back, at least relative to other recoveries and the size of the market (i.e., GDP). To be transparent, this analysis leaves out investments in business "structures" because that type of investment is clearly faltering as a result of the bursting of the residential and commercial real estate bubble (and not because of regulatory uncertainty).

*Figure A.* Growth in equipment and software investment as a percentage of gross domestic product over the last four recoveries

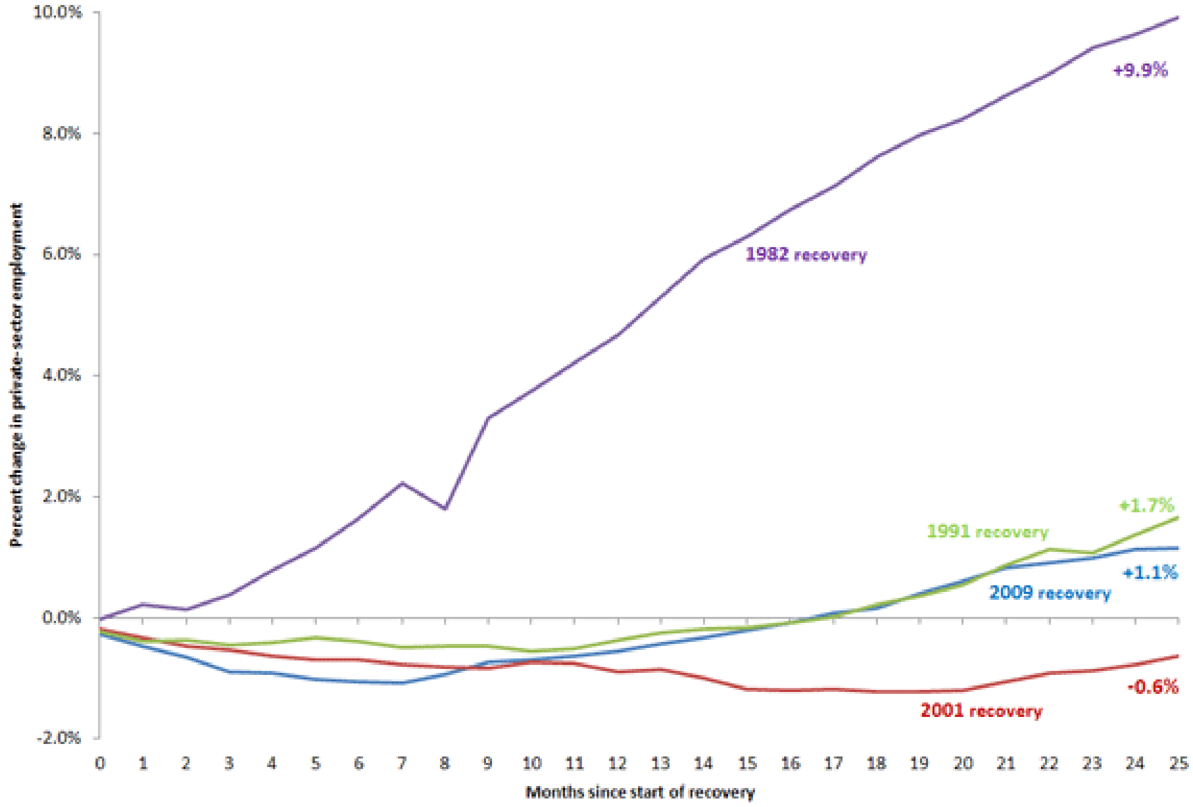


Source: EPI analysis of Bureau of Economic Anlaysis data.

Private-sector job growth has also been better in this recovery than in the last recovery, as shown in **Figure B**, which looks at the growth over the first 25 months of the last four recoveries. The three recoveries since 1991, however, had very little job growth, at least at first, and all have been referred to as "jobless" recoveries. There was much faster employment growth in the 1980s recovery—mostly because the Federal Reserve had much more room to support this recovery through lower interest rates than it has had during the post-1980s recessions (and the 2000s recoveries in particular). There is certainly nothing special about job growth in the current recovery that stands out from the 1991 and 2001 recoveries to indicate a special regulatory-caused job problem.

The most unusual aspect of this recovery is that government jobs have declined by roughly 600,000 (2.6 percent), whereas government jobs grew in the prior recoveries. Obviously, the loss of government jobs is not the consequence of fears of regulation. Despite the loss of government jobs in this recovery but not the last one, there has been more job growth overall (public- and private-sector) in the first 25 months of this recovery (up 0.5 percent) than in the corresponding period in the 2001 recovery (when jobs fell 0.4 percent).

*Figure B.* Private-sector employment growth over the last four recoveries



Source: EPI analysis of Bureau of Labor Statistics data.

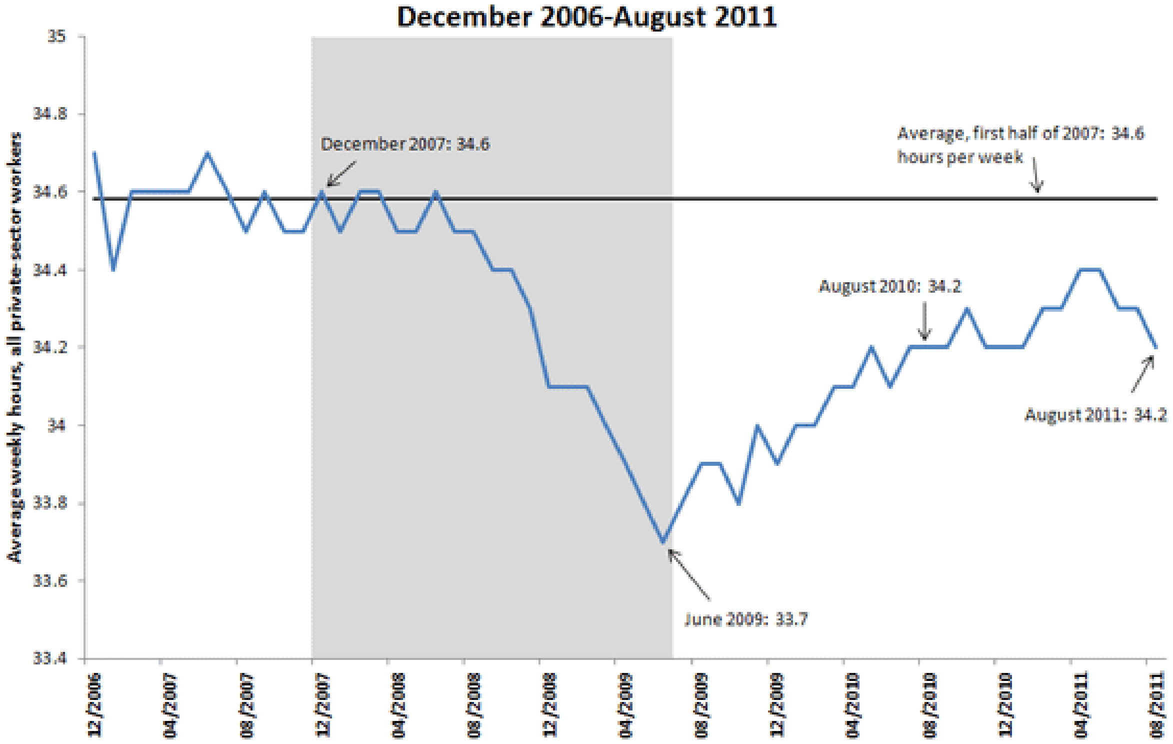
Perhaps a better test is to look at employment growth relative to growth of the economy, an analysis that corresponds to our treatment of investment. One way to do that is to examine whether the historic relationship between GDP growth and unemployment—referred to as Okun's law—has changed in this downturn and recovery. It has not: Employment growth is what we would expect given the growth of the economy. For instance, the Goldman Sachs economics team recently wrote, "the link between the growth rate of real GDP and the change in the unemployment rate, known as Okun's law, continues to be very tight" (Goldman Sachs 2011).

Other analysts, such as Jared Bernstein (2011) and Menzie Chinn (2011), also find that the unemployment/employment growth we are experiencing is very much in line with the GDP we have seen, and no new factor—such as fear of regulation—is present.

## Trends in weekly hours inconsistent with "uncertainty" argument

Another set of data also calls into question the "regulatory uncertainty" argument. If firms were nervous about hiring new employees but had immediate profitable sales opportunities (say, before new regulations are established), then they could readily increase the weekly work hours of current employees to produce more goods and services. The Center for Economic and Policy Research's Dean Baker (2011) and EPI's Heidi Shierholz frequently point out that weekly hours are still far below their pre-recession level. **Figure C** depicts recent analysis by Shierholz (2011) of hours data through August 2011. It shows that weekly work hours for private-sector workers averaged 34.6 in 2007 but had fallen to 33.7 by June 2009 (the start of the recovery). Since then, weekly hours have recovered about half that loss and were at 34.2 in August. If employers restored working hours to their pre-recession level, that would be the equivalent of adding 1.2 million jobs, suggesting that a lot more staffing is readily available (without making permanent new hires) to produce output of goods and services if employers so desired. It is hard to believe that regulatory uncertainty is what is preventing employers from adding work hours to current employees to fulfill current profitable opportunities to sell goods or services. Something else must be going on: Customers and sales opportunities are simply not there.

**Figure C. Average weekly hours of private-sector workers, December 2006-August 2011**



December 2007: 34.6

Average, first half of 2007: 34.6 hours per week

August 2010: 34.2

August 2011: 34.2

June 2009: 33.7

**Source:** Shierholz 2011
**Note:** Shaded area denotes recession

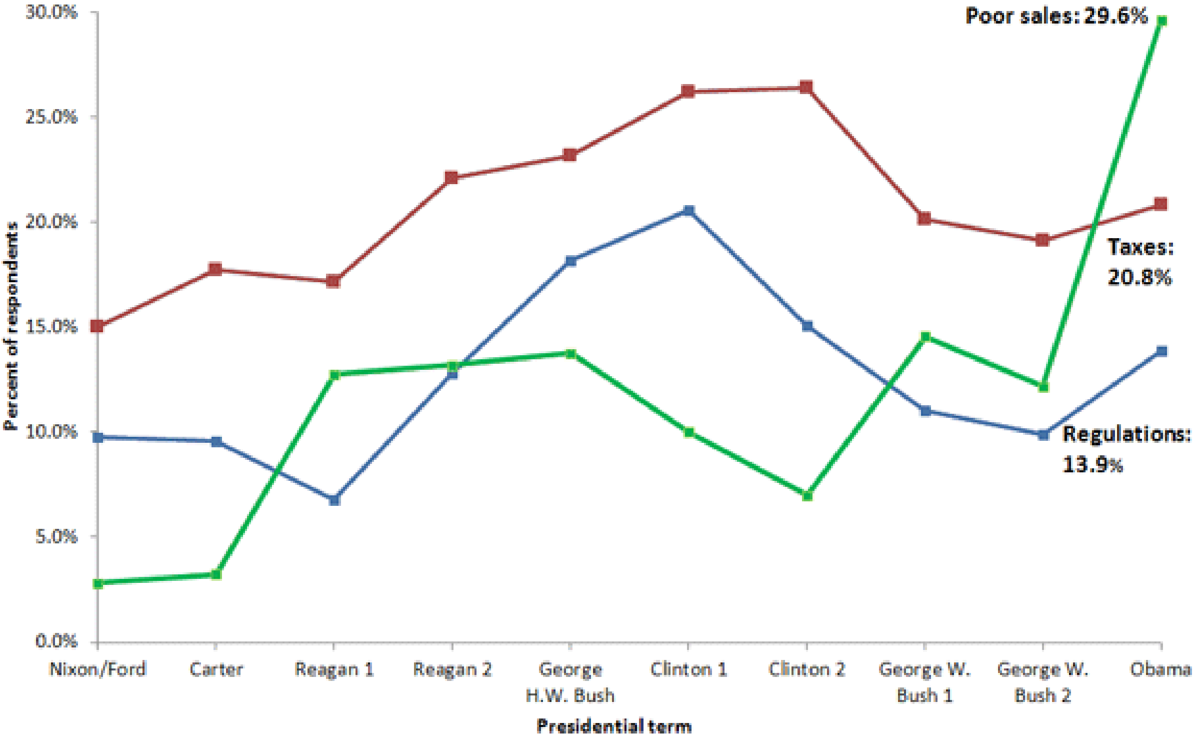
If one looks at what employers are doing rather than what the trade associations and their allies on Capitol Hill are saying, then recent employment and investment behavior is easy to explain—investment and employment/unemployment are what we would expect in a severe downturn followed by a slow growing economy in the recovery. There is no shift from historic patterns, and there does not seem to be any evidence that fears of future regulation are shaping the slow growth and weak employment gains we have seen.

## What do employers say in surveys?

What businesses (and business economists) say in private surveys also does not support the "regulatory uncertainty" mantra one hears from the D.C.-based business trade associations.

The National Federation of Independent Business (NFIB), which describes itself as "the leading small business association representing small and independent businesses," does a regular survey of small businesses. One question that has been asked since 1973, is "what is the single most important problem your business faces?" The answer choices are inflation, taxes, government regulation, poor sales, quality of labor, interest costs, health insurance costs, the cost of labor, and other matters. Interestingly, the single largest response is "poor sales," the choice of 30 percent of respondents since President Obama was sworn in (averaging the 10 quarters between early 2009 and spring 2011). In other words, *slack demand* appears to be the key concern of small businesses (**Figure D**).

***Figure D.*** **Single most important problem reported by small business, by presidential term**



**Source:** EPI analysis of NFIB small business survey data through 2011, quarter 2.

Some conservative analysts acknowledge this fact but then point out that taxes and regulation were the next highest concerns identified in the NFIB surveys—evidence, they claim, that tax and regulatory uncertainty are also preeminent. In the Obama years, some 13.9 percent of small businesses identified government regulation and another 20.8 percent identified taxes as their primary problem, the leading answers after "poor sales." Fortunately, one can obtain the NFIB's entire historical series (back to the fourth quarter of 1973) on this survey question and put the question in historical perspective, constructing the averages for each presidential term (NFIB 2011).

It turns out that small businesses have always complained about regulation and taxes and not especially so under Obama. For instance, the share concerned about regulation under Obama (13.9 percent) is not substantially higher than under George W. Bush (9.9 percent and 11.0 percent) or Ronald Reagan's second term (12.8 percent). There is also less concern about regulation under Obama than under Bill Clinton or George H. W. Bush. Recall also that there was rapid employment growth in the second Clinton term, so high concerns about regulation (which rose steadily from Reagan's first term to their highest level in Clinton's first term) are not necessarily associated with poor employment growth.

There is a similar story on taxes. Sure, there are 20.8 percent of respondents, on average, in the Obama years who see taxes as the primary problem facing their business. Yet, that intensity of concern about taxes is not all that different than under George W. Bush and is less than that reported during the first Reagan term through Clinton's second term. It is hard to find a recent spike in concern about regulations or taxes that supports the story of escalating uncertainty or fears of regulations holding back the economy.

Besides the NFIB survey of small businesses, there are two recent surveys of economists that also indicate the "uncertainty" story is baseless. First, the *Wall Street Journal's* recent survey of economists (Hollander 2011) showed that "U.S. companies are reluctant to hire—but not because of uncertainty over government policies.… A majority of the 53 economists surveyed (Izzo 2011) from July 8-13…say it is the lack of demand that is keeping hiring down." EPI's Isaac Shapiro wrote a blog post about the National Association for Business Economics' recent survey of 250 of its members, who include both academic business economists and practicing business economists (i.e., those who use economics in the workplace). According to Shapiro (2011), the survey contains the following results:

- The vast majority (80 percent) of those surveyed believe the current regulatory environment is good for American businesses and the overall economy.
- The large majority of business economists believe concerns about economic uncertainty are a proxy for generalized concerns about the bad economy. (That is, the concerns do not reflect business worries about regulation.) Few believe economic uncertainty is a major concern that is holding back economic progress.

In conclusion, when looking at both what employers are *doing* in terms of hiring and investing and what they (and their economists) are *saying* in private surveys, it's nearly impossible to make the argument that uncertainty about regulations is holding back the economy. A *Bloomberg News* (2011) editorial makes the point even more broadly:

> *"There is no doubt that certainty is generally preferable to uncertainty, in the economy as in most aspects of life….But there is no evidence that uncertainty has increased during the Obama presidency, or that, if it has, the president's policies are responsible for it…The charge of 'creating uncertainty' is a way to blame Obama for the U.S.'s economic trials without having to explain the connection."*

*With research assistance by Nicholas Finio*

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