

Why GDP Growth Has Not Provided Jobs Yet

By Brian Hamilton, Chief Executive Officer, Sageworks, Inc.

Why aren't businesses hiring? There is a lot of analysis about this, but, to get a better understanding, it may be best to work in reverse by looking at the past and figuring out what the relative strength or weakness of conditions are today and then examine which policies, if any, might work. There is always a tendency for us to inflate our perception of current economic woes since these conditions happen to be acting on us. This is especially true if there is little understanding of the past. To explain economic conditions, business pundits and politicians seem to either apply inaccurate analysis based upon little data or self-serving positions. This takes a complex issue and renders it unintelligible, making it impossible for people to plan.

For simplicity purposes, let's go ahead and accept the rough, traditional definition of a recession as when real, inflation-adjusted GDP falls for two consecutive quarters (there are other important factors in evaluating economies, to be sure). The most recent recession, before the 2007 downturn, was between July 1990 and March 1991 when real GDP fell by 1.4 percent.¹ When the economy started expanding again in March, employment did not really recover until much later, August 1993.² (It started to improve prior to August, but for the sake of this analysis, I am considering "recovered" to be within 125 percent of its original level before the recession took hold.) For example, at the end of the 1990 recession, unemployment was 6.8 percent, but it continued to rise and finally peaked at 7.8 percent in June 1992 after the recession ended. Employment didn't really recover, though, until August 1993 when unemployment dropped down to within 125 percent of the July 1990 level. The recessionary cycle lasted only eight months, but its effect on unemployment did not end so quickly. So, the lag between GDP growth and healthy employment was about two years—a long time, especially for those without jobs.

Time	Recession Duration (months)	Decline in Real GDP	Increase to Unemployment	Months Until Unemployment Peaked ^a	Months Until Unemployment Recovered ^b
Dec 2007-June 2009	18	-4.1%	5.4%	4	23+
Jul 1990-Mar 1991	8	-1.4%	2.6%	15	29
Jul 1981-Nov 1982	16	-2.6%	3.3%	0	11
Jan 1980-Jul 1980	6	-2.3%	1.8%	0	0
Nov 1973-Mar 1975	16	-3.2%	4.4%	2	33

^a These figures include months—since the formal end of the recession—that passed before the unemployment rate reached its highest point.

^b I am considering "recovered" to be at or below 125% of its pre-recession level. Again these figures include months after the formal recession ended. From the last recession, employment hasn't yet "recovered."

¹ All GDP data used herein comes from the real GDP calculations provided by the Bureau of Economic Analysis and uses chained 2005 dollars, seasonally adjusted at annual rates. The recession durations and unemployment figures use monthly figures, but the corresponding quarterly data was used for GDP, measuring peak to trough. For more information on their data, visit www.bea.gov.

² Unemployment data was mined from the Bureau of Labor Statistics and is seasonally adjusted. To access this data visit www.bls.gov.

Prior to 1990, the most recent recession began in July 1981 and ended in November 1982 according to the National Bureau of Economic Research. Real GDP measures are available by quarter at best, so conservatively looking at the change from Q3 of 1981 to Q4 of 1982, real GDP dropped by 2.6 percent. Unemployment rates during this recession peaked at the end, hitting 10.8 percent, but it did not recover for another 11 months.

Prior to 1981, there was another short recession during the early part of 1980. During that six month period, real GDP decreased by 2.3 percent, and unemployment rose from 6 to 7.8 percent. It declined slightly after this 1980 recession but was not able to improve much prior to the next recession in 1981.

And finally, the recession that occurred from 1973-75 is important to consider as well, especially given our current economy. Between November 1973 and March 1975, real GDP decreased by 4.4 percent. The effect on unemployment was worse, and it didn't reach its high—9.0 percent which was nearly double its position at the start of the contraction—until two months after the recession ended. Even then, employment didn't recover for 33 months after the recession.

Thankfully, periods of economic growth between contractions are typically longer than these periods of decline, so the economy as whole expands over time—Americans are good business people. In fact, the period after the 1990-91 recession, from 1991-2001, was the longest period of business expansion in the U.S. on record. In 2001, there were no two consecutive periods of decline, so while early 2001 was not a great time for our economy it does not meet our simple criteria for a recession.

During the most recent recession, the economy began contracting during December 2007, and real GDP dropped cumulatively by 4.1 percent before it reached its trough in June 2009. GDP began growing again that June, but unemployment did not reach its height until October, four months later. At its peak, unemployment had more than doubled, rising 5.4 percentage points to 10.1 percent in October 2009. And, since then unemployment has *very slightly* decreased; as of today, it is still elevated at around 9.1 percent—way too high.

Over the past 40 years, the average time between growth of GDP after a recession and a recovery in employment is approximately 19 months. This means that we are doing slightly worse than average, which at least gives some better perspective, if not comfort. Since this recession caused the biggest shock to employment levels, it makes some sense for recovery to take some time.

But, what to do, that is the key? Now, let's overlay some of the most important influencers on these times and see what falls out. There are three major factors outside of general economic cycles that may affect conditions in any economy: wars, domestic policy (taxes, regulation, and other government actions that might disrupt how people plan), and "externalities"—things that are specific to a time that simply throw a monkey wrench into everything. Of course, no one can know with certainty which factors have the largest effect on a particular economy, which always keeps the debate alive and interesting. For example, the 9/11 terrorist attacks probably did not have a great effect on economic conditions, but it is difficult to tell for sure.

Starting with the recession of 1990-91. During the first quarter, the Republic of Iraq invaded the State of Kuwait, and the U.S. soon intervened. More importantly, the conflict caused uncertainty about future oil supply, and the result was the 1990 oil price spike. These rising prices, combined with consumer pessimism and/or fear from the savings and loan crisis, probably caused the contraction. It is not clear why hiring took so long to recover, but my guess is that companies would not willingly increase their payroll if they were unsure about the price or even availability of oil and its impact on overhead costs.

The recessions in 1981-82 and 1980 should be considered together. GDP was able to recover during the few months between them, but the unemployment rate was elevated throughout the period. The 1970s had ended with an energy crisis, similar to the troubles we would see in 1991, but more importantly the Federal Reserve tightened the money supply, hoping to curb the high inflation from the 1970s. Some of us can remember devastating double-digit inflation and interest rates. Once those interest rates came down, the economy and hiring saw much improvement. There were fewer unknowns for business owners to incorporate in hiring decisions, which is why I think hiring was able to pick up more quickly than with other contraction periods. It is hard to tell with certainty what brought us out of this recession, but it is not hard to understand why

businesses would hire more people as a significant part of their cost structure (cost of debt/interest) was rapidly decreasing.

And for the 1973-75 recession, we can reasonably assume it was OPEC's impact on oil prices, stagflation from government spending, and the market crash in 1973 causing the recession. Without knowing how the oil pricing changes would conclude or how the market crash would recover, business owners again hesitated to add employees.

So, what does this mean for today? Why aren't business owners hiring people? Like the 1973-75 and 1990-91 recessions, why is there such a lag with job growth? I think businesses have uncertainty around oil prices, yes, but the real cause is their uncertainty about conditions and interferences with their operating environment. If not this, what else?? Interest rates are low. Inflation has largely been under control since the late 1970s. And GDP is growing, probably the most important barometer.

Beyond the fact that there will always be cycles in the economy for which no one can be blamed (You almost never hear this from the media. Bad things happen, and sometimes no one is to blame), you have to look at our friends in Washington and say that they have been so *indecisive* on the correct things (the national deficit) and so *decisive* on the wrong things (such as national health care, possible tax increases) that they are introducing fear and uncertainty into the market. Ask yourself; if you ran a business today, would you really increase your risks by hiring people? It is not a question of whether national health care is a legitimate issue; it is legitimate. It is about the timing and method with which the issue was addressed. And, unfortunately, health care is just one issue. Republicans are not exempt from criticism either. Which is in the most important, strategic interest of the United States: having jobs for people and growing the economy or waging at least two or three major military efforts, causing a major diversion of resources and mindshare? Look at the national debt: both parties *clearly* own this issue, as the national debt has grown almost consistently over decades under both parties. In fact, there is very little research on the possible effects of the deficit on hiring, which we are not even addressing here. It is common sense that operating within a country that has become almost a debtor nation cannot make you feel great about hiring people and taking risks.

Finally, at root, in the arguments, there is an almost universal misunderstanding of the 27 million businesses that create the vast majority of jobs in this country. Only about 5,000 businesses in the country are "public" companies; the rest are privately-held, run by people, who like the rest of us, worry about paying their bills, sending their kids to college, and/or saving for retirement. Privately-held businesses probably account for approximately 70% of GDP, and they create up to 80% of new jobs. So, if we accept that only these businesses can create long-lasting job growth, let's examine what the government has done for them: threatened to increase their taxes; introduced more uncertainty, cost, and administration to a large part of their income statements, namely health care; and continued to spend more money than ever, increasing the national debt and creating uncertainty around future interest rates.

It is arrogant and misinformed to simply say that "businesspeople" are "conservative" and risk-intolerant. This entirely misses the point. Most people I know who run businesses are not conservative or liberal; they are practical and need to be. The people who run businesses already operate, even without government interference, within extremely risky operating conditions, conditions that most of us would not tolerate. Most are valiantly hanging on; the average net profit margin for these companies is approximately 3.5 percent. (So, out of every sales dollar, these people are only making about four cents). If you do the math on average sales for these companies, you quickly realize that these people are not rolling cigars in \$20 bills as some members of the political establishment imply, a thoughtless supposition that stops meaningful discourse on an issue important to every American.

If you do anything to increase the operating risk of these companies or to increase their operating costs, it seems logical that these companies and people would try to control their biggest operating cost—people. If someone told you that you might lose your job next month, would you start spending more money? It is imperative that we do everything we can at a government level to add stability for these businesses and allow them to plan. If there was ever a time, now is the time for the government to step back and let free market economics work the way it has for over 200 years in America. Paradoxically, the politicians who would benefit most politically by a recovery seem bent on imposing themselves on the current system. Businesses that survived the

2007-09 recession know how the market works or should work if uninterrupted—they would not have survived the recession if they didn't. Let them take the reigns, so they can feel more confident in the market and start hiring, which history shows us they will do. *The government needs to understand that only the people who run privately-held businesses can create long run employment in the United States. Everything else is a temporary fix.* Over 200 years ago, some Americans coined the phrase, "Don't tread on me." Today, the new mantra might be "Leave us alone."

About Brian Hamilton: Brian Hamilton is the co-founder and Chief Executive Officer of [Sageworks](#). He is an original co-developer of "FIND" (Financial Information into Narrative Data), the company's core artificial intelligence technology which converts financial numbers into plain-language reports. "FIND" is the basis of ProfitCents® and Sageworks Analyst®, applications that are used today by thousands of financial institutions and accounting firms throughout North America and the United Kingdom. Brian holds an MBA from Duke University and a bachelor's degree from Sacred Heart University. He is a noted expert in finance who has been published and quoted in most major national media outlets. He is currently a guest columnist for Forbes.com. Brian also directs Inmates to Entrepreneurs, a community outreach program focused on teaching ex-offenders to start low capital businesses upon release from prison.

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