

Is Regulatory Uncertainty a Major Impediment to Job Growth?

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Recently at a Senate hearing Secretary Geithner said, “I’m very sympathetic to the argument you want to be careful to get the rules better and smarter, but I don’t think there’s good evidence in support of the proposition that it’s regulatory burden or uncertainty that’s causing the economy to grow more slowly than any of us would like.”

Economists from across the political spectrum have also weighed into this debate and reached the same conclusion. Bruce Bartlett, a senior advisor in both the Reagan and George H.W. Bush administrations, said that “[no hard evidence](#)” has been offered for claims that regulation is the “principal factor holding back employment.” And in a recent [Wall Street Journal survey of economists](#), 65 percent of respondents concluded that a lack of demand, not government policy, was the main impediment to increased hiring.

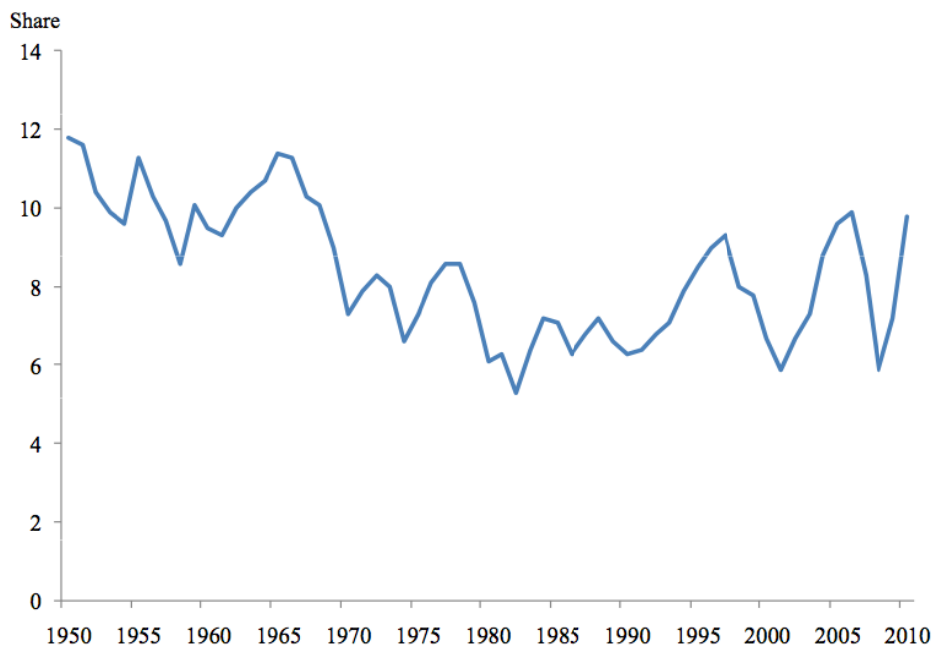
Nonetheless, two commonly repeated misconceptions are that uncertainty created by proposed regulations is holding back business investment and hiring and that the overall burden of existing regulations is so high that firms have reduced their hiring.

If regulatory uncertainty was a major impediment to hiring right now, we would expect to see indications of this in one or more of the following: business profits; trends in the workforce, capacity utilization, and business investment; differences between industries undergoing significant regulatory changes and those that are not; differences between the United States and other countries that are not undergoing the same changes; or surveys of business owners and economists. As discussed in a detailed review of the evidence below, none of these data support the claim that regulatory uncertainty is holding back hiring.

Business Profits

If regulation was a significant drag on business today, we would expect to see profits constrained after recent regulatory reforms were passed into law. However, corporate profits as a share of gross domestic income have about recovered their pre-recession peak, and earnings per share in industries most affected by recent regulatory changes, such as energy and health care, are among the highest in the S&P 500. This growth is inconsistent with a corporate sector held back by regulation.

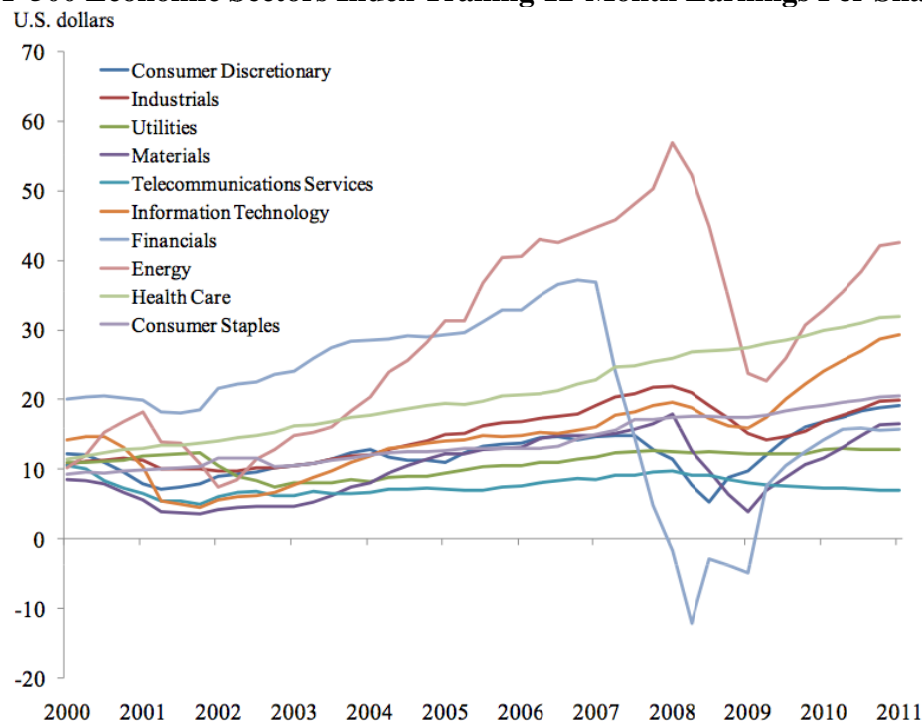
Corporate Profits as a Share of Gross Domestic Income



Note: Corporate profits with the inventory valuation and capital consumption adjustments for domestic industries.

Source: Bureau of Economic Analysis, National Income and Product Accounts.

S&P 500 Economic Sectors Index Trailing 12-Month Earnings Per Share



Source: Bloomberg

Trends in Workforce, Capacity Utilization, and Business Investment

If regulatory uncertainty was the primary problem facing businesses, firms would prefer to use their existing capacity and current workers as much as possible, while avoiding building additional capacity until they are more certain about the contours of future regulation.

Specifically, if demand was strong but businesses were concerned about future regulations, they would increase the hours of the workers they already employ rather than hire additional workers. We have seen no evidence of this in the data: the average work week for private employees has been roughly flat for the past year. Similarly, if demand were strong, firms could easily expand using existing capacity without taking on the cost and risk of added capacity. However, the share of total potential industrial output in use remains 3 percent below its long-run average. Low capacity utilization is inconsistent with concerns about future regulatory risk, but aligns with weak demand holding back current production.

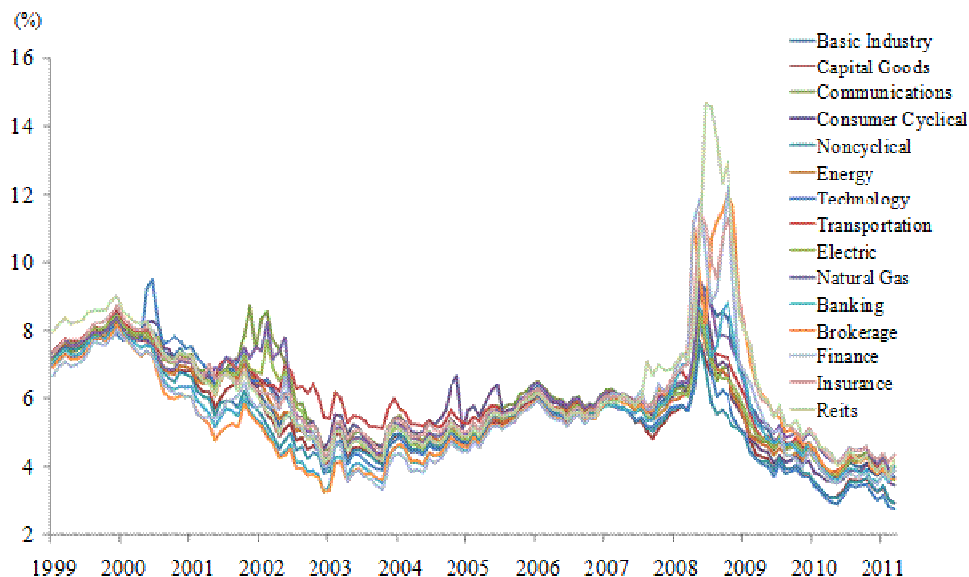
At the same time, business investment has led economic growth over the last few years. Since the end of the first quarter of 2009, real investment in equipment and software has grown by 26 percent – about five times as fast as the economy as a whole. However, businesses would not increase investment if they thought that future regulation posed a threat to their ability to operate profitably.

Financial Indicators

If regulatory uncertainty were having a significant impact on business performance, we would expect this to be reflected in capital markets. However, financial indicators do not provide any evidence in favor of this hypothesis.

As shown in the chart below, corporate bond yields are low across a range of industries, suggesting that firms in industries facing greater regulatory risk, such as insurance and energy, are not being priced out of the market. ^[1]

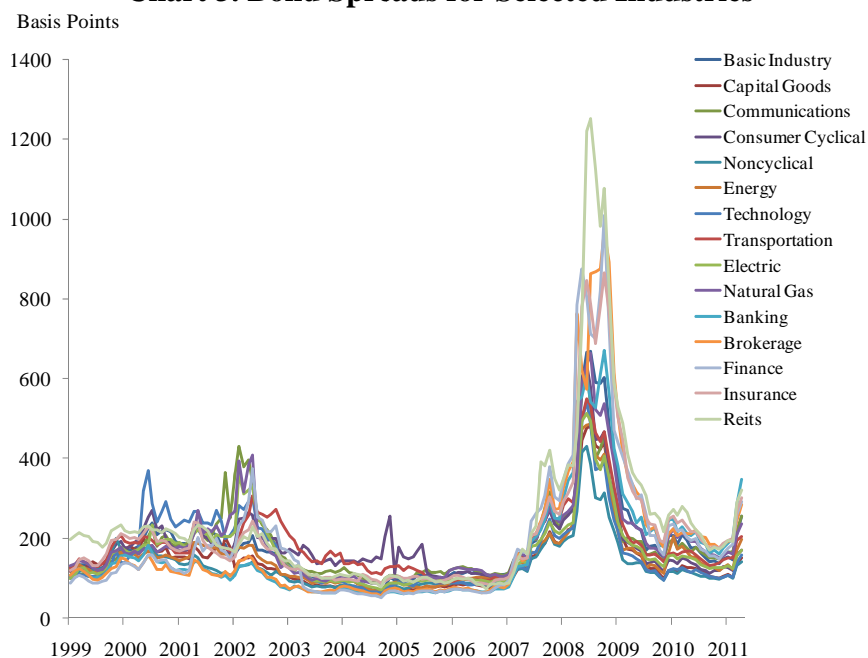
Bond Yields for Selected Industries



Source: Barclays investment grade corporate subindices, measured as yield to worst at the end of the month.

Bond spreads provide more direct information on how the market views the risk in different industries. This risk includes, but is not limited to, risk resulting from uncertainty over future regulatory action. Bond spreads shot up during the financial crisis, particularly for industries directly involved, including real estate investment trusts (REITS), brokerages, insurance, and financial firms. However, spreads moved down fairly steadily once the worst of the crisis passed, and between mid-2010 and mid-2011, spreads were compressed across industries at a fairly low level (albeit not as low as that observed in the mid-2000s). Since the summer, spreads have moved up and dispersion across industries has increased. However, the increase in spreads corresponds with an increase in aggregate uncertainty, which is likely associated with the intensification of sovereign debt problems in Europe (discussed further below). While it is true that the recent rise in spreads has been greatest in industries assumed to face regulatory uncertainty – such as REITS, Finance, and brokerages – these industries were also most directly affected by the problems in Europe. Other industries facing the possibility of additional regulation but less affected by the debt crisis – such as energy, electricity, and natural gas – saw spreads rise by less.

Chart 3. Bond Spreads for Selected Industries

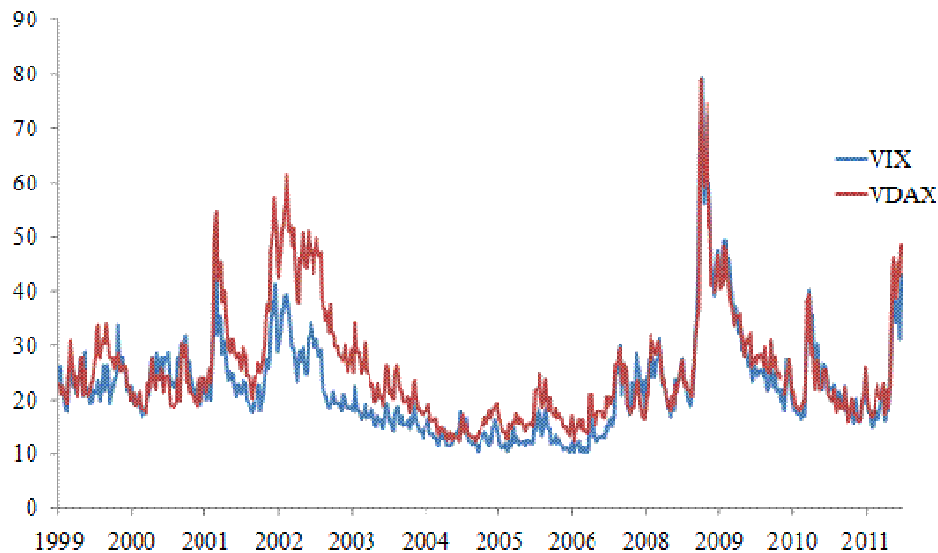


Note: Option-adjusted spread relative to nearest maturity benchmark Treasury

Source: Barclays investment grade corporate subindices

One commonly cited measure of uncertainty is the Chicago Board Options Exchange Market Volatility Index (known as the VIX), which measures the implied volatility of S&P 500 index options. For most of the past year or so, the VIX has stood only a bit higher than in the pre-crisis period, and while it rose significantly in early August, it has come down somewhat in recent weeks (see chart below). However, as can be seen, the sharp increase in the VIX in August and previous sharp increases in late 2008 correspond to virtually identical movements in the VDAX, a similar measure calculated for the German stock market. The correlation between these two indicators suggests that uncertainty in both countries primarily reflects global financial and economic conditions, rather than conditions specific to the United States, such as regulatory changes.

Stock Market Volatility in the United States and Germany



Source: VIX: Wall Street Journal/Haver Analytics; VDAX; Handelsblatt/Haver Analytics

What Business Owners and Economists are Saying

In recent surveys, business owners and economists do not list regulation as the main problem facing their business, nor do they blame regulation for job cuts:

- In the September survey of small business owners by the National Federation of Independent Businesses, more than twice as many respondents cited poor sales (29.6 percent) as their largest problem than cite regulation (13.9 percent).
- In an August survey of economists by the National Association for Business Economics, 80 percent of respondents described the current regulatory environment as “good” for American businesses and the overall economy.
- As noted above, in a recent *Wall Street Journal* survey of economists, 65 percent of respondents concluded that a lack of demand, not government policy, was the main impediment to increased hiring.
- According to data from the Bureau of Labor Statistics, less than three-tenths of 1 percent of mass lay-offs in the second quarter of this year were due to government regulations or intervention. ^[2]

A Sensible Path Forward

As Secretary Geithner noted during his recent Senate hearing, we should always be looking for ways to improve our regulatory system. That is why the President has ordered a government-wide review of existing federal regulations to create a 21st century regulatory system that protects public health and safety while also promoting economic growth and saving Americans billions of dollars. That review is ongoing and has already [made substantial progress](#) toward these goals.

These reforms will enhance the functioning of the economy and complement the increase in aggregate demand required to spur hiring and bring down the unemployment rate. Policy makers in the United States must address these fundamental concerns by putting in place a set of powerful measures to provide near-term support to the economy while restoring fiscal sustainability over the medium-term.

This report originally appeared as a blog post on Treasury Notes by Dr. Jan Eberly, Assistant Secretary of the Treasury for Economic Policy.

[1] Similarly, recent work by Jay Livingston has shown that the unemployment rates in sectors where regulation has been increasing are actually below the national average.

[2] An extended mass layoff event is defined as “the filing of 50 or more initial claims for unemployment insurance benefits from an employer during a 5-week period, with at least 50 workers separated for more than 30 days.”