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Reduced Job Creation—Not Increased Layoffs—Explains High Unemployment

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Unemployment remains stuck at 9 percent because of low job creation, not higher job losses. In fact, job losses hit a record low in March 2011. Fewer entrepreneurs are starting new companies, and fewer business owners are expanding existing enterprises. Reduced job creation entirely explains the economy's high unemployment. If job creation had returned to normal levels after the recession ended, employment would now have fully recovered.

High Unemployment. Between the start of the recession in December 2007 and fall 2009, the unemployment rate jumped sharply from 5 percent to 10.1 percent. Since then, unemployment has only slightly recovered, and the unemployment rate remains at 9 percent.

This represents the longest stretch of such high unemployment in the postwar era. While the unemployment rate was briefly higher during the 1981–1982 recession, the economy quickly recovered from that downturn. This has not happened today. The job market has recovered at a slower pace than from any other recession in the past half-century. Payroll employment remains below recession levels by 4.7 percent, or 6.5 million jobs.

What has caused this labor market weakness? The immediate answer seems obvious: job losses. Thousands of companies have gone out of business or downsized, laying off millions of workers and increasing unemployment. While this answer contains a large element of truth, layoffs and job losses are not the main reason unemployment remains high.

Job Losses Hit Record Low. The Bureau of Labor Statistics (BLS) tracks gross job gains and gross job losses at private-sector businesses. Gross job gains are the total increase in jobs at a company between quarters, and gross job losses are the total decrease in jobs.[1]

In the last quarter of 2007, private employers created 7.6 million jobs and shed 7.4 million jobs—enough net new jobs to keep unemployment steady as new workers entered the labor force. During the recession, job losses did increase, peaking at 8.5 million jobs lost in Q1 2009.

Since the recession ended in June 2009, however, job losses have fallen well below their pre-recession rates. In the first quarter of 2011 (the most recent data available), job losses hit a record low. Private employers eliminated 6.1 million positions—the fewest since the BLS began keeping track in 1992. Private-sector workers with jobs today are less likely to be laid off than before the recession began.[2]

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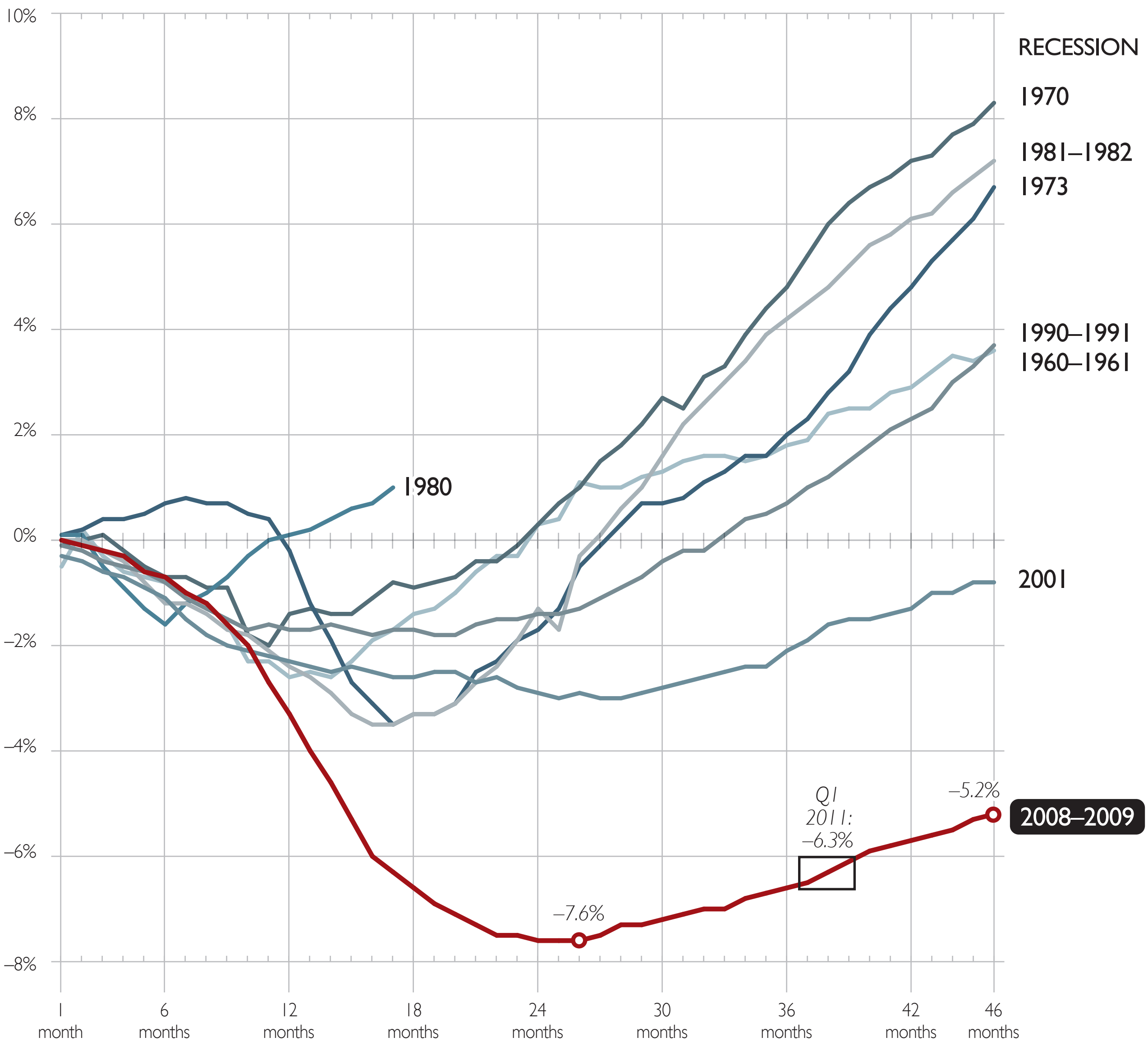
Employment Recovery Remains Sluggish

Private-sector payroll employment today is 5.2 percent lower than it was before the recession began 46 months ago. That places the current economic recovery far below all other recessions since the 1960s.

Percentage Change in Private-Sector Payroll Employment



Months Since Start of Recession

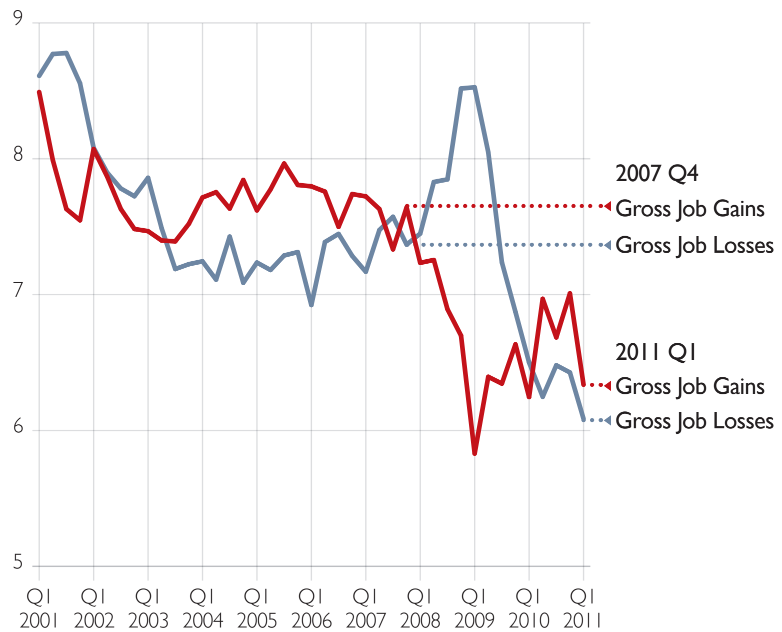
Source: U.S. Department of Labor, Bureau of Labor Statistics, "Current Employment Statistics," at *http://www.bls.gov/ces/* (November 22, 2011).

Chart 1 • WM 3422 heritage.org

New Jobs Remain Scarce

The current unemployment rate remains high due to a lack of new jobs, not due to job losses. In fact, job losses hit their lowest level since the government began keeping track in 1992. Unfortunately, new jobs are also being added at a far lower rate than a decade ago.

Millions of Gross Job Gains and Losses per Quarter



Sources: U.S. Department of Labor, Bureau of Labor Statistics, Business Employment Dynamics / Haver Analytics.

Chart 2 • WM 3422 heritage.org

Record-Low Job Creation. Unemployment remains high because job creation has fallen. From the recession's onset to the first quarter of 2009, private job creation fell by 24 percent to 5.8 million jobs.[3] That was the lowest quarterly job creation on record. Since then, job creation has only slightly recovered. In the first quarter of 2011, employers created just 6.3 million new jobs—1.3 million fewer jobs than in the quarters before the recession began.[4]

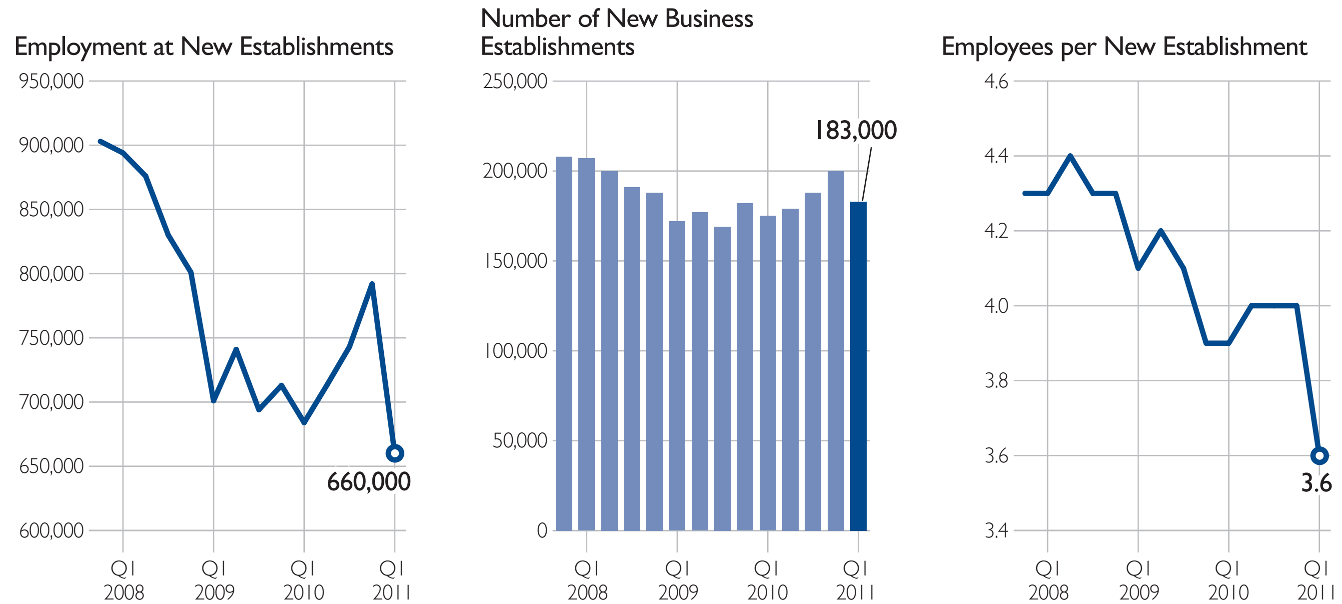
Fewer existing businesses are expanding, while fewer entrepreneurs are starting new businesses. In the first quarter of 2011, the number of workers hired in new business establishments fell to just 660,000, 27 percent fewer than when the recession began.[5] This is the lowest number of workers hired at new businesses that the BLS has ever recorded—lower even than the worst points of the recession.

The drop in hiring at new businesses has occurred because entrepreneurs are starting fewer enterprises and because they are hiring fewer workers per new enterprise. The average number of workers hired at new establishments fell to 3.6 per business in Q1 2011, also the lowest on record.

Lack of Job Creation Is the Problem. If—like job losses—job creation recovered when the recession ended, America would not face an unemployment crisis. The dark blue line in Chart 4 shows the percentage change in private-sector employment from the start of the recession. The light blue line shows how private-sector employ-

1. Press release, "Business Employment Dynamics—First Quarter 2011," Department of Labor, Bureau of Labor Statistics, November 17, 2011, at *http://bls.gov/news.release/pdf/cewbd.pdf* (November 18, 2011).
2. Heritage Foundation calculations based on data from the Department of Labor, Bureau of Labor Statistics, "Job Openings and Labor Turnover Survey." In Q3 2011, private-sector employers laid off 4.3 percent of their workforce. In 2007, the quarterly private-sector layoff rate averaged 4.6 percent, and in 2006, it averaged 4.4 percent.
3. Heritage Foundation calculations based on data from the Bureau of Labor Statistics, "Business Employment Dynamics." Figures compare gross job gains in Q4 2007 and Q1 2009.
4. *Ibid.*, comparing Q1 2011 and Q4 2007.
5. Heritage Foundation calculations using Business Employment Dynamics data. Figures compare the seasonally adjusted number of workers hired at new establishments in Q1 2011 and Q4 2007.

Employment at Startup Companies Tapers Off



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Business Employment Dynamics," at *http://www.bls.gov/bdm/* (November 22, 2011).

Chart 3 • WM 3422 heritage.org

ment would have changed if, when the recession ended in Q3 2009, job losses occurred as they actually did, but job creation returned to pre-recession levels.[6] By 2011, net employment would have fully recovered.

This is of course a hypothetical scenario. Chart 4 does not show an alternative economic history; rather, it shows that reduced job creation fully explains why America has endured prolonged high unemployment.

Focus on Entrepreneurship. The government cannot directly increase job creation. Centrally planning new businesses from Washington does not work. Government officials do not know which enterprises are likely to succeed, and political criteria inevitably take precedence over economic ones. Government industrial policies have a long record of failure—a fact highlighted by Solyndra's recent implosion.

The government can encourage job creation, however, by creating a favorable climate for entrepreneurs and investors. Research shows that potential entrepreneurs start more new companies in countries with smaller governments and lower regulatory burdens.[7] Lower taxes and non-intrusive regulations increase the return and reduce the risks of starting or expanding an enterprise.

6. That is, the figure shows private-sector employment if quarterly gross job losses occurred as they historically did and gross job gains returned to their Q4 2007 level (7.642 million) in Q3 2009 and remained at that level.

7. Ruta Aidis, Saul Estrin, and Tomasz Marek Mickiewicz, "Size Matters: Entrepreneurial Entry and Government," *Small Business Economics*, Vol. 36 (August 2010); Magnus Henrekson, "Entrepreneurship: A Weak Link in the Welfare State?" *Industrial and Corporate Change*, Oxford University Press, Vol. 14, No. 3 (2005), pp. 437–467; Christian Bjørnskov and Nicolai J. Foss, "Economic Freedom and Entrepreneurial Activity: Some Cross-Country Evidence," *Public Choice*, Vol. 134, No. 3–4 (2008), pp. 307–328; and Kristina Nyström, "The Institutions of Economic Freedom and Entrepreneurship: Evidence from Panel Data," *Public Choice*, Vol. 136, No. 3 (2008), pp. 269–282.

What If Hiring Had Returned to Pre-Recession Levels?

Percentage Change in Payroll Employment

Source: Heritage Foundation calculations using data from the U.S. Department of Labor, Bureau of Labor Statistics, "Business Employment Dynamics" (BED), at *http://www.bls.gov/bdm/* (November 22, 2011), and "Current Employment Statistics" (CES), at *http://www.bls.gov/ces/* (November 22, 2011). Note that because these figures combine figures from the BED and CES they differ slightly from the data in Chart 1, which uses only data from the CES.

Chart 4 • WM 3422 heritage.org

Washington has done the opposite. President Obama massively increased government spending and has strongly resisted attempts to reduce it. He intends to close the deficit with massive tax increases on the so-called rich—investors and entrepreneurs. The regulatory burden is also increasing, in particular regulations associated with the President's health care plan. The proportion of small-business owners reporting that government regulations are their single greatest problem has risen from 11 percent to 19 percent since March 2011.[8] Government regulations have become the second greatest problem small-business owners report facing, behind only poor sales (26 percent). The tax burden comes in third at 18 percent.

To reduce unemployment, Congress should focus on policies that foster business growth. While the government has little power to improve business sales, it directly controls the tax and regulatory burdens. Congress can and should do more to foster entrepreneurship.

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8. William C. Dunkelberg and Holly Wade, "Small Business Economic Trends," March 2010 and October 2011, National Federation of Independent Business.