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Inheriting Recessions

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Inheriting Recessions

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Three of the last six U.S. presidents have inherited a recessionary economy: Ronald Reagan, George W. Bush, and Barack Obama. Let's define "inheriting a recession" as meaning that on the date a president is sworn into office, the economy is technically still in recession or enters one within a few months. Most economists would agree that presidents have little short-term control over the economy, but that their fiscal policies can be implemented quickly and affect macroeconomic performance after the first year. Reagan, inaugurated in January 1981, actually endured a double-dip recession—one that had been raging since early 1980 and a second that hit in July 1981—but the economy experienced a strong and sustained recovery that began in November 1982 during his second year in the White House. Bush was inaugurated in January 2001, and the economy entered recession just weeks later. Obama entered office in January 2009, like Reagan, after the United States had been in recession for a full year.

All three men could fairly claim they "inherited" a recession as well as fundamental economic problems. Reagan took over a nation experiencing double digit inflation and double digit interest rates. Bush took over an economy with a manufacturing sector in freefall and a crashed dot-com financial bubble. Months later, the nation was attacked on 9/11 and Wall Street was literally smoldering for months. Obama faced a financial crisis stemming from a burst real estate bubble. However, the policy responses of the three presidents and economic results were markedly different. Reagan faced a divided Congress, whereas Bush and Obama enjoyed unified partisan control over Congress during their first 24 months in office.

Ronald Reagan worked with Democratic majorities in Congress to reform the U.S. tax code and bring down the top marginal rate from 70 to 50 percent in 1981, then further to 28.5 percent in 1986. George Bush oversaw tax reforms that cut rates across the board in 2001, which were accelerated in 2003. Barack Obama maintained the income tax structure in place by default, but has worked tirelessly to raise top marginal rates. His signature domestic policy achievements were a near-trillion dollar stimulus (debt-financed federal government expenditures) and major health care reform (which includes significant tax increases).

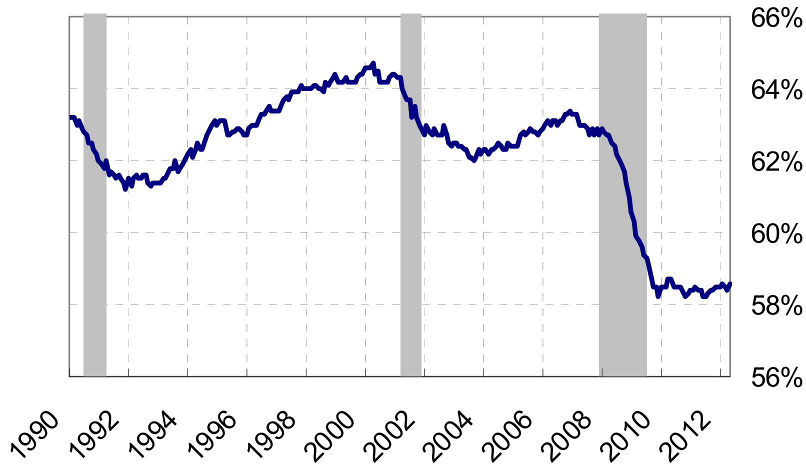
The Jobs Impact

The labor market is a coincident variable that moves up and down in tandem with the business cycle. When the economy is in recession, the labor market moves in lock step. Companies are reluctant to hire, jobless claims spike, and workers are often discouraged enough to leave the labor force. The unemployment rate is a demographically neutral measure of labor strength, unlike the count of payroll jobs which is sensitive to immigration and the age of the workforce. However, unemployment does not capture the effect of severe workforce discouragement. For a truly neutral metric, economists look at the ratio of total employment to total population, known as E-Pop.

A historical look at the E-Pop is shown in Figure 1. Since 1990, E-Pop never fell below the 61 percent level until March of 2009. It hovered around 63 percent for two decades until the 2008 shock. The E-pop ratio dropped 4.5 percentage points during the recession, and has not recovered at all in the years since. During the Obama administration, the E-Pop ratio has been stuck between 58 and 59 percent.

Figure 1. Collapse in U.S. Employment

Employment-Population Ratio (recession bars in gray)

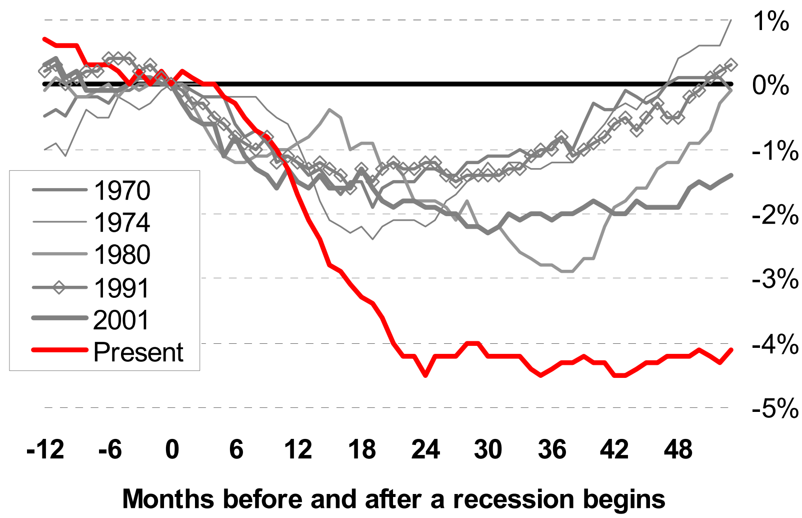


Source: Bueau of Labor Statistics, Tim Kane (Hudson.org)

To put the time series in context, Figure 2 shows the E-Pop's movement before and after a common zero reference point for the six major recessions since 1970. The typical E-Pop pattern in previous recessionary cycles is actually remarkably steady compared to the random movements often observed in most other economic data. Specifically, the E-pop cycle has normally been a 1.5 to 3 percentage point decline over the first 24-months that recovers to normal at the 48-month point. There has been literally no recovery during the Obama administration, now 54 months after the recession began. The net decline of 4.5 percentage points is indeed unprecedented, but the fact that E-pop remains 4.0 points below its recent high is astounding. Each percentage point equals roughly 3 million U.S. jobs, meaning the economy is over 12 million jobs below potential.

Figure 2. The New Normal?

Net change in employment/population ratio from recession start



Source: Bueau of Labor Statistics, Tim Kane (Hudson.org)

The historical record shows that recessions are often inherited. All presidents face different challenges with unique headwinds and tailwinds. The severity of the 2007-2009 recession was uniquely large. On the other hand, no president enjoyed the tailwind of loose monetary policy on the scale provided by Bernanke's Federal Reserve, nor the massive debt-financed government stimulus that continues to this day. As for unique challenges, no presidents aside from Franklin Roosevelt and George Bush suffered attacks on American soil like Pearl Harbor and 9/11. Certainly the current Federal Reserve supportive policies are a sharp contrast with what Reagan faced.

As for policy actions, no other president since Herbert Hoover in 1932 responded to a recession by raising taxes as aggressively as Obama. The results to date confirm that the high-tax, high-spend policy approach is failing to generate a real recovery, and worse, has created a new normal that is 12 million jobs below the old normal.

About Tim Kane

Tim Kane is the Chief Economist at Hudson Institute and Founder of the social networking firm, StoryPoint. Kane's research on entrepreneurship and job creation has been widely cited, notably in the 2011 Economic Report of the President. He has served in multiple executive and scholarly roles at think tanks and universities. Kane's forthcoming book *Bleeding Talent* (Palgrave Macmillan) will explore entrepreneurial leadership in the U.S. military.

Previously, Kane was a Senior Scholar at the Ewing Marion Kauffman Foundation, where he established the *growthology.org* blog and initiated the annual Economics Bloggers Forum. Kane organized a quarterly survey of top economics bloggers, which he continues to produce as a Hudson Institute report.

Kane's commentary has appeared in the New York Times, USA Today, and other outlets. He often provides analysis on CNN, CNBC, ABC, NBC, CBS, FOX, MSNBC, Bloomberg, and PBS' Nightly Business Report. With a track record of successful entrepreneurial startups, his research on job creation has been widely cited.

The former Director of International Economics at The Heritage Foundation, Kane was the lead author of the Heritage/*Wall Street Journal* "Index of Economic Freedom." As a former intelligence officer in the U.S. Air Force, he served two tours of duty in Asia. Kane earned a bachelor's degree from the U.S. Air Force Academy and a doctorate in economics from the University of California San Diego.

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