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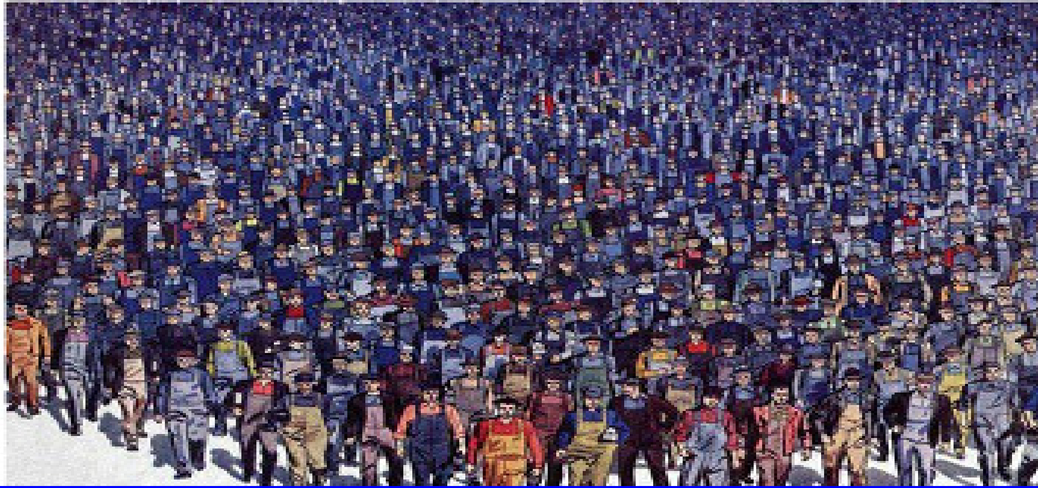

Employment Condition Trends Outlook

2013

A Collection of Contemporary Essays

Employment Condition,
Trends & Outlook

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By

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2013

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Executive Summary

The Great Recession as it has come to be known was declared over in June 2009. Nevertheless, the economy is still struggling to recover and remains in the throes of a recovery that is the slowest of the 11 recessions since World War II and possibly the slowest since The Great Recession of the 1930s.

The economy created only 157,000 jobs in January 2013. That is not much more than the number of jobs necessary to cover the nation's rising population and new entrants into the work force. It is surely not enough to measurably drive down the nation's unemployment rate of 7.9%. It has stubbornly clung to the 8±% level for the last 50 months and there are no signs it will decline measurably over the short term.

Many, if not most of the job losses driven by the Great Recession have been structural rather than cyclical. Most historical recession related job losses have been cyclical and, when graphed, the recovery was "V" shaped. Typically, when a recession ended and industries recovered, workers were called back. Not this time. The pattern of recovery began to change following the recession of the early 1990s. The reasons are varied but technology has been chipping away at payroll employment, especially manufacturing, for decades.

Today, we also have some self inflicted employment wounds created by actions of the government in the form of sequestration, healthcare, regulation and more.

As if recession driven employment were not enough, the nation is experiencing a "birth dearth" together with a simultaneous decline in immigration. For economists and policy makers, that begs the question "who will support large numbers of baby boom retirees" going forward?

Unemployment has taken a huge toll on the collective psyche of the nation. Those who have become unemployed, often stay unemployed longer than at any time in history. Indeed of the 12.3 million unemployed

Americans (January 2013) nearly 40% of them have been unemployed long term. The average duration of unemployment is now a record breaking 35 weeks. During long periods of unemployment, persons often see their skills erode and sometimes experience depression, health, marriage and relationship problems. Children are too often severely affected. In addition to the personal and family tragedy of job loss, there is also a huge impact on neighborhoods, communities and of course, the broader economy.

A large number of our readers are real estate appraisers. With that in mind, we have included a little information about that profession.

Small business has historically been thought of as the engine of the economy. This time is different. Small entrepreneurs are not currently bringing new jobs to the economy in the numbers they once did. Hopefully that will change as recovery is energized. If not, the scourge of slow recovery is destined to continue.

So who is creating jobs? The services sector will lead the way and a big part of that will be housing due to its huge multiplier effect.

We hope you find this short series of essays insightful and useful.

All the Best …

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The Current Employment Condition

In January 2013, the economy experienced a net gain of 157,000 jobs. The unemployment rate inched up to 7.9. January was another in a seemingly endless string of mediocre job reports. The back-story, however was more important. November and December job gains were revised up and annual benchmark revisions showed stronger gains than originally reported.

The January 2013 employment situation report offered up a mixed view of the U.S. labor market. Payroll employment grew by 157,000 jobs over the month. The private sector added 166,000 jobs while state and federal government shed 9,000. At first blush, January looks like another in a long line of mediocre job reports. The bigger story, however, is the revisions for November and December as well as the annual benchmark revisions which showed more jobs having been added than originally reported throughout most of 2012. November payroll growth was revised up to +247,000 (from +161,000) while December was revised up to +196,000 (from +155,000).

The Bureau of Labor Statistics also performs an annual "benchmark revision" wherein the original monthly estimates for the previous year are revised using the full universe of data from the employment tax system. The level of non-farm payroll employment in March 2012 was revised up by 424,000 jobs (not seasonally adjusted) or +0.3%. All in, the increase to last year's payrolls was a highly significant +747,000 with a total of 600,000 jobs having been created in the last three months. That is a revised average of 200,000 new jobs per month since November. On average, payrolls increased by about 181,000 jobs monthly over the last year rather than the 153,000 average monthly gain previously estimated.

As a result, 2013 is beginning with a little stronger employment foundation than originally thought. Nevertheless, the job market still faces widespread uncertainty and significant negative pressure.

Returning to the January numbers, the 157,000 net gain is underwhelming. By sector, health care continued its string of monthly job gains. Growth in ambulatory health care services such as physician offices and outpatient care centers grew by 28,000 jobs. That was partially offset by a modest loss in employment at residential care facilities resulting in a net gain of 23,000 jobs. The sector has added 320,000 jobs over the last year.

Employment in construction increased by about 28,000 jobs. The gain was almost equally divided between residential and non-residential specialty trade contractors. Since its trough in January 2011, the sector has added 296,000 jobs with about one-third of that gain occurring in just the last three months. The recent gain is largely the result of the housing sector beginning to rebound. Nevertheless, the construction sector remains about 2.0 million jobs below its peak level in April 2006 at the height of the housing bubble. Going forward, we expect the sector to continue to grow steadily but modestly as housing, particularly new construction, continues its slow but steady recovery.

Service providing industries added about 130,000 jobs during the month. The gains were spread among a wide variety of industries. Retail trade also added about 33,000 jobs. Clothing stores led the way among retailers. That seems unusual given the weakness in consumer spending. The sector also lost 8,000 temporary workers. While the loss is typical in January as seasonal employees are released, the number is high by historical standards. It is unclear at this writing whether retailers over-hired in anticipation of stronger holiday sales; are anticipating slower sales going forward or are dealing with the requirements of the affordable healthcare act.

Employment in wholesale trade rose by 15,000 jobs in January. The gain was largely in the non-durable goods component (consumables). The sector has added about 291,000 jobs since its cycle low in May 2010. At the same time employment in manufacturing, financial activities,

professional and business services and leisure and hospitality were essentially unchanged over the month.

Transportation and warehousing declined. Couriers and messengers lost 19,000 jobs following strong seasonal hiring in November and December. That seasonal pattern of growth followed by decline is typical.

The government sector lost 9,000 jobs in local and federal government in January. Over half of the jobs lost were in public education. Total government payrolls have contracted by 74,000 jobs over the last 12 months. Most were in state and local government. The contraction is slowing and we expect the burden of job losses to shift to the federal government this year as sequestration takes a currently uncertain toll on defense and other federal government spending.

Total payroll unemployment was essentially unchanged at about 12.3 million in January. Those unemployed long term, which by Bureau of Labor Statics definition is 27 weeks or longer was essentially unchanged at about 4.7 million persons or 38.1% of the unemployed population. Those working part time because their hours were reduced or they could not find full time employment remained at about 8.0 million workers. Those marginally attached to the workforce fell by 366,000 as compared to a year earlier although the total is still elevated at 2.4 million persons. That category also includes 804,000 discouraged workers which is a category of workers who have given up looking as they believe there is no job available for them. These categories total 22.7 million and represent the approximate number of Americans who are unemployed or under-employed.

The **unemployment rate** in January inched up 0.1% to 7.9%. Among the major worker groups, both adult men and adult women (age 20 and over) experienced an unemployment rate of 7.3%. The teenage unemployment rate (age 16-19) was 23.4%. By race or ethnicity, whites experienced a 7.0% unemployment rate while blacks experienced 13.8% and Hispanics experienced 9.7%. By educational attainment, those with less than a high school education experienced 12% unemployment. With a high school diploma, unemployment dropped to 8.1%. It dropped further to 7.0% with either some college or an associate degree and to

3.7% with a Bachelor's degree or higher. All rates are seasonally adjusted by the BLS.

The nation's official unemployment known variously as the headline unemployment rate or the U-3 measure was 7.9% in January. It has hovered at or near eight-percent for the last 50 months and there are no leading indicators to suggest the rate will decline significantly anytime soon. Moreover, the rate may even be deceptively low as it does not account for more than 5.0 million persons who have left the labor force since the technical end of the Great Recession in June 2009. The headline rate also does not account for persons moving from full time to part time employment. Indeed the raw number of jobs may rise even if full time employment declines but part time employment rises.

The better measure in our view is the so-called *U-6 measure of labor underutilization* as it offers a more comprehensive look at both unemployment and underemployment. The U-6 starts with the official unemployment rate (U-3) then adds discouraged workers (sum = U-4), then adds all other marginally attached workers (sum = U-5) and finally adds involuntary part time workers resulting in the U-6 measure. The BLS asserts that the U-6 is not truly an "unemployment" rate as it includes some who are working such as the involuntary part time workers. Indeed, that is correct. It does, however, more precisely measure the effect of underemployment including those persons involuntarily moving from full time to part time. This issue will take on more significance going forward as more companies shed full time workers in favor of part time workers to avoid the need to provide health care benefits under the Affordable Care Act which is in the early stages of implementation.

The U-6 measure of labor underutilization in January was 14.4%. It has been stuck at that level (±) throughout most of the current post recession period making this the slowest employment recovery following any recession since World War II.

The nation's **labor force participation rate** was 63.6% in January. That is the lowest participation rate since 1981; some 32 years ago. It was 65.7% when the recession technically ended in mid 2009 and was also

higher than the current rate throughout the last four recessions. Some will pass off the extraordinary low participation rate as more baby boomers retiring and leaving the labor force. According to the non-partisan Congressional Budget office, however, an aging and retiring population explains only about one-third of the downward change. The balance is the product of a troubled economy where Americans cannot find full employment. The employment to population ratio was 58.6% in January. It too was unchanged.

Looking forward at employment. The short term future for employment is mixed. While growth is far from robust, housing appears to have turned the corner. After being a drag on economic growth since the bubble burst in 2007, housing is now contributing positively. We expect that trend to continue and with it will come additional jobs. While new home construction and sales are far from robust, permitting activity, construction starts and sales have all risen and the multiplier effect of creating jobs in allied industries is significant.

On the down side, the labor force faces several new challenges this year. By some accounts, the economy could lose one-million jobs if Congress and the President fail to change the law that will make sequestration a reality in March or soon thereafter. Federal government spending cuts are already being felt. In addition, small businesses are being squeezed by slow economic recovery together with the effect of higher taxes plus the effect of the Affordable Healthcare Act. Indeed, small businesses are not creating the number of jobs they did during previous recoveries and that is clearly slowing the current recovery.

Notwithstanding the January payroll data revisions, we expect monthly job creation to remain in the 150,000 range for most of 2013. That will be enough to support population growth and new work force entrants but it is not likely to push the unemployment rate down measurably.

Employment Dynamics to Watch

Unemployment takes on more structural characteristics rather than cyclical thus contributing to more uncertain and volatile employment dynamics.

The Great Recession, as it has come to be known, profoundly changed the nation's employment sector. Today, nearly four years after the recession was declared over, employment and the broader economy still struggle to recover. The reasons, which are not at all obvious are both many and diverse and range from structural changes in employment dynamics, the darker side of technology, fiscal policy, law, regulation and much more.

Job losses during recessions. Have usually been cyclical and, when graphed, they resemble a "V" shape. Historically, jobs were lost then the economy or industry recovered and employees were rehired either by the same company or at least in the same or allied industries. That was the pattern throughout eight of the eleven recessions since World War II. That pattern began to change following the recession of the early 1990s. While the losses were not particularly deep, the "loss curve" flattened and it took about 32 months to recover. That is far longer than historical recoveries. The same pattern repeated itself following the relatively mild recession 10 years later in the early 2000s. It took about four years to recover lost jobs and during the recovery, wages stagnated. Enter the 2007 Great Recession. Job losses were much deeper than at any time since The Great Depression of the 1930s and have still not recovered.

The common element throughout the three recent recessions is technology. While technology has been chipping away at employment for decades, its effect became most pronounced in the early 1990s and, in our view, that was the leading cause of the shift from cyclical to structural job loss. Moreover, from the three most recent recessions, it has become apparent that many jobs — especially at lower levels — probably will not be replaced. Technology now does what people might

have historically done. That means that to remain employed, many Americans must upgrade their skills and learn new ones. Retraining has become a huge need as has the need to better educate our children and better prepare them to compete in a more technological global economy. Workers are no longer mindlessly assembling so-called widgets. Robots now do that but people run the computers that run the robots and that takes an entire new skill set which goes far beyond the rote task of assembly.

As the economy recovers, global competition and skill based technological change will drive worker skill requirements even higher. If the level of educational achievement does not keep up — and it has not for nearly four decades — many workers will be left behind, wages will stagnate, long term unemployment will rise and wage inequality will widen further thus increasing the structural unemployment rate even more. Moreover, America's well recognized innovation advantage will suffer. A depressing sidebar is that the median wage for men with only a high school education has declined an inflation adjusted 46% since 1970. If that trend continues, the effect will ripple through the broader economy inhibiting spending. It may also lead to a widening gap between the wealthy and middle class and perhaps lead to cultural changes and even unrest such as we have seen in several European companies in recent years.

Duration of unemployment is another unwanted trend of recent vintage. Today, the average duration of unemployment has reached a disturbing 35 weeks which is the longest it has ever been. The longer someone is unemployed, the more their skills are likely to deteriorate and the less likely they are to find a comparable new job. The back story here is that many employers are reluctant to hire the long term unemployed and that is clearly exacerbating an already difficult employment recovery.

The nation's employment problem is exceedingly complex and certainly defies easy or traditional answers. Much of the traditional reasoning and rules of thumb no longer apply.

Sequestration & Healthcare Reform:

Fiscal policy, law and regulation weigh heavily on private industry and may delay employment recovery.

The Great Recession as it has come to be known profoundly changed the nation's employment dynamics. Today, nearly four years after the recession was declared over, employment and the broader economy still struggle to recover. In addition to recession related employment difficulties, the sector faces what can only be described as self-inflicted wounds; in other words, those created directly by fiscal policy, law or regulation. The following is a brief look at two emerging trends — sequestration and healthcare — that may soon trigger adverse economic consequences.

Sequestration, an odd government term used to describe automatic spending cuts agreed to by law after the so-called super committee failed in 2011, will likely have a profoundly negative effect on employment, especially in the defense sector where the automatic cuts could total some $600 billion. Sequestration was originally scheduled to kick in on January 1st however Congress and the President, as part of the fiscal cliff law passed quickly over the New Year's holiday, booted implementation down the road until March1st; a date that is now rapidly approaching. Unless, changed very significantly, sequestration may profoundly and adversely affect federal spending, employment, consumer spending and the broader economy. A recent study commissioned by USA Today, estimated that the steep defense cuts alone could eliminate one-million jobs. Those are direct cuts but the multiplier effect would be greater and would ripple through the broader economy.

Indeed, the anticipated effects may be showing up already. After a huge increase in federal spending in the third quarter of 2012 that contributed to unusually high GDP growth (+3.1%), defense spending declined 22% in the fourth quarter leading the GDP into negative territory (-0.1%).

The requirement to provide healthcare benefits or face fines under the **affordable care act** (also known as Obamacare) is weighing heavily on many small businesses and even large employers of modest wage workers. Historically, it was the employers' option to provide benefits to employees and the employees' option to accept or reject employment without benefits. Going forward, however, healthcare benefits will be mandatory for employers of 50 or more full time workers. Firms with fewer than 50 full time workers are exempt. New Treasury Department rules released in early January give employers until June 30th before their staffing levels begin to influence the fines they may incur beginning in 2014 for not providing legally required healthcare. Those fines could be as much as $3,000 per Obamacare subsidized worker. Since the law exempts part time workers, which is defined in the law as those working fewer than 30 hours per week, the obvious strategy for some employers is to make more employees part time.

The effect of that strategy showed up in the January Employment Situation Report. The report showed that the number of payroll employees rose by 32,000 while the total hours worked actually declined. Indeed, the retail work week declined in January to 30.1 hours. Looking back further, aggregate hours worked was lower than it was a year ago even though the number of workers has increased by some 200,000. At the same time, the number of involuntary part time workers, which had been slowly declining in recent years, recently increased again by 212,000. While these changes are barely enough to move the needle at the macro level, they are significant at the firm level and will almost certainly grow over time.

Looking forward, we expect the trend toward part time employment to continue, especially in the retail sector which is the most likely sector to have large numbers of modestly paid workers. The cost of healthcare compliance; or fines for non-compliance, is significant and clearly enough to break many firms. This is another trend that will have a lengthy and profound effect on employment dynamics.

Economic Impact of the U.S. Birth Dearth

The nation's birth rate and immigration have both declined concurrently to record low levels thus weakening the U.S. demographic advantage and raising the important question "Who will support all the newly minted retirees

According to the Census Bureau , the U.S. birth rate declined in 2011 to the lowest level ever recorded. It was led by a steep decline in births to immigrant women since the beginning of The Great Recession .in late 2007. In 1990, immigrants were about eight-percent of the U.S. population. Twenty years later, in 2010, they represented about 13% of the population. During that period, births to U.S. born women, which were about 3.5 million in 1990, remained the same or declined each year until 2010. By contrast, births to immigrant women numbered about 646,000 in 1990. They increased each year until 2007 when births peaked at 1.1 million. Over the entire 20 year period, births to immigrant women grew by more than 44%. Immigrant mothers accounted for 23% of U.S. births in 2010. That is up from 16% in 1990 but down slightly from the 25% peak experienced from 2005 – 2007. The bottom line is that births to immigrant women rose continuously for 17 of the 20 year period while births to U.S. born women stayed the same or declined each year.

The overall U.S. birth rate, which is measured by the annual number of births per thousand women of child-bearing age between ages 15 and 44, declined 8% between the onset of the recession in late 2007 and 2010. The birth rate for U.S. born women declined by 6% while the rate among foreign born women declined 14%; more than double. Additionally, according to preliminary data from the National Center for

Health Statistics, the overall birth rate in 2011 was 63.2 births per 1,000 women of child bearing age. That is down from 71 as recently as 1990 and is the lowest since at least 1920; the earliest year for which data are available.

For historical perspective, the total U.S. birth rate peaked during the height of the post World War II “Baby Boom” at 122.7 births per 1,000 in 1957. The rate stabilized after that at 65-70 births per 1,000 until it fell coincident with the onset of the Great Recession in 2007. To make demographic matters even worse for the U.S., net immigration also began falling around the same time as did the U.S. labor force participation rate.

The cause of this demographic perfect storm is largely economic. When jobs became scarce in the U.S. and unemployment rose coincident with the Great Recession couples deferred marriage and family or household formation. Additionally, potential immigrants had less reason to come to the U.S. Even older Americans began retiring or dropping out of the work force causing the labor force participation rate to decline to its lowest level since the early 1980s (currently 63.6%).

The effect is severe. At one time, the U.S. had rising births and strong immigration. The country was economically able to meet the many challenges of an aging population and the pension, social security and healthcare needs aging brings with it. It no longer has that advantage. Moreover, the shifting population dynamic has also weakened the country’s ability to sustain an innovation edge.

Looking forward, if the current trends in births and immigration continue, the U.S. will not have enough younger persons to support the needs of the aging population and the nation’s innovation edge may remain impaired. The bottom line is the U.S. (perhaps surprisingly) needs more people. If they don’t come from a reversal of the birth rate trend, they will need to come through more, not less, immigration. That promises to be a difficult political battle.

Social Impacts of Long Term Unemployment

Joblessness weighs on individuals, families, communities & the nation's collective psyche. Are Europe like conditions in our future?

The Great Recession technically ended in mid-2009. Recovery since then has been slow, uneven and oftentimes painful. The recession and slow recovery have ravaged the nation's labor force. Over 12 million Americans were unemployed in November 2012. Another 8.2 million were working part time because they couldn't find full time employment. Still another 2.5 million were marginally attached to the work force and another 979,000 were discouraged workers who believe there is not a job available for them. Add them up and 22.7 million Americans are either unemployed or under-employed. The November headline unemployment rate of 7.7% suddenly soars to an under-employment rate of 14.4% — nearly double the headline rate.

Unlike most other recessions, many, if not most, of today's job losses are permanent rather than cyclical. Many people are not likely to be called back to the positions they left and that may mean a need for re-training at best or long term joblessness — and its consequences — at worst. As of November, over 40% of the unemployed, some 4.8 million people have been unemployed long term which, by BLS definition, is more than 27 weeks. That is among the highest rates since 1948 when the Bureau of Labor Statistics began tracking that demographic.
The U.S. labor market remains in a hole over 4.4 million jobs deep. That is approximately the number of jobs that still need to be created to bring the unemployment rate down to its pre-recession level of around five-percent. Through good time and bad, the nation's unemployment rate has averaged 5.7% since 1948 although it appears likely that the post-Great Recession rate will pose a new normal. Economist Edmund Phelps, who won a Nobel Prize for his work on the natural rate of unemployment, estimates that the new floor for unemployment will be

between 6.5 and 7.5%. While the recession has loosened its financial grip, the scars on the nation's psyche — and on millions of Americans — will remain evident for years, even after the economy recovers. While the labor market will recover, unemployment and *under*-employment are likely to remain permanently higher than historical norms.

Sociologists, behavioral economists and others have been studying the effects of long term employment on individuals and society for years. Several trends are evident and effects of long term unemployment are well documented.

According to the Bureau of Labor Statistics, 23.7% of teenagers, 16-19 years old (male and female) are unable to find jobs. Prolonged joblessness has left many idle and discouraged. Instead of becoming productive citizens, the start of their most productive and innovative years has been postponed by the recession. They are unable to learn the life skills so critical to becoming responsible and self sufficient adults. Faced with long term unemployment, they quickly lose their youthful enthusiasm and the "*I can do anything I set my mind to"* attitude many have and parents often instill in their teenagers. Household formations have declined throughout the U.S. Marriage and parenthood are being delayed by the slack economy in general and the mediocre employment situation in particular. Additionally, according to Pew Research, growing numbers of young adults are moving back with their parents.

Even newly minted college graduates are feeling the pain of prolonged unemployment. Evidence shows that young people who do not develop strong roots in the labor market within a year or two of graduation have difficulty righting themselves. They also face competition from new classes of graduates who do not need to explain the absence of employment soon after graduation. Long term and widespread unemployment often have profoundly negative human, interpersonal and social impacts. Unemployment always affects individuals but too often it affects marriages, children, relationships, inter-generational relationships, communities, innovation and more. The following is a look at several significant impacts.

Krysia Mossakowski, a sociologist at the University of Miami discovered

that people who have long periods of unemployment in their late teens and early 20s are more likely to develop long lasting changes in behavior and mental health. They are far more likely to develop a heavy drinking habit (defined by Mossakowski as five or more alcoholic drinks daily). They are also more prone to experience serious bouts of depression in middle age according to Mossakowski. If this era of high and prolonged unemployment continues much longer, it has the potential to alter the life course of a generation of young adults and quite possibly the generation behind them due to the indelible impact of the experience.

The impact of The Great Recession has fallen squarely on young men theoretically about to embark on higher education or enter the workforce. Over 31% of young men 16 and 17 years old were unemployed at the end of November. That rate stays above 23% through the teenage years and over 12% through the mid 20s. Women have fared better with unemployment 5-7% lower than their male counterparts in nearly every age cohort.

Moreover, men of all ages suffered roughly three-quarters of the 8.0 million recession driven job losses since 2008. Industries that tend to be male dominated such as construction, finance and manufacturing have been especially hard hit while female dominated employment, including education and healthcare, held up better. It would not be unreasonable to expect that women may dominate the U.S. work force within the next few years.

This trend is not new but it has intensified. Manufacturing employment growth has been flat since the 1970's. Over time, construction became the "new manufacturing" and now it too has crashed coincident with "The Great Recession." The faux demand for housing and commercial real estate during the boom era of the middle 2000s created thousands of construction, finance and real estate related jobs. Today, many of those jobs have been eliminated and won't be replaced anytime soon. The demand drivers are simply not there and are not likely to return for perhaps a decade. Even with the mid decade boom years, the 2000's were a lost decade for employment overall and this decade is shaping up in the same fashion. During the 2000s, percentage job growth was negative (-0.8%). While the U.S. population grew by 30 million, the

economy created a mere 400,000 jobs.

Social consequences of long term male unemployment. In addition to the economic impact, the high level of male dominated long term unemployment often has severe personal consequences. Jacksonville, Florida based biological psychiatrist, Herbert Wagemaker, M.D. commented that "long term unemployment often leads to a loss of identity followed by hopelessness and helplessness." "That in turn makes men susceptible to alcohol or drug abuse and to serious depression." Unlike women, men tend to identify themselves with what they do rather than who they are. "Men are more prone to depression but ironically they are treated less frequently than women," he added.

The body of knowledge on this subject is lengthy. Some forty years ago, Glen Elder, a socialist at the University of North Carolina discovered consistent traits among men (but not women) who suffered hardship by prolonged unemployment during the Great Depression when they were in their 20s and 30s. Elder wrote that these men came across as "beaten and withdrawn," "without ambition, direction and confidence" in themselves. Men who did not experience the same early adult life difficulties and unemployment rarely displayed such traits.

More recently, in Japan, researchers from the *Productivity Center for Socio-Economic Development* reported that workers who began their careers during Japan's lost decade of the 1990s and are now in their 30s make up six out of 10 cases of depression, stress and work related mental illness.

Physical health also tends to deteriorate during periods of unemployment. That is most likely the result of inadequate financial resources for healthcare and greater emotional stress. Till Von Wachter, an economist at Columbia University and Daniel Sullivan of the Federal Reserve Bank of Chicago recently studied mortality rates of young men who had experienced periods of unemployment during the 1970s and 1980s. Their study concluded that life spans of workers who had lost their jobs in their 30s were shorter than those who had lost a job later in life and about 1.5 years shorter than those who had never lost a job.

Researchers have also long studied the impact on children caused by a long term parental job loss and discovered that a job loss is not a short term singular event but rather an event that will have long term emotional, and economic consequences which are often carried from one generation to the next. Even generational income can be affected. In a 2005 research paper by Marianne Oreopoulos and Anne Stevens published by the National Bureau of Economic Research (NBER), the researchers discovered that a father's job loss had not only current generational consequences but the next generation had earnings some 9% less than similar children whose father did not experience a job loss.

Innovate or stagnate. The U.S. has a long and storied history of leading the world in innovation. Not including the current recession, the nation has endured 10 recessions since World War II. The average duration was 10 months; the average employment decline 2.7% and the average jobless rate increase was 3.2%. The Great Recession has been like none of the post war down turns. Many economists (including the writer) believe the recession in Florida and other sunbelt states actually started as much as a year earlier. Moreover it has been twice as severe as measured by GDP, job losses and the jobless rate.

This recession has had a profoundly negative impact on innovation. Not only has the downturn been severe, it has been accompanied by a credit crisis and the near collapse of the U.S. financial system in late 2008, the effects of which linger to this day. The severity plus the combination of events has constrained both university level and private research and development which are likely to have a long term adverse effect on the broader economy.

Fiscal Cliff & Affordable Healthcare Laws

The economic impact is coming into sharper focus and it's not a pretty picture

The combination of the newly enacted fiscal cliff legislation, formally known as *"The Tax Payer Relief Act of 2012"* and *"The Patient Protection and Affordable Care Act"* known commonly and perhaps pejoratively as Obamacare has triggered a tsunami of new taxes. The total impact appears to be around $264 billion this year alone making 2013 significant for delivering one of the largest one-year tax increases in American history. And we're only 10 days into the new year.

We wrote about the fiscal cliff legislation almost immediately after it was signed into law. As is usually the case the devil is in the details and now those details are beginning to emerge. The math is simple. Key provisions of the so-called Bush tax cuts are eliminated by the new law thus generating about $39.5 billion each year for the next decade. The expiration of the so-called payroll tax holiday will create another $160 billion in taxes on average each year for the decade and the Affordable Care Act will add another $41.8 billion in taxes for each of the next 10 years.

While the number crunching continues, the tax impact of the 157-page *American Taxpayer Relief Act of 2012* is coming into sharper focus. In 2013, new tax revenues will include:

- **$160 Billion Hike in Payroll Taxes.** This is the result of the expiration of the payroll tax "holiday." It increases the payroll tax (FICA) that helps fund Social Security. The tax is increased from 4.2% to 6.2%. Some news outlets have incorrectly reported that as only a 2% increase. Actually, it is a two percentage point increase which translates into a 47.6% increase. Moreover, the non-partisan Tax

Policy Center estimates that this increase will hit lower and middle income taxpayers hardest on a percentage basis.

- **$39.5 Billion in Income Tax Rate Hikes.** The so-called Bush tax cuts expire on high income earners. Such earners who make more than $400,000 ($450,000 for married couples) will see their marginal income-tax rates rise from 35 percent to 39.6 percent. That shift is projected to result in $395 billion in taxes over the next 10 years. While the tax affects less than one percent of American households it affects many high-spending professionals and small business owners who pay taxes on the personal returns (Sub Chapter "S" Corporations, etc.).

- **$15 Billion from Limiting Deductions.** The new law calls for a "personal exemption phase out," or PEP, affecting the exemptions and deductions that wealthier families can claim. It affects individual filers at $250,000, and $300,000 for joint filers. The tax bill for a couple earning $400,000 averaging about $50,000 in deductions each year will rise by about $1,000 according to a recent Wall Street Journal calculation.

- **$5.5 Billion in Capital Gain and Dividend Taxes.** The new tax rate for capital gains and dividends will rise from 15 percent to 20 percent (this figure doesn't include an additional 3.8 percent surcharge on investment income for high-income earners, which will kick in during 2013 to help defray the cost of The Affordable Care Act.

- **$2 Billion in Estate Taxes.** The law increases the top rate for gift and estate taxes from 35 to 40 percent. The Tax Policy Center reports that this change will affect over 77% of American households. The hastily enacted 157 page law does not reduce spending but rather adds to it and increases the federal deficit another $3.9 trillion over the next decade. It also raises taxes about $600 billion over the decade. Also disturbing is that for every dollar of spending cut, there were $41 in tax increases.

The Economic Impact of Affordable Health Care

In addition to the fiscal cliff law, taxes required by The Affordable Care Act are being implemented simultaneously. They will create yet another laundry list of taxes estimated to total some $41.8 billion in 2013. Here is a look at those taxes.

- **$21Billion in Medicare Taxes.** The healthcare law calls for a nine-tenths of 1 percent increase in the hospital insurance (Medicare) payroll tax paid by couples earning more than $250,000 a year, or $200,000 per year for single filers.
- **$11 Billion from Surcharge on Capital Gains and Dividends.** Married couples earning more than $250,000 per year, or single filers earning $200,000 will incur a 3.8 percent surcharge in the tax rate for capital gains and dividends. That is in addition to the "fiscal cliff" compromise that hiked taxes on capital gains and dividends from 15 to 20 percent.
- **$4.5 Billion by Limiting Deductions**. The Affordable Health Care Act eliminates corporate deductions for retirees' prescriptions thereby raising tax costs to employers.
- **$2 Billion in Excise Fees.** A 2.3 percent excise tax on manufacturers and importers of medical devices such as stents, pace makers and certain medical supplies and equipment. This tax is widely expected to be passed through to patients (consumers).
- **$2 Billion by Limiting Healthcare Itemized Deductions.** This is a reduction in the amount tax payers can deduct from their income taxes if they incur high medical expenses.
- **$1.3 Billion from Limiting Flexible Savings Accounts**. A $2,500 limit will go into effect on tax-free flexible spending accounts, which employees use to help defray medical expenses. There was previously no government imposed limit. Limitations were plan related.

The tax burden associated with the Affordable Healthcare Act will climb even higher in 2014 when the tax penalty for not complying with the mandate to purchase healthcare insurance begins to kick in. Some experts predict that millions of Americans may opt to pay the tax penalty

rather than comply with the mandate. The logic is that a 25 year old who typically has around $700 in expenses would not likely purchase a policy with an expected $4,000 premium. The CBO estimates the U.S. Treasury will collect $167 billion in such fines over the next 10 years.

Finally, some observers opine that the rising private insurance premiums which are almost certain to occur due to the health care act are form of “hidden tax “ that will directly hit insured individuals and companies. For example, in California, Aetna has proposed a premium increase of 22%. Anthem Blue Cross of California will reportedly raise premiums as much as 26% and Blue Shield has proposed a 20% increase. In Ohio and Florida, the story is similar. Insurers have reportedly already been able to raise premiabout 20%. These premium increases are significant and can amount to several hundred dollars each month for consumers depending upon their plan. There is a bit of irony here too. In 2010, Anthem Blue Cross proposed a 39% rate increase which was both widely criticized but touted as a reason for the Affordable Health Care Act which was expected to reduce such large rate increases.

The tax hikes resulting from the fiscal cliff legislation and the Affordable Healthcare Act are two separate and distinct taxes. Either will affect most Americans and the broader economy. Simultaneous implementation, however, is almost certain to have a profoundly negative effect on an economy struggling to recover from the worst recession since The Great Depression. Renewed recession in 2013 is not out of the question as some $160 billion in annual discretionary spending is being removed from the economy.

Pending Fiscal Crises. The fiscal cliff law did not deal with other issue plaguing the shaky economy. Spending cuts required by so-called sequestration were deferred another two months. Sequestration is an arcane government term loosely defined as *triggered spending cuts*. In this case The Budget Control Act (BCA) which was enacted after the bi-partisan super committee failed requires that nearly $1.0 trillion ($984 billion) be cut from defense and non-defense federal government spending in substantially equal parts of $492 billion each. This, of course, is unless Congress and the Administration decide to change the

law which seems highly likely at this writing.

Congress and the Administration must also deal with the nation's "debt ceiling" of about $16.4 trillion which was already exceeded last December 31st. Current public debt at this writing now totals $16.432 trillion and is rising by the minute. As an aside, the per capita share of the national debt is now over $52,000.

The "United States Public Debt," as it is more formally called, is comprised of two major pieces. They are debt held by the public which totaled about $11.579 trillion or about 73% of the nation's Gross Domestic Product. The other component is Intra-Government Holdings which is largely U.S. debt held by foreign investors. Currently, China and Japan are the largest holders of U.S. debt at about $1.1 trillion each.

Appraisal Profession Ages and Population Shrinks

Demographics, recession and cleansing drive systemic change

The appraisal profession as a whole has been aging at least since the 1980's. Practitioners have grown older and new entrants to the profession have slowed, with the exception of a brief period during the housing bubble. Today, 58% of practicing appraisers are age 51 or older followed by 31% in the 36 to 50 age cohort. Only 10% are age 25-35 and a mere one-percent are under 25. Approximately 48.4% have been practicing for 20 or more years while just 7.5% have been practicing for less than four years. Moreover, approximately 70% of appraisers are male, 30% are female, 58% hold bachelors degrees and 16% hold masters degrees. Twenty five percent have something less than a bachelors degree.

As shown on the chart at the bottom of the page, the total number of licensed and certified appraisers listed on the nationwide Federal Registry is currently about 104,100. That is down 14% from the cyclical peak in 2007 when large numbers of persons entered the appraisal business; particularly the residential side of the business where barriers to entry were minimal and there was a discernible shortage of appraisers during the housing bubble years. The Appraisal Institute reckons that the number of appraisers, excluding those who hold multiple state licenses or certifications, is perhaps around 85,000. That number is down 9% from 2007. The number of appraisers has been contracting at 3% per year for the last four years.

So what is driving the declining number of appraisers and what might the future hold for both the profession and users of appraisal services? First is the age cohort. The average age is high and many are retiring; some after lengthy careers. Note the previously described duration of practice. More importantly, they are not being replaced. Second is the

recession which took a huge toll on residential appraisers in particular. Residential sales volume declined 50%; new home sales volume declined 80%; residential loan volume declined 50% and all sectors have been slow to rebound. Finally, in our view there is a natural cleansing action taking place. Many persons entered the appraisal business who were unqualified, had too little experience and training (notwithstanding licensing requirements) and have left or are leaving the industry today.

In the writer's view, professional commercial appraisers will continue to do well due to their analytical skill. The residential side of the business will become bifurcated in the sense that there will be residential analysts who will excel at what they do and be compensated well for their professionalism and skill. There will also continue to be the form fillers and their work will be largely dominated by automated valuation and other more clerical forms of evaluation. As the shake-out continues unabated, there will almost certainly be fewer appraisers and that does not bode well for the profession or users of appraisal services.

A Different Kind of Recovery: Who Is Really Creating the Jobs This Time and Why?

It's Not Who You May Think

The Great Recession as it has come to be known was declared over at the end of June 2009. The economy has therefore been "recovering" for over three years. By historical standards, employment should have recovered and the economy should be robust or at least performing nearer its potential. Nevertheless, it is not. Despite numerous Federal Reserve and Administration attempts to stimulate the economy, nearly every sector from consumer spending, employment, housing and commercial real estate are all bouncing along the bottom in a recovery which is the weakest since at least World War II.

Conventional wisdom (or perhaps political mythology) suggests that small business is the engine of the economy and the contributor of most jobs. Indeed, that was true prior to The Great Recession. Today however, big business is leading the jobs recovery and that may help explain the mediocre job creation. It may also suggest that recovery may take much longer than is widely expected.

Data from the Bureau of Labor Statistics (BLS) suggest that small firms actually did better *during* the recession. BLS Employment Dynamics data show that small firms (companies with fewer than 20 employees) cut back about two-percent from peak to trough while companies with more than 1,000 employees cut back by nearly 14%. This is surprising since small firms tend to be more dependent upon bank financing than large firms and financing virtually dried up during the recession. Large firms usually have more avenues open to them to raise cash. These avenues may include corporate bonds, equity issuance and commercial paper. The data reveal that not only did small firms experience fewer job losses during the recession, they actually cut back less on hiring than did larger

firms. Larger firms often implemented rigid hiring freezes while the smaller and nimbler entrepreneurial companies hired as resources permitted and opportunities arose.

Labor Dynamics changed post recession. Larger firms have been hiring much more aggressively while smaller firms have languished. BLS data which is also confirmed by the payroll processing firm ADP, indicate that less than 30% of job gains since 2010 were the result of hiring by companies with fewer than 50 employees. The vast majority of new hires were by large companies. One explanation may be that since large companies in general cut deeper they have more to make up than smaller companies. Nevertheless, there are weaknesses in that theory too. Business dynamics data indicate that there are fewer new firms being formed today *and* those that are being formed are hiring fewer employees than they did historically. A study by the Hudson Institute, a Washington, D.C. based conservative think tank, shows that existing companies (big and small) tend to be net job losers averaging a net loss in aggregate of around 1.0 million jobs each year. New firms however, have historically gained 3.0 million jobs on average each year. Nevertheless even the size of a new firm has declined over the years. In 1998, the average size new firm has 6.4 employees. By 2011, the average size firm had fallen to 3.9 employees.

There appear to be numerous reasons for the change in labor dynamics and the shift to big companies being the predominant job creators. Reasons include the lingering effect of The Great Recession, business, tax and healthcare cost uncertainty, technology and cost saving techniques chipping away at employment, increased productivity and structural employment changes leading to more permanent than cyclical losses.

In our view, diminished home equity has also had a profoundly negative effect on small business. A significant amount of home equity has historically been used to fund entrepreneurial ventures. Today, in an era of seriously diminished home equity, entrepreneurs are often unable to start, or fund new ventures or grow existing small businesses. That leaves larger firms as today’s primary job growth driver - at least for now.

Who Will Create the Jobs?

The Nation Needs Jobs But Where Will They Come From & When?

Employment has improved since the depths of the recession. Indeed, in January 2009, the nation's economy lost an astounding 820,000 jobs. After annual benchmark revisions and large upward monthly revisions to last November and December job numbers, the economy added 181,000 per month on average throughout 2012. That's good but by no means good enough. In January there were still 12.3 million Americans unemployed. That includes some 4.7 million Americans who have been unemployed long term or, by Bureau of Labor Statistics (BLS) definition, 27 weeks or longer. In fact, the average duration of unemployment is now a staggering 35 weeks.

In addition to the personal tragedy of job loss, unemployment does not bode well for the broader economy. While unemployment compensation may cover some of the consumable necessities, the unemployed can't spend significantly. Generally, they don't buy homes. They don't remodel or buy furniture and appliances and they don't buy cars and other big ticket items that drive the economy.

Despite improvement in employment, there is still a long list of factors frustrating employment recovery. Some, such as structural changes in employment dynamics, will take time to resolve. Others, such as sequestration and healthcare, are self-inflicted by government in the form of law, policy and regulation and it will take a united government to undo the actions … or perhaps not. We have shared our thoughts about some of these factors in recent commentaries. The big question for most of us today is *"where will new jobs come from"* in the short and mid-term future or is mediocre job growth accompanied by historically high unemployment just the new normal?

After six long years of housing distress, we think housing will ultimately

return to being an important employment growth agent. The reason is not just housing but rather the huge multiplier effect the sector creates. A home purchase always has a ripple or "multiplier effect" in the economy. In other words, for each dollar that is spent, there are additional dollars spent over and above the initial investment that ripple through the economy. Multipliers take many forms but in housing, economists and policy analysts attempt to quantify three fundamental things: jobs, spending and tax revenues. These multiplier impacts tend to occur in two phases. The first is when the house is constructed. The second is throughout occupancy. An existing home sale produces a multiplier effect but certainly not as great as when a new home is constructed and sold. The first impacts in new home construction occur when the home is built. There is spending on the workers who build the home as well as in the firms that support them. There are usually office staff, cost estimators, buyers accountants and more. In addition to the direct impact of home construction, are the ripple effects; those that ripple through the local economy in some form. Generally two forms are measured. There is the *"indirect impact."* from jobs and spending created from businesses that are *suppliers* to the construction operation. This might include building supplies, architectural and engineering spending, cabinetry, flooring, decorating, sales, financing and more.

Induced impact is created where workers and others spend their wages. This might include restaurants, retail stores, healthcare and other establishments. The induced impact tends to create jobs for these consumer related businesses. Then, of course, are taxes which are paid throughout the process and continue to be paid long after construction is complete.

With the steadily improving housing market, we are already witnessing some indirect effects in home improvement stores, tools, transportation and more. According to auto and light truck analyst firm, Edmonds, builders are once again buying big trucks; something they haven't done in significant numbers for at least six years. Indeed, the biggest job creator will ultimately be the service sector.

William L. Pittenger

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