The New York Times
nytimes.com

September 11, 2005

The Crime: Slow Job Growth. A Suspect: Enron.

By DANIEL GROSS

WHILE the economy has enjoyed steady growth and low inflation since the recession ended in the fall of 2001, many companies have been reluctant to add new workers. "Any way you slice the data, employment growth has been disappointing in this recovery," said Lawrence F. Katz, professor of economics at Harvard. The Economic Policy Institute, a liberal research group in Washington, concludes that the lag in job growth has caused an "employment deficit" in the United States of 3.2 million jobs.

Mystified economists have pointed to various possible culprits: outsourcing, competition from China, high health care costs and lower work-force participation, to name a few. But there's one force that so far has managed to avoid blame for the sluggish pace of job growth: Enron.

Until now. In 2000 and 2001, as the bull market imploded, there was a spike in accounting problems - a mix of outright fraud, earnings manipulation and more benign restatements necessitated by changes in business conditions. Clearly, investors were burned by earnings restatements at Enron and WorldCom, and at hundreds of smaller and less infamous companies. "Nobody had actually explored the real consequences of earnings management, as opposed to the financial ones," says Thomas Philippon, assistant professor of economics at New York University's Stern School of Business.

In a recent National Bureau of Economic Research working paper, Professor Philippon and a colleague, Simi Kedia, assistant professor of finance and economics at Rutgers, argued that the widespread accounting problems for which Enron was emblematic might have helped suppress employment growth - in the affected companies, and in the industries in which the misreporting was concentrated.

Professors Philippon and Kedia examined the roster of companies that restated earnings from January 1997 to June 2002, as compiled by what is now the Government Accountability Office, and matched it up with available employment data. It was a regrettably large sample: 919 restatements by 845 public companies. About one-tenth of publicly traded companies announced at least one restatement.

Not surprisingly, companies that were misrepresenting their financial results - intentionally or inadvertently - helped juice employment growth in the late 1990's as they added employees. "During periods of suspicious accounting, firms hire and invest excessively," the professors said. From 1997 to 1999, the restating companies added 500,000 jobs, a 25 percent increase.

When these companies restated their earnings, the growth they had reported often turned out to be an illusion. As a result, the same companies shed labor quickly. At its peak, Enron employed 20,000 people. But in the weeks after its earnings restatement in November 2001, this new-economy profit machine was suddenly revealed to be an old-fashioned money pit. Within months, the company was down to about 500 employees. The authors label Enron a "typical - if somewhat extreme - example" of

a company whose employment rose and fell rapidly.

On the whole, Professors Philippon and Kedia conclude, companies that had to restate earnings in 2000 and 2001 axed anywhere from 250,000 to 600,000 jobs in 2001 and 2002. That would account for a significant chunk of the jobs lost during the period.

There's more to the story, though. Earnings restatements and accounting problems were concentrated in certain industries, such as energy, telecommunications and business services. And in those industries, many of the companies that didn't have to restate their earnings wound up reducing their head counts. Enron didn't just fire its employees; it terminated relationships with consultants, suppliers and trading counterparts in energy-related industries.

"The end of Enron was clearly bad news for Enron's industry and Houston's economy as a whole," said Joshua D. Rauh, assistant professor of finance at the University of Chicago Graduate School of Business.

What's more, restatements create industrywide uncertainty that can inhibit future hiring. When WorldCom was revealed to have fudged its earnings, it became clear that the business model for telecommunications and data services wasn't nearly as profitable as WorldCom had made it out to be. "All of the sudden, the entire industry appears to have excess labor," Professor Kedia said. And once many of the assumptions about the industry's business models turned out to be false, executives and investors were naturally gun-shy about hiring and expanding.

PROFESSORS Philippon and Kedia added indirect effects on jobs to the direct job losses sustained by restating companies and then constructed a model to extrapolate these estimates to the entire United States economy. They concluded that the effects went a long way toward explaining why employment growth fell to zero in 2001 from 2 percent in 1999.

"I don't want to oversell this, but if the indirect effects are what we think they are, then they can account for the job loss in 2001 and 2002," Professor Philippon said.

These conclusions are speculative. And economists, while open to the suggestion that accounting problems have an impact beyond the stock market, warn against putting too much credence in a single explanation.

"Explaining the unique characteristics of this unbalanced recovery is more like 'Murder on the Orient Express' than finding a smoking gun in somebody's hands," said Jared Bernstein, an economist at the Economic Policy Institute. "There are a lot of suspects."

Daniel Gross writes the "Moneybox" column for

Slate.com.

Copyright 2005 The New York Times Company | Home | Privacy Policy | Search | Corrections | XML | I