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Jobs Picture Darkens

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Total employment contracted in February for the second straight month, and private employment contracted for the third straight month. The February jobs report illustrates that economic growth is sluggish at best and could even be negative.

Despite the job losses, some evidence suggests that the employment picture is not dire. The unemployment rate remains surprisingly low at 4.8 percent. Wages increased by 3.7 percent compared to the previous year, which is indicative of a solid job market. Workers are not overly discouraged. Compared to last year, only 21,000 more people are not working because they are discouraged about their chances of finding a job. This is a tiny fraction of the 4.7 million people who are unemployed but say they would like a job.[1]

Many of the current proposals for stimulating the economy would make matters worse. The federal government should focus on policies that could help restore the economy to full strength, such as easing the burdens on businesses and entrepreneurs.

February Employment. Employment declined by 63,000 jobs in February, with private employment declining by 101,000 jobs and government employment increasing by 38,000 jobs. Employment in December and January was also revised downward. Private employment has now contracted for a full quarter—the first two-month decline in five years.

Construction (–39,000) and manufacturing (–52,000) continue to be hard-hit by the economic slowdown. Retail trade (–34,000) declined in February as well. Real estate (–7,100) was hurt by the downturn in the housing market, which then spread to the financial sector (–4,800). Health care (36,000) and leisure and hospitality (21,000) posted some of the largest job gains.

All measures of the unemployment rate show that unemployment has increased over the past 12 months. The official unemployment rate in February 2007 was 4.5 percent, which is lower than this year's rate of 4.8 percent. Similarly, the unemployment rate that includes discouraged workers (those who, for economic reasons, are no longer actively looking for a job) is 5.1 percent, up from 4.7 percent a year ago.

Almost 70 percent of unemployed workers have been unemployed for less than 15 weeks. The number of workers who have been unemployed for 27 weeks or more and are in danger of exhausting their unemployment benefits has declined over the past quarter. Despite the rising unemployment rate, the duration of unemployment has not increased much over the past year. In February 2007, the average length of unemployment was 16.6 weeks, and the median was 8.2 weeks. In February 2008, those

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numbers increased slightly to 16.8 weeks and 8.4 weeks, respectively.

What Congress Should *Not* Do. Congress should resist the urge to simply "do something" in response to the latest indicators. Policymakers must ensure that any response is constructive. Many of the policies that lobbyists are now promoting as stimulus measures would actually harm the economy. The following responses would worsen the economic situation:

Increase Taxes. Every major school of economic thought, from Neoclassical to Keynesian, holds that policymakers should not raise taxes on a weakening economy. Tax increases simultaneously take money out of taxpayers' pockets and decrease their incentive to work and invest. Virtually no economists believe that this would be the proper course.

Nonetheless, the recently unveiled House budget resolution raises taxes by $70 billion to offset the cost of not following through with a planned increase in the alternative minimum tax (AMT) on middle-class taxpayers. The AMT was never intended to tax the middle class and affects them only because Congress did not index it for inflation. Congress has consistently passed annual patches to ensure that the AMT does not affect the middle class. Congress has not collected AMT taxes on the middle class and never intended to do so. It does not need to counteract the benefits of sparing taxpayers one tax hike by raising other taxes.

Extend Unemployment Insurance. Some analysts are urging Congress to extend unemployment insurance eligibility to nine months from the current six months. Advocates point to a 2004 study concluding that this approach provides the most "bang for the buck" because each $1 spent on additional UI benefits would increase GDP by $1.73.[2] The argument is that this will get money into the hands of needy consumers who will spend it immediately, thus stimulating the economy.

This argument is flawed. Households respond to additional government benefits by changing their behavior. Only about 50 cents of every dollar in UI benefits finances new consumption.[3] The other 50 cents finances household consumption that would have occurred otherwise, either by spouses working longer hours or by family members spending savings.[4]

The UI system was designed to provide workers with insurance against the risk of involuntary job loss, not to stimulate the economy. Paying workers to stay unemployed for a longer period of time does little to promote economic growth. Real-world studies find little evidence that increasing UI benefits boosts the economy.[5]

Restrict Trade. Prominent policymakers are calling for restrictions on international trade. Both

1. These 4.7 million people are assumed to be marginally attached to the labor force. They are not actively looking for a job but state that they would like a job. They might not be looking for a job because they are in school, are sick, or have family commitments.
2. Mark Zandi, "Assessing President Bush's Fiscal Policies," Economy.com, July 2004, at *www.economy.com/dismal/economycom_bushfiscalpolicy.pdf*.
3. Jonathan Gruber, "The Consumption Smoothing Benefits of Unemployment Insurance," *American Economic Review*, Vol. 87 (March 1997), p. 195. Note that a 10 percent increase in the replacement rate (representing a 10 percent increase in individual income) reduces the fall in individual consumption by 2.65 percent. Footnote 9 notes that the average recipient gets 48 cents out of every additional dollar for which he or she is eligible because not all workers eligible for benefits receive them. Thus, when UI raises incomes by 4.8 percent, consumption rises by 2.65 percent, so each dollar spent on UI raises consumption by roughly 50 cents.
4. B. Cullen and J. Gruber, "Spousal Labor Supply as Insurance: Does Unemployment Insurance Crowd Out the Added Worker Effect?" *Journal of Labor Economics*, Vol. 18, No. 3 (2000), pp. 546–572; Eric M. Engen and Jonathan Gruber, "Unemployment Insurance and Precautionary Saving," *Journal of Monetary Economics*, Vol. 47 (June 2001), pp. 545–579.
5. Kyung Won Lee, James R. Schmidt, and George E. Rejda, "Unemployment Insurance and State Economic Activity," *International Economic Journal*, Vol. 13, No. 3 (Autumn 1999), pp. 77–95; George M. Von Furstenberg, "Stabilization Characteristics of Unemployment Insurance," *Industrial and Labor Relations Review*, Cornell University, Vol. 29, No. 3 (April 1976), pp. 363–376.

Democratic presidential candidates have called for abrogating NAFTA if Canada and Mexico do not concede to new trade restrictions, and the prospects for passage of the Columbian Free Trade Agreement appear dim.

Members of Congress must resist rising protectionist sentiment. Virtually every economist on both the Left and the Right agrees that free trade benefits the economy. The passage of the Smoot–Hawley Act in 1930 virtually shut down international trade and was one of the major factors that turned a recession into the Great Depression. Americans will not become more prosperous by shutting off trade and investment from the rest of the world.

Congress Should Lower Business Taxes. American businesses pay a 35 percent tax rate, which is much higher than that paid by companies in most other developed countries. This makes America less attractive to investors and puts American businesses at a competitive disadvantage internationally.

Congress should lower the business tax rate to spur domestic investment and job creation. The business tax reforms proposed by House Ways and Means Committee Chairman Charles Rangel (D–NY) are a good step in the right direction. The plan would lower the business tax rate while removing special-interest tax credits and deductions from the business tax code. Businesses and entrepreneurs, not government, create jobs and drive the economy. Congress should ease the burdens it places on them.

Conclusion. The economy is clearly weakening. Private-sector employment has fallen for the past three months, driven by job losses in the construction and manufacturing sectors. However, wages have grown at a strong pace, and the unemployment rate is still historically low. The economy is clearly sluggish, but America is hardly in an economic emergency.

In this environment, Congress must resist the rush to legislate and should ensure that any response actually helps the economy. Congress should not raise taxes, extend eligibility for unemployment insurance benefits, or restrict international trade. Instead, it should ease the burden it places on businesses and entrepreneurs.

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