WebMemo
Published by The Heritage Foundation

No. 2218
January 13, 2009

Cut Tax Rates and Create 2.5 Million— No, 3.5 Million New Jobs

J. D. Foster, Ph.D.

President-elect Barack Obama has pledged to create 3.5 million new jobs by the end of 2010. Of course, he does not intend to create the jobs himself but for the economy to create the jobs stimulated by his policies. In a welcome development, the President-elect has provided a clear measure by which to judge the performance of his policies.

The United States economy employed about 113 million people in the private non-farm labor force in December 2008, according to the most commonly used measure of employment generated by the Department of Labor. The Obama jobs pledge will be met, therefore, if employment reaches 116.5 million by the end of 2010. This level of job growth suggests that our nation should expect a sizable expansion of output and income generated by the U.S. economy by the end of 2010. Reaching this goal will require effective stimulus policies from the federal government, and the only fiscal policy that can even come close to reaching the goal is to cut marginal tax rates.

The Jobs Target. Employment in the United States peaked at about 115.8 million jobs in November 2007. Weakness, especially in the housing sector, caused a slow deterioration in the labor market through August 2008 with an average monthly loss of 94,000 jobs, but the contraction in employment accelerated in September. According to the most recent jobs reports, private-sector employment contracted by an enormous 581,000 jobs in November and by 531,000 more in December.

Recent events confirm that the target for jobs creation was chosen carefully. Obama's first jobs pledge prior to the November jobs figure was to create 2.5 million jobs. Added to the level of employment at the time, this would have meant private-sector employment was to reach 116.5 million. The November jobs report showed a drop in employment of about a half million, and the job creating target was increased by a half million, to 3 million jobs created, affirming the 116.5 million total jobs target. Then the December jobs report showed about another half million jobs lost and the President-elect raised the jobs target again to its current total of 3.5 million jobs, re-affirming the 116.5 million jobs target.

The emphasis is on private sector jobs because while public sector employment at the federal, state, and local levels often contributes to our national security, economy, and society in meaningful ways, these jobs must all be supported by the private sector. The economy does not advance by asking private sector workers to bear the cost of thousands of additional government workers.

The President-elect has said repeatedly that he intends to "save or create" these jobs through his

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/wm2218.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

policies. A stimulus program will be effective if the economy contracts less than it would have without the stimulus, thereby saving jobs. However, it will never be clear how many more jobs would have been lost absent the stimulus, and so no attempt to quantify the number of such jobs would be credible. The President-elect is unlikely to waste his credibility on a shadowy jobs number promise, so the beneficial presumption is that he is referring to his policies creating jobs—that is, raising the absolute level of private-sector employment to the target of 116.5 million.

The Wrong Direction for Fiscal Policy. The credit crunch has produced a recession that is likely to be quite severe. The Federal Reserve has responded massively with traditional measures such as cutting the Fed Funds rate almost to zero and through awe-inspiring new programs to purchase assets directly from various frozen credit markets.

The new President and new Congress are sure to want to join a robust fiscal policy response to the powerful monetary policy response and will need to do so to meet the 3.5 million jobs pledge. To be helpful, the fiscal policy stimulus must be well-designed, and to be effective it must have sufficient heft.

Most of the stimulus talk out of the Congress to date, consistent with expressions from the Obama team, centers around massive new spending programs. The federal government appears likely to run deficits totaling over $2 trillion over the next two years even before any stimulus is added. If deficit spending were truly stimulative, the economy would already be poised to race.

Additional deficit spending will be no more effective than the first $2 trillion, and the reason is very simple: Government spending does not create additional demand in the economy. Deficit spending must be financed by borrowing, so while government spending increases total demand, government borrowing reduces private demand.[1] If Obama and the Congress choose this path, there is very little chance of making good on the jobs pledge.

Job-Creating Policies for the Great Recession. The only effective fiscal stimulus is to defer the pending tax hike into the more distant future and cut individual and corporate tax rates further.[2] Stimulating the economy requires reducing the impediments to starting new businesses, hiring, working, and investing. Reducing regulatory burdens would help, but doing so is time-consuming from a legislative perspective, and there are no obvious and meaningful sources of excessively burdensome regulation that can be quickly remedied. The only quick, and effective, remedy is to cut tax rates. This is the path Obama needs to take to make good on his pledge to create 3.5 million more private-sector jobs.

—J. D. Foster, Ph.D., is Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

1. See, for example, Brian Riedl, "Why Government Spending Does Not Stimulate Economic Growth," Heritage Foundation *Backgrounder* No. 2208, November 12, 2008, at *http://www.heritage.org/Research/Budget/bg2208.cfm.*
2. See J. D. Foster and William W. Beach, "Economic Recovery: How Best to End the Recession," Heritage Foundation *WebMemo* No. 2191, January 7, 2009, at *http://www.heritage.org/Research/Economy/wm2191.cfm*.