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February Unemployment Fell, but Recovery Remains Slow

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In February, employment grew by 192,000 workers, and the unemployment rate fell to 8.9 percent, the lowest level since April 2009. The Bureau of Labor Statistics's monthly report shows that the labor market is improving, with job growth in several sectors. Revisions for December and January increased those monthly job hires by 58,000. This report, combined with other macroeconomic indicators, show that the labor market's recovery is steady and growing stronger.

Unfortunately, the labor market recovery is slow, and the Congressional Budget Office estimates that the unemployment rate will not fall below 8 percent until 2013.[1] It is important for Congress to focus on reducing the deficit even as the economy improves. Congress needs to ensure that the increasing debt will not result in higher taxes that will reduce future employment outlooks.

The February Report. The household survey reported that the unemployment rate had a statistically insignificant decline of 0.1 percentage points to 8.9 percent in February. This is the lowest unemployment rate in almost two years and the third month in a row that the unemployment rate fell.

The unemployment rate for adult men fell by 0.1 points, but the unemployment rate for adult women increased by 0.1. The unemployment rate by level of education dropped sharply for workers with less than a high school education from 14.2 percent to 13.9 percent, but it is still much higher than the unemployment rate of high school grads (9.5 percent) and college graduates (4.3 percent). While the February decline is not considered statistically significant, it shows that the sharp fall of the unemployment rate from 9.8 percent to 9.0 percent in two months is not just a statistical blip in the volatile survey.

The labor force participation rate remained at its 25-year low of 64.2 percent as the labor force grew by only 60,000 workers in the past month. The participation rate of adults increased for both men and women. However, many teenagers exited the labor market, which held the participation rate flat. It is expected that the labor force will grow in upcoming months as workers return to the labor market.

While the mean number of weeks unemployed climbed to 37.1 weeks from 36.9 weeks, the median number of weeks unemployed fell to 21.2. This is because there has been a decline in the number of workers who have lost their jobs to layoffs or have been unemployed for less than five weeks. As a recovery takes hold, the median duration of unemployment will continue to fall.

The payroll survey reported that 222,000 private-sector jobs were created, while state and local governments reduced hiring by 30,000 jobs. Almost every sector had jobs gains except for retail

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trade (–8,100). Manufacturing (33,000), health care and social assistance (36,200), mining and logging (70,000), and professional services (47,000) were the strongest sectors. Construction (33,000) had an increase, although it is likely that some of this gain was due to a weather-induced downturn the previous month.

This month's payroll survey was of particular interest due to the concerns that the anemic job growth in January was a reflection of harsh winter weather. It is likely that some hourly jobs, such as construction or temporary help, were negatively affected by the weather, and the job growth in February reflects the recovery from the winter downturn.

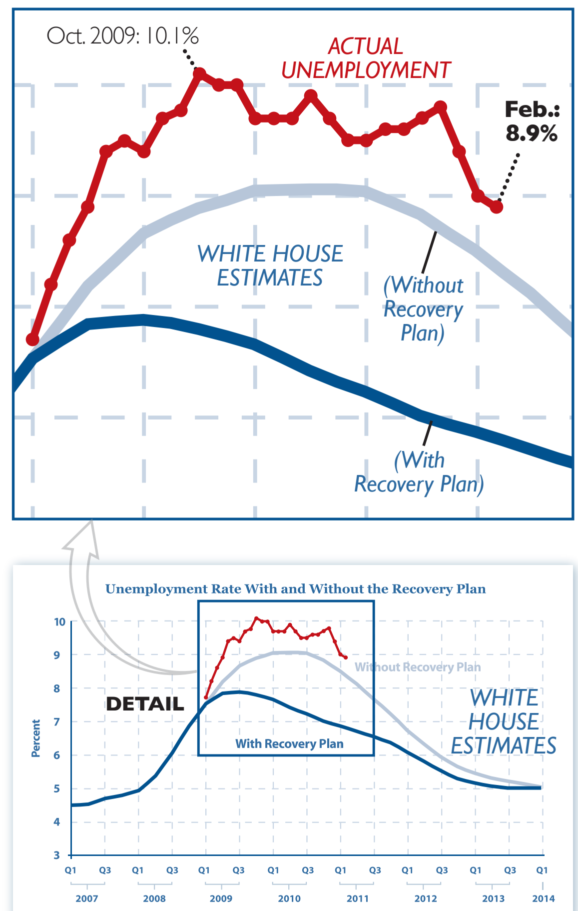
Fiscal Discipline and Jobs. The House of Representatives has recently taken modest steps toward reining in the budget deficit when it passed a continuing budget resolution last week. The House budget for the remainder of fiscal year (FY) 2011 reduces authorized spending by $61 billion. This would reduce the projected $1.5 trillion FY 2011 deficit by 4 percent.[2]

Liberal economists have reacted by predicting an economic cataclysm if the government goes ahead with these spending reductions. Economist Mark Zandi, who predicted that the 2009 stimulus would substantially boost the economy, predicts that the House budget would cost 700,000 jobs and cut GDP by 0.5 percent.[3] Economists with the left-wing Center for American Progress contend that these budget reductions would cost the economy 1 million jobs and possibly send America back into recession.[4]

These predictions lack credibility. They come from the same economists who predicted that the stimulus would spur hiring and economic growth. They are based on models programmed to show that increases in government spending have large "multiplier" effects on the economy. These same models predicted a current unemployment rate of 7 percent if Congress passed the stimulus and 8.5 percent if Congress did not increase government spending.

Unemployment Rate: February 2011

President Obama promised that government spending would "stimulate" the economy and quell rising unemployment by "creating or saving" millions of jobs. In January 2009, Obama's advisers produced a chart (bottom) visualizing the positive results of his recovery plan. But actual unemployment (below, detail from box at bottom) has far exceeded the White House estimates.



Sources: Unemployment data from the Bureau of Labor Statistics; original chart from Christina Romer and Jared Bernstein, "The Job Impact of the American Recovery and Reinvestment Plan," January 10, 2009.

Chart 1 • WM 3181 heritage.org

1. Congressional Budget Office, "The Budget and Economic Outlook, Fiscal Years 2011–2021," January 26, 2011, at *http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf* (March 4, 2011).
2. Douglas W. Elmendorf, Director, Congressional Budget Office, "Outlook for the Economy and the Budget," February 24, 2011, at *http://www.cbo.gov/ftpdocs/120xx/doc12076/CBO_Presentation_to_NEC_2-24-11.pdf* (March 4, 2011).

Based on these claims, Congress spent over $800 billion on the stimulus. Contrary to the predictions from these same models, however, the economy stagnated over the past two years, with unemployment well above 9 percent. The current recovery has occurred only after the stimulus spending has largely run out. Models programmed to show beneficial effects of government spending do not accurately project the unemployment rate.

These models fail because they assume that federal spending does not come at the expense of the resources available for private-sector investment. They also assume that investors and entrepreneurs do not look toward the future. In these models the government can run enormous deficits today, and business owners will not expect this to cause the government to raise their taxes in the future.

Modern models that incorporate future expectations and allow federal spending to affect investment show that reducing federal spending has a very small effect on overall employment. It also directly leads to increases in private investment.[5] These facts square with America's actual economic experiences with the stimulus.

America is on an unsustainable economic course. The country cannot run trillion-dollar deficits indefinitely. If they believe it cannot repay its debt, bondholders will eventually stop lending the government money. To prevent that, the government will have to enact either deep and rapid spending cuts or ruinous tax increases or raise interest rates. Entrepreneurs and investors know this. The House of Representatives has proposed reducing federal spending by roughly 1.6 percent. This is a modest first step toward bringing America's fiscal house in order. Taking this step, however, would show business owners that the government is serious about fixing its long-term problems and will help ease their concerns about future tax increases. This would spur investment and private-sector job creation.

Congress Can Help Speed the Recovery. The labor market in February continued to improve, with the headline unemployment rate falling below 9 percent for the first time in almost two years. With 222,000 new jobs in the private sector, the labor market is now adding jobs at a rate that will reduce labor market slack. However, the labor market needs to improve even more quickly to help the millions of Americans still unemployed.

Congress can help the labor market by ensuring that pro-growth policies are enacted. One such policy is to reduce the federal deficit and the new debt acquired by the government. Each dollar of new debt will have to be paid off by taxpayers when interest rates are higher. This would hamper economic growth and delay a full labor market recovery.

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3. Lori Montgomery, "GOP Spending Plan Would Cost 700,000 Jobs, New Report Says," *The Washington Post*, February 28, 2011, at *http://www.washingtonpost.com/wp-dyn/content/article/2011/02/28/AR2011022802634.html* (March 4, 2011).
4. Dana Milbank, "Boehner the Budget Hawk Shifts His Course," *The Washington Post*, February 16, 2011, at *http://www.washingtonpost.com/wp-dyn/content/article/2011/02/15/AR2011021506021.html* (March 4, 2011).
5. John Cogan, Tobias Cwik, John B. Taylor, and Volker Wieland, "New Keynesian versus Old Keynesian Government Spending Multipliers," *Journal of Economic Dynamics and Control*, Vol. 34 (2010), pp. 281–295.