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Heritage Employment Report: May Jobs Report Has No Spring in Its Step

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Analysts expected a slow but steady employment report in May. The actual employment report was considerably worse than expected. Employers created only 69,000 net jobs, and the unemployment rate edged up to 8.2 percent. Revisions also showed that employers created 49,000 fewer jobs than originally estimated in March and April. Coupled with the recent downward revision to GDP estimates by the Bureau of Economic Analysis[1] and rising unemployment insurance claims, this report suggests the labor market recovery is approaching stall speed. The European economy is also sliding into a deeper crisis.

Given all of this economic news, the U.S. economy cannot afford the massive tax hikes scheduled for the end of this year. Congress should act quickly to prevent massive tax increases—a genuine Taxmageddon—from further weakening the labor market.

The Employment Report. Job growth was strongest in the health care (+33,000) and transportation and warehousing (+36,000) sectors. Employment in manufacturing also increased (+12,000). Government employment fell (–13,000), as did construction (–28,000). The drop in May construction jobs may have happened because the unusually warm winter allowed contractors to start projects earlier, causing jobs to be created in the winter instead of the spring. Most other sectors showed flat growth.

Other payroll survey indicators also showed a weaker labor market. Employers often increase the hours of their existing workforce or hire temporary workers before committing to new full-time employees. Strong labor demand also raises wages. In May, average hourly wages increased just $0.02, while weekly hours dropped 0.1 hours and temporary help jobs barely increased (+9,000). In January, temporary help employment had increased by four times that amount.

The household survey also showed a week labor market, although not as weak as the headline numbers suggest. The unemployment rate increased by 0.1 percent to 8.2 percent. This was largely driven by a 0.2 percentage point increase in the labor force participation rate (63.8 percent), not by job losses. This represents a statistical correction from the April report, which showed the unemployment rate falling by 0.1 points and the labor force participation rate falling by 0.2 percentage points. Such statistical fluctuations often happen in the household survey, which has a much larger margin of error than the payroll survey. Taken over a longer time frame—which smoothes out statistical noise—the household survey shows a labor market that is failing to improve.

Other economic indicators also show a softening economy. The Commerce Department revised its initial estimate for first quarter GDP growth down to 1.9 percent from 2.2 percent—well below the 3 percent typical for an expanding economy. New unemployment insurance claims rose 10,000 to 383,000 last week, a noticeable increase from the average 364,000 weekly claims in March and close to the recessionary level of 400,000.

Economy at Risk. This could hardly come at a worse time. The American economy faces numerous

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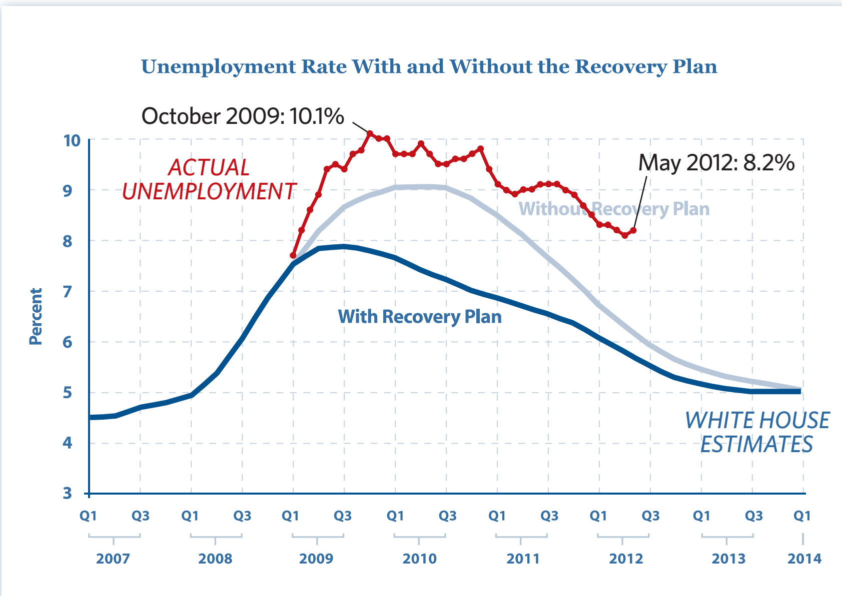
CHART 1

Unemployment Rate: May 2012

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 visualizing the positive results of his recovery plan. But actual unemployment (in red) 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.

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challenges, both domestically and abroad. The foremost foreign challenge is the fact that much of Europe is teetering on the edge of an economic recession. The uncertainty surrounding the euro currency as well as the stability of some European countries will be an anchor on the U.S. economy, because Europe is such a valued trading partner. The ability of the U.S. to influence the outcome of this crisis is limited.

However, American policymakers do have the ability to prevent a major domestic calamity that is scheduled to occur on January 1, 2013. That date is the start of Taxmageddon, when Americans must pay $494 billion more in taxes.[2] This tax increase comes from the expiration of the 2001 and 2003 tax cuts, the expiration of the payroll tax cut and some other tax extenders, and the start of the Obamacare tax increases. Economists from almost every school of thought and the Congressional Budget Office[3] believe that this would result in a recession due to the slowdown in economic growth.

Taxmageddon will result in dramatically higher taxes on capital as the top tax rate on dividends will almost triple from 15 percent to almost 45 percent. Capital gains taxes will be 50 percent higher. The taxes on wages will also increase, reducing the incentives to work. This is why even Keynesian models predict that Taxmageddon could reduce GDP growth by a few percentage points, enough to start a new recession.[4]

The uncertainty over which, if any, tax hikes will be prevented is already having a negative impact on the economy. Businesses are planning for 2013, and this uncertainty will cause delays in business expansions and additional hiring. One business official says that "as long as proposed changes remain up in the air,

1. Bureau of Economic Analysis, "Gross Domestic Product: First Quarter 2012 (Second Estimate)," http://bea.gov/newsreleases/national/gdp/2012/gdp1q12_2nd.htm (accessed June 1, 2012).
2. Curtis S. Dubay, "Taxmageddon: Massive Tax Increase Coming in 2013," Heritage Foundation *Issue Brief* No. 3558, April 4, 2012, http://www.heritage.org/research/reports/2012/04/taxmageddon-massive-tax-increase-coming-in-2013.
3. Congressional Budget Office, "Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013," May 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf (accessed June 1, 2012).
4. Ibid.
5. Michelle Hirsch, "New Survey: Taxmageddon Paralyzes Business Plans," *The Fiscal Times*, May 30 2012, http://www.thefiscaltimes.com/Articles/2012/05/30/New-Survey-Taxmageddon-Paralyzes-Business-Plans.aspx#page1 (accessed June 1, 2012).

companies will be forced to continue to burn fuel operating in holding patterns rather than charting productive courses forward."[5] Quite simply, businesses can not properly price the cost and profit of new activities and will choose to hold cash rather than engage in new job-creating activities.

How Congress Can Help Now. This very weak jobs report is particularly daunting given the weakness in Europe and other foreign countries. While it contains just one month of data, the jobs report indicates that the U.S. economy is continuing its slow, stop-and-start recovery—especially when taken together with other, recent economic data.

Last year, Congress did not stave off some tax increases until they were already scheduled to take effect. They should not repeat the same mistake again. The longer Congress waits to prevent Taxmageddon, the more uncertainty there will be on the tax impact to workers and businesses. This is an element of the economy that is in the complete control of American policymakers. They should act quickly to increase certainty and stability at a time where the economy greatly needs it.

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