The Heritage Foundation
LEADERSHIP FOR AMERICA

ISSUE BRIEF

No. 3691 | AUGUST 3, 2012

Heritage Employment Report: Sluggish Labor Market in July

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The Bureau of Labor Statistics' July employment report shows that, contrary to predictions of a summer jobs recovery, the unemployment rate has ticked up to 8.3 percent.[1] According to a survey of employers, they added a net of just 163,000 new jobs, up from the pace of the previous two months but still too slow to make a significant dent in the unemployment lines.

Labor force participation dropped another 0.1 points to 63.7 percent. Other indicators of future labor demand also failed to improve. While adding jobs is better than losing them, this job growth is only slightly more than needed to keep pace with population growth. At this rate, unemployment will remain elevated for many years to come.

Despite this economic weakness, many in Congress are proposing that taxes be raised by $500 billion in 2013. Every major school of economic thought—from supply-side to Keynesian—concludes that raising taxes on investors and job creators will further retard the already weak recovery. Congress should defuse the tax hike immediately and then reduce the budget deficit by restraining spending.

July Employment Report. The labor market remained sluggish in July. The household survey found that the unemployment rate rose 0.1 points to 8.3 percent. This increase was not due to workers rejoining the labor force and thus being officially measured as unemployed. In fact, the labor force participation rate fell by 0.1 percentage points to 63.7 percent as 150,000 workers left the workforce. The average duration of unemployment did fall by just over a week to 38.8 weeks. However, this could have been driven by the long-term unemployed stopping their job search, not finding new jobs.

The payroll survey paints only a slightly more optimistic picture of the labor force. Employers reported adding a net 163,000 jobs in July. This paltry growth is marginally more than the approximately 100,000 to 150,000 jobs needed to keep pace with population growth.[2] Professional and business services (+49,000), education and health services (+38,000), food services (+29,000), and manufacturing (+24,000) all posted notable gains. Employment was essentially flat in the mining, construction, and retail trade sectors, while employment in government fell (–9,000).

However, indicators of future increases in labor demand remained flat in July. Employers often initially work their existing employees longer (and pay overtime) or hire temporary help workers before committing to hiring new full-time workers. However, average weekly hours remained flat at 34.5. Temporary help service employment ticked upwards only slightly (+14,000). These indicators suggest that employers are unlikely to ramp up hiring in the next few months. Revisions also subtracted a net 6,000 jobs from the May and June employment reports.

The employment report accords with the recent disappointing GDP estimates, which showed that the economy grew just 1.5 percent in the second quarter. Until the economy starts growing at a faster rate, unemployment will remain stuck around 8 percent—a grim prospect for the 12.8 million unemployed.

This paper, in its entirety, can be found at
http://report.heritage.org/ib3691

Produced by the Center for Data Analysis

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Scheduled Taxmageddon. Adding to the economy's woes, current law calls for taxes to rise by $494 billion in January 2013.[3] Among other increases, if Congress takes no action:

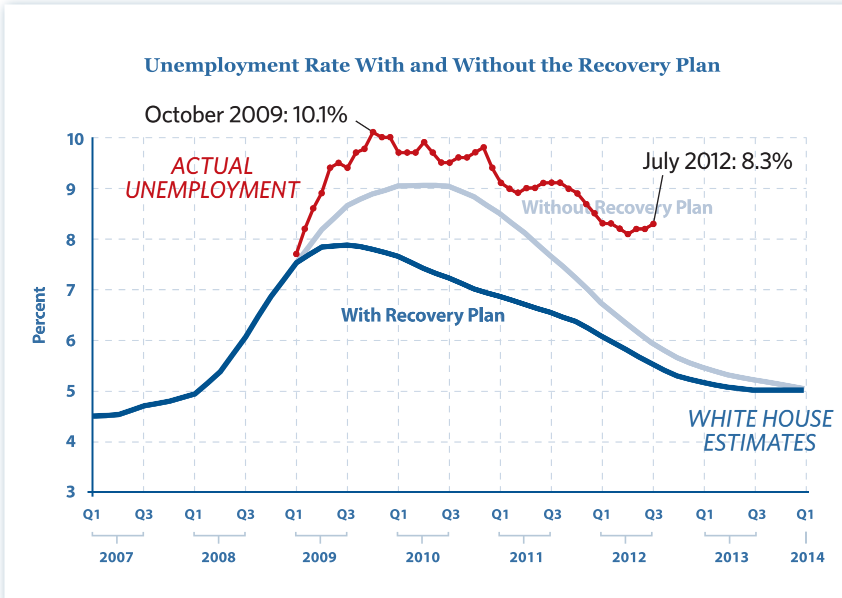
- The top federal income and payroll tax rate will rise from 37.8 percent to 43.4 percent;
- The 25 percent tax bracket will rise to 28 percent;
- The 10 percent tax bracket will rise to 15 percent;
- The tax on dividends will rise from 15 percent to 43.4 percent;
- The capital gains tax rate will rise from 15 percent to 23.8 percent; and
- The alternative minimum tax will be extended to tens of millions of middle-class families.

Several Members of Congress, such as Senator Patty Murray (D–WA), have openly called for Congress to allow these tax increases to occur to gain leverage in budget negotiations.[4] This would be a serious mistake. Even the prospect of these tax hikes is already seriously harming an already weak economy, and if they are allowed to take effect in 2013, the results would be punishing.

CHART 1

Unemployment Rate: July 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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Unemployment remains high because job creation has slowed considerably since the recession began—not because of more layoffs. While layoffs spiked in late 2008 and early 2009, they have since returned to pre-recession levels. New hiring, however, remains one-sixth below its 2007 levels.[5] Unemployment remains high because fewer entrepreneurs

1. See U.S. Department of Labor, Bureau of Employment Statistics, "The Employment Situation—July 2012," August 3, 2012, http://www.bls.gov/news.release/pdf/empsit.pdf (accessed August 3, 2012).
2. Unemployment rose because the unemployment rate is measured with the household survey, not the payroll survey. The household survey reported that employers hired a net 195,000 fewer workers in July.
3. 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.
4. "Sen. Patty Murray (D–WA): Dems Will Go Over 'Fiscal Cliff' Unless GOP Relents on Bush Tax Cuts," YouTube, July 16, 2012, http://www.youtube.com/watch?v=Os1HDOkjQv4&feature=player_embedded (accessed August 3, 2012).
5. Heritage Foundation calculations using data from U.S. Department of Labor, Bureau of Labor Statistics, "Job Openings and Labor Turnover Survey," Tables A and B.

are starting new businesses and fewer owners of existing businesses are taking the risk of expanding their operations.

The significant tax increases will reduce the incentive to invest, start new businesses, and expand existing operations. Investors and entrepreneurs will still bear all of the downside of business risks, but if they succeed, the government will take more of their earnings. Small business owners are only two percentage points more likely to identify poor sales (23 percent) than taxes (21 percent) as their single most important problem.[6]

While macroeconomists disagree on many points, every modern school of economic thought—from supply-side to Keynesian—concludes that the government should not raise taxes during a recession. Congress should not do so now.

Research by Harvard economists shows that countries that try to close large budget deficits by raising taxes usually fail.[7] The economic damage from higher taxes prevents governments from raising the revenues they expected. However, countries that close their deficits by reducing government spending typically succeed—and without harming their economies. Congress should deal with America's unsustainable deficits by reducing spending instead of hiking taxes.

Treading Water. The July employment report finds the economy treading water. The establishment survey suggests that employers created 163,000 new jobs, barely enough to keep pace with population growth. But the household survey showed a 195,000 drop in jobs, leading to an increase in the unemployment rate to 8.3 percent even as labor force participation fell again.

Coupled with weak economic growth in the second quarter, the report is a warning signal to policymakers in Washington. The economy cannot afford the prospects of nearly $500 billion in tax increases on middle-class families, investors, and job creators that are scheduled for the beginning of the year. Congress should act quickly to prevent taxes from rising and instead close the deficit by reducing spending.

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6. William Dunkelberg and Holly Wade, "NFIB Small Business and Economic Trends: July 2012," http://www.nfib.com/Portals/0/PDF/sbet/sbet201207.pdf (accessed August 3, 2012).

7. Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes versus Spending," *Tax Policy and the Economy*, Vol. 24 (2010); Alberto Alesina and Robert Perotti, "Fiscal Expansions and Adjustments in OECD Countries," *Economic Policy*, No. 21 (2005), pp. 207–247; Alberto Alesina, Silvia Ardagna, Roberto Perotti, and Fabio Schiantarelli, "Fiscal Policy, Profits, and Investment," *American Economic Review*, Vol. 92, No. 3 (June 2002), pp. 571–589; Alberto Alesina and Silvia Ardagna, "Tales of Fiscal Adjustment," *Economic Policy*, Vol. 13, No. 27 (October 1998), pp. 487–545.