The Heritage Foundation
LEADERSHIP FOR AMERICA

ISSUE BRIEF

No. 3796 | DECEMBER 7, 2012

Heritage Employment Report: Job Market Struggles in November

Rea S. Hederman Jr. and James Sherk

The economy created 146,000 jobs in November, and the unemployment rate fell to 7.7 percent from 7.9 percent in October. The numbers in the November report were not substantially affected by Hurricane Sandy, according to the Bureau of Labor Statistics (BLS).

While the headline numbers are positive, there are some major concerns inside the report. For instance, labor force participation fell sharply. Indeed, the sole reason for a decline in the unemployment rate was a drop of 350,000 in the number of people in the labor force. The BLS also substantially revised downward October and September numbers, where it estimated that 45,000 fewer jobs were created than originally reported. The labor market continues to struggle as businesses—particularly small businesses—delay hiring decisions out of fear of higher taxes through Taxmageddon.

The November Report. Economists at the BLS caution about the impact of Hurricane Sandy on this report. Data for the November unemployment survey was collected during the week of November 5. Thus the report was collected at a time when a large population of the U.S. was still impacted by the hurricane. However, the BLS currently estimates that the hurricane did not skew the numbers for the affected areas.

Overall, the report says that 146,000 jobs were created and the unemployment rate fell 0.2 percentage points to 7.7 percent. The unemployment rate drop is perfectly mirrored by the decline in the labor force participation rate, which fell from 63.8 percent to 63.6 percent, another 0.2 point drop. The fact that potential workers are staying out of the labor force is unique in modern times to this recession. Recent research indicates that government expansion of transfer payments—such as extended unemployment benefits, food stamps, and housing bailouts—played a role by discouraging potential workers from returning to the labor force.[1]

The November report looks like a partial correction of the October report. In October, the BLS originally reported 171,000 new jobs and the labor force participation climbing. This month's report saw a downward revision to 138,000 jobs and the participation rate falling to the same level it was in September, a number barely above the August low of 63.5 percent.

The duration of unemployment fell as the number of long-term unemployed declined. However, this decline is likely a result of these potential workers simply dropping out of the labor force by either giving up, going on disability, or taking early retirement.

The payroll survey continued to show a trend of sluggish growth, with job creation averaging 138,700 for the past three months. Construction (–20,000) and manufacturing (–7,000) fell. Retail trade (+52,600) was the strongest service sector, even surpassing health care and social assistance (+22,000). Temporary help showed a slight increase (+18,000) and has now increased for two straight months.

The number of average work hours remained flat at 34.4, still below the September level. Earnings showed a slight increase after declining in October. Overall, the future indicators for the labor market continue to show weak growth.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3796**

Produced by the Center for Data Analysis

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Replacement Rate. The payroll job growth is also less impressive than it appears. The economy needs to create approximately 125,000 jobs per month to keep pace with population growth. Unemployment will rise if job creation consistently falls below that level. November's payroll job creation was only marginally higher than this benchmark.

If the economy continues at this rate, the recovery will take an excruciatingly long time. Calculations from the Federal Reserve Bank of Atlanta indicate that, at this pace, it will take over five years for unemployment to return to its normal level.[2]

Small Business Hiring Falling. Other economic indicators also point to economic weakness. According to Gallup, for the past two years more small business owners have expected to expand their workforces than to contract them. That changed suddenly in November.

In October, 10 percentage points more small business owners planned to expand their workforce than contract it. In November, that number dropped to four percentage points fewer small business owners hiring than firing.[3] That is the lowest level this survey has shown since late 2008.

Fiscal Cliff. This economic weakness demonstrates that this is a bad time for Congress to sharply raise taxes. Yet some in Congress and the Administration have called for exactly that. This week, Treasury Secretary Timothy Geithner threatened that the Administration would go off the "fiscal cliff" if Congress would not accept substantially higher taxes. The fiscal cliff consists of approximately $500 billion in annual tax increases and $100 billion in spending cuts scheduled to take effect on January 1.[4]

America needs to shrink the deficit, but large tax hikes are exactly the wrong approach. Harvard economist Alberto Alesina finds that countries that attempt to close their deficits by raising taxes generally fail to do so—the economic damage from the higher rates largely offsets the benefits from the revenues they bring in. However, countries that rely on spending cuts to close their deficit see fewer (or no) negative economic effects. They also typically succeed in getting their finances in order.[5]

The current economic weakness makes it all the more important for Congress to cut the deficit by cutting spending, not raising taxes. Instead, the Administration proposes the opposite approach. The President has suggested spending tens of billions more on stimulus programs in addition to his proposed tax hikes. Congress should reject this approach and close the deficit through deep spending cuts.

Some in Congress also propose keeping the maximum duration of unemployment insurance benefits at a year and half. Congress should reject this approach. Unemployment benefits provide important humanitarian assistance, but they also keep workers unemployed longer.[6] Congress should reduce the maximum duration of benefit to a more appropriate level of one year. Congress should also fully offset this cost with spending reductions.

There Is Still Time. While the headline of a declining unemployment rate sounds like good news, the details of this labor report are disconcerting. The unemployment rate fell solely because 350,000 people left the labor force. In fact, the household survey reports that the unemployment rate actually showed a decline in workers, which would have boosted the unemployment rate if it were not for so many people leaving the labor force.

The concern of the fiscal cliff is reaching fever pitch as this is the last jobs report before the billions of

1. Casey Mulligan, *The Redistribution Recession* (Oxford: Oxford University Press, 2012), pp. 41–96.
2. Federal Reserve Bank of Atlanta, "Jobs Calculator," http://www.frbatlanta.org/chcs/calculator/ (accessed December 7, 2012).
3. Dennis Jacobe, "U.S. Small-Business Owners' Hiring Intentions Plunge," Gallup Economy, December 6, 2012, http://www.gallup.com/poll/159098/small-business-owners-hiring-intentions-plunge.aspx (accessed December 7, 2012).
4. Romina Boccia, Katie Tubb, and James Sherk, "What's in the Fiscal Cliff?," Heritage Foundation *Issue Brief* No. 3787, November 28, 2012, http://www.heritage.org/research/reports/2012/11/what-is-in-the-fiscal-cliff.
5. Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes Versus Spending," *Tax Policy and the Economy*, Vol. 24 (2010), pp. 35–68.
6. David Card and Phillip B. Levine, "Extended Benefits and the Duration of UI Spells: Evidence from the New Jersey Extended Benefit Program," *Journal of Public Economics*, Vol. 78, Nos. 1–2 (October 2000), pp. 107–138; Lawrence Katz and Bruce Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics*, Vol. 41, No. 1 (1990), pp. 45–72; Stepan Jurajda, "Estimating the Effect of Unemployment Insurance Compensation on the Labor Market Histories of Displaced Workers," *Journal of Econometrics*, Vol. 108, No. 2 (2002), pp. 227–252; John T. Addison and Pedro Portugal, "How Does the Unemployment Insurance System Shape the Time Profile of Jobless Duration?," *Economics Letters*, Vol. 85, No. 2 (November 2004), pp. 229–234; and Rafael Lalive, Jan Van Ours, and Josef Zweimüller, "How Changes in Financial Incentives Affect the Duration of Unemployment," *Review of Economic Studies*, Vol. 73, No. 4 (October 2006), pp. 1009–1038.

dollars of higher taxes commence. It is clear that businesses have changed their behavior in anticipation of the higher taxes and uncertainty that the fiscal cliff presents. Many small businesses are not hiring, and larger businesses are delaying investment and expansion opportunities. Policymakers should have avoided Taxmageddon in the summer, but there is still just enough time to do the right thing.

*—**Rea S. Hederman Jr.** is Deputy Director of and Research Fellow and **James Sherk** is Senior Policy Analyst in Labor Economics in the Center for Data Analysis at The Heritage Foundation.*