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TRENDMACRO LIVE!

On the December Jobs Report

Friday, January 4, 2013

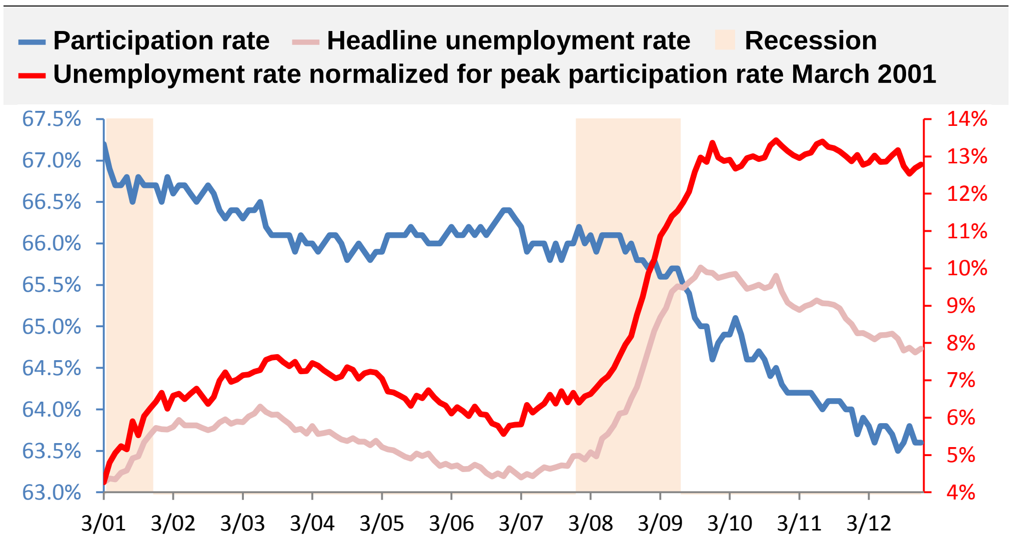
Donald Luskin

Coming to the jobs market in '13: new disincentives to work, and more incentives to not work.

This morning's Employment Situation report is the last one reflecting labor market conditions before the new American Taxpayer Relief Act (ATRA) takes effect (see "Tax Hikes Have Consequences" January 2, 2013). It was yet another middling jobs report in our Not So Great Expansion following the Great Recession. ATRA will only make it more difficult for the labor market to return to vibrancy.

- ATRA's failure to extend the Social Security payroll tax "holiday" will reduce after-tax pay by 2.1%. *This will lower the incentive to work.*
- ATRA's perpetuation for one year of extended 99-week unemployment benefits, on the other hand, *will raise the incentive to not work.*

The reality of the present labor market is that highly productive older workers are deferring retirement, crowding out less productive younger workers still developing their skills. We see this by adjusting the reported 7.8% unemployment rate for the decline in labor force participation (please see the chart below), giving a true rate of 12.8%.



Source: BLS, NBER, TrendMacro calculations

Update to strategic view

US MACRO: Another not so great jobs report in the Not So Great Expansion following the Great Recession. For 2013, the new tax bill won't help -- the end of the payroll tax "holiday" reduces the incentive to work, and the perpetuation of extended unemployment benefits raise the incentive to not work. The demographic reality of productive older workers crowding out less productive younger workers remains, and this perverse shift in incentives makes it more difficult for the labor market to clear.

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This demographic reality implies that, all things approximately equal, younger workers are going to have to accept the lower wages commensurate to their lower productivity if they wish to find employment. The higher payroll tax is a deadweight loss to them, requiring them to accept even lower after-tax wages than they would have last year for the same work. At the same time, extended unemployment benefits insulate them from the economic pressure that would normally require them to offer their labor services at market-clearing prices.

There is much room for improvement in the labor market, improvement which ought to be supported in 2013 by improvement in the global economic backdrop. Europe is no longer a systemic risk to the world banking system, and China is seemingly not headed anytime soon to a hard landing. And whatever its flaws, ATRA has taken the risks of legislated cliffs out of the tax code, at least for individual taxpayers. But against these improvements are ATRA's direct and substantive demand-side and supply-side blows to the labor market. We don't think it’s enough to trigger a formal recession in the US in 2013. But it's enough to keep us mired in the Not So Great Expansion.

Bottom line

Another not so great jobs report in the Not So Great Expansion following the Great Recession. For 2013, the new tax bill won't help -- the end of the payroll tax "holiday" reduces the incentive to work, and the perpetuation of extended unemployment benefits raise the incentive to not work. The demographic reality of productive older workers crowding out less productive younger workers remains, and this perverse shift in incentives makes it more difficult for the labor market to clear.

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