JOINT ECONOMIC COMMITTEE 2005 ANNUAL REPORT

RANKING MINORITY MEMBER'S VIEWS AND LINKS TO MINORITY REPORTS

DECEMBER 2005

RANKING MINORITY MEMBER'S VIEWS AND LINKS TO MINORITY REPORTS

I. Overview

The economy grew in 2005, but the benefits of that growth continued to show up in the bottom lines of companies rather than in the paychecks of workers. In the recovery from the 2001 recession, working families have been left behind from the start, and they continued to be left behind in 2005.

The signature policies of the Bush Administration and the Republican Congress have not addressed the problems facing ordinary American families. Successive rounds of tax cuts were poorly designed to stimulate job creation and produced a legacy of large budget deficits. Those large and persistent budget deficits contributed to an ever-widening trade deficit and massive borrowing from abroad. Most of the benefits of the tax cuts accrued to very high-income taxpayers, while cuts in programs that benefit middle- and lower-income families were viewed as the best way to pay for those tax cuts.

Policymakers faced a challenge in 2005 from the devastation to the Gulf coast from Hurricanes Katrina and Rita. The economy suffered a blow to employment and economic activity, and a budget that was already under strain had to absorb additional funding for emergency relief and planned reconstruction. In addition, the hurricanes focused attention on problems that had been ignored, such as the lack of emergency preparedness, inadequate investment in critical infrastructure, and, most sadly, neglect of our most disadvantaged citizens.

Many economists predicted that the economy would be resilient in the face of the hurricanes (see the JEC Democrats' report *Potential Economic Impacts of Hurricane Katrina*), and they appear to have been correct. However, the challenges facing policymakers remain (see *Meeting America's Economic Challenges in the Wake of Hurricane Katrina*, a forum sponsored by the JEC Democrats and the Democratic Policy Committee).

Unfortunately, there has been no change in the priorities or policies of the Bush Administration and the Republican Congress to address the problems facing the country's most disadvantaged citizens

or to help ordinary working families deal better with job and retirement insecurity and the rising costs of energy, health care, and education for their children. The Congress ended the first session of the 109th Congress debating budget reconciliation bills that would cut spending on programs that benefit middle- and lower- income families in order to partially fund the extension of tax cuts that mostly benefit very high-income taxpayers. The rest of the tax cuts would be financed by adding still more to the budget deficit.

The JEC Democrats' report, *Potential Economic Impacts of Hurricane Katrina* can be found at:
http://www.jec.senate.gov/democrats/Documents/Reports/katrinareportsep05.pdf

Materials from the JEC Democrats/Democratic Policy Committee forum, *Meeting America's Economic Challenges in the Wake of Hurricane Katrina*, can be found at:
http://www.jec.senate.gov/democrats/hearings.htm.

II. The Economy in 2005

The U.S. economy grew at an average annual rate of 3.8 percent over the first three quarters of 2005 despite the destruction caused by the Gulf hurricanes in late August and September. That growth rate is somewhat faster than the economy's long-term trend rate of growth, which is generally thought to be in the range of 3¼ to 3½ percent per year.

Above-trend growth was possible because productivity growth was strong and there was still slack in the labor market from the protracted jobs slump that began with the 2001 recession. A growing economy led to a pick-up in job creation and a modest reduction in the unemployment rate in 2005, but other indicators continued to point to softness in the labor market.

The Labor Market

Over the first eight months of the year and prior to Hurricane Katrina, employers added an average of 196,000 jobs per month to their payrolls. Hurricane-related job losses contributed to a sharp slowdown in aggregate job growth in September and October, but national payroll employment picked up again in November when over

200,000 jobs were created. The unemployment rate, which was 5.4 percent at the end of 2004, came down in early 2005 and settled into a narrow range around 5 percent for the rest of the year.

For an economy going through the most prolonged jobs slump in the postwar period, any improvement in the labor market was welcome. Nevertheless, many Americans remained unemployed and the official unemployment rate did not reflect hidden unemployment associated with depressed labor force participation. For those people with jobs, wage growth lagged far behind growth in output and productivity. Rising energy prices caused consumer prices to grow substantially faster than wages. Moreover, wage growth was uneven, with low-earning workers hit hardest by sluggish wage gains and more recently by declining real wages.

A protracted jobs slump. The jobs slump associated with the recession that began in March 2001 was the most protracted jobs slump since at least the end of World War II (the period over which we have comparable data). In fact, one would have to go back to the 1930s to find a worse jobs slump.

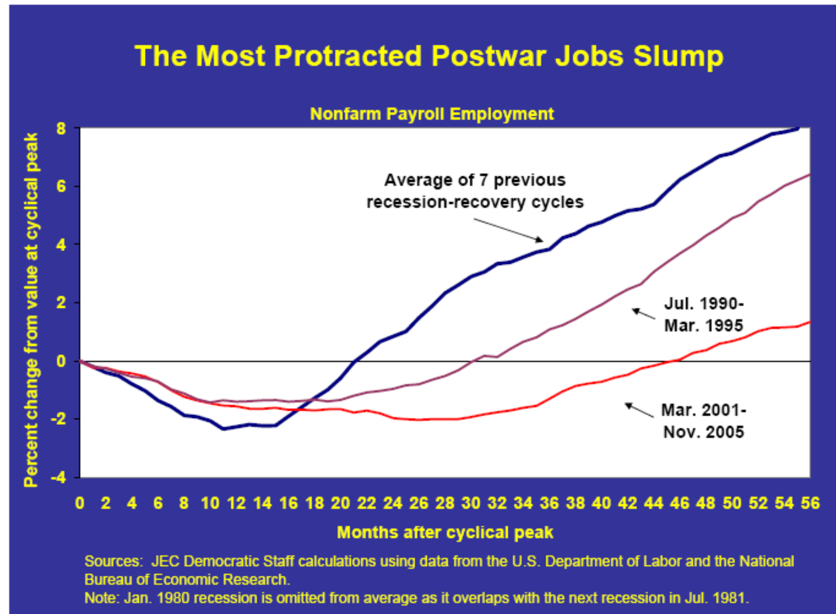
On average in the postwar period, job losses have stopped about a year after the onset of a recession and employment has begun to increase after about 15 months. Within two years, employment has surpassed its pre-recession peak and is expanding at a healthy pace. The most recent jobs slump was dramatically different from that pattern and even more protracted than the so-called “jobless recovery” following the 1990-91 recession (**Chart 1**).

The 2001 recession began in March and ended in November, according to the National Bureau of Economic Research, the widely recognized arbiter of business cycle dating. However, job losses continued until May 2003—more than two years after the start of the recession. It was not until January 2005, nearly four years after the start of the recession, that payroll employment climbed above its March 2001 level. Payroll employment increased in every month from June 2003 through November 2005. However, the pace of job creation over that period was just 149,000 jobs per month—only a little faster than the pace needed to keep up with normal growth in the labor force.

Whereas it was common to see job gains of 200,000 to 300,000 and sometimes 400,000 jobs per month in the 1990s

expansion, gains of that magnitude were rare in the recovery from the 2001 recession. The economy created 3.4 milion jobs between the end of the recession in November 2001 and November 2005. That is 4.9 million fewer jobs than were created over a comparable period in the recovery from the 1990-91 recession.

Chart 1



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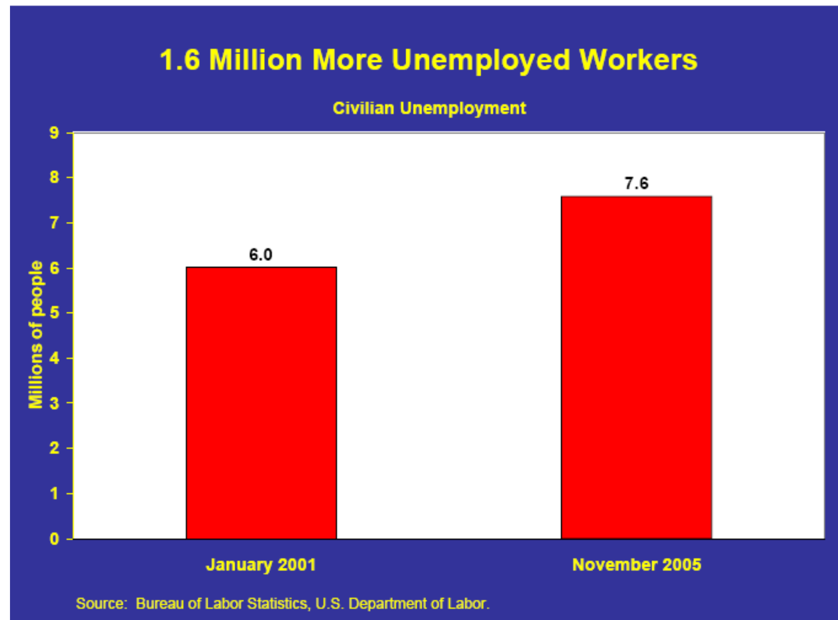
Indicators of labor market weakness. Millions of Americans who want to work do not have jobs. Although the unemployment rate has come down from its peak of 6.3 percent (reached in June 2003), the rate of 5.0 percent in November 2005 was still 0.8 percentage point higher than it was in January 2001 when President Bush took office and a full percentage point higher than it was in 2000.

In November 2005, 7.6 million people were officially counted as unemployed—1.6 million more people than were unemployed when President Bush took office in January 2001 (**Chart 2**). To be counted as unemployed, a person must be actively looking for work, but in a weak labor market there can be considerable hidden unemployment and underemployment if people who want to work have been discouraged from looking for work and if people who want to work full-time can only find a part-time job.

Chart 2



In a typical business cycle recovery, people come back into the labor force as the prospects of finding a job improve, but in the most recent jobs slump labor force participation has remained depressed compared with what it was at the start of the recession. In November 2005 the labor force participation rate (the proportion of the population working or actively looking for work) was 1.1 percentage points lower than it was at the start of the recession in March 2001. As a result of sluggish job creation and the depressed labor force participation rate, the proportion of the population with a job (the employment-to-population ratio) was 1.5 percentage points lower than it was at the start of the recession.

In November 2005, 4.8 million people who were not in the labor force said they wanted a job; about 1.4 million of these are considered "marginally attached" to the labor force because they have searched for work in the past year and are available for work. At the same time, 4.2 million people were working part-time because of the weak economy but wanted to be working full-time. The Bureau of Labor Statistics estimates that if marginally attached workers were included, the unemployment rate would have been 5.9 percent in November 2005, and if those working part-time for economic reasons were also included it would have been 8.7 percent.

A final indicator of labor market weakness is the fact that the number of people unemployed for more than 26 weeks is twice as high as it was when President Bush took office. Twenty-six weeks is the cut-off for regular state unemployment benefits, and the President and the Republican-controlled Congress failed to renew the Temporary Extended Unemployment Compensation program when it expired in December 2003. As a result, those who subsequently exhausted their regular state benefits did not receive any additional federal benefits, even though it was difficult to find a new job in a labor market that remained relatively weak.

The number of long-term unemployed as a fraction of total unemployment fell below 20 percent in June 2005 for the first time in 32 months—the longest stretch on record in which that fraction exceeded 20 percent. In November 2005, a still-large 18.4 percent of the unemployed had been without a job for more than 26 weeks.

Sluggish wage growth. For those workers who are employed, wage gains have been swamped by increases in the cost of living. Over the first 11 months of 2005, real (inflation-adjusted) average hourly earnings of production and other nonsupervisory workers in private nonfarm establishments fell at an annual rate of 0.7 percent. While the most recent declines in real earnings have been especially sharp because of the rise in energy prices, wages have been growing relatively slowly for some time.

Since the economic recovery began in late 2001, output per hour in the nonfarm business sector has grown at a 3.4 percent average annual rate, but the average hourly pay and benefits of the workers producing that output has grown at an average annual rate of just 1.5 percent after inflation.

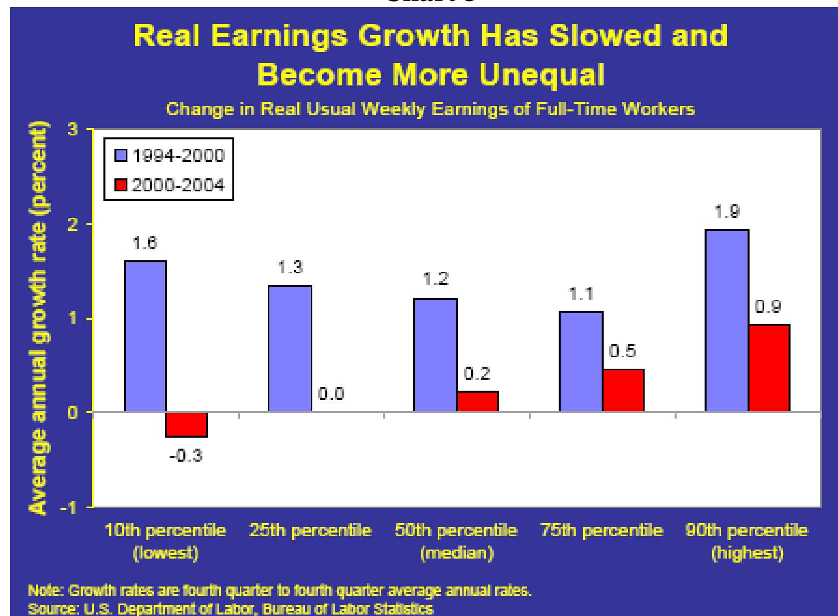
Over most of that period non-wage benefits grew more rapidly than wages, but that is because employers were absorbing higher costs for the health insurance and other benefits they were providing. The take-home pay of workers was stagnating. In the second and third quarters of 2005, total pay (wages plus benefits) did not keep up with inflation.

Strong productivity growth has boosted national income and profits, but wages have lagged. From the end of the recession in the fourth quarter of 2001 until the third quarter of 2005, aggregate

compensation (wages and salaries plus benefits) rose 20.4 percent, while corporate profits rose 64.2 percent—more than three times as fast. Aggregate wages and salaries rose just 16.6 percent. As a percentage of national income, wages and salaries reached an all-time low in 2004 and remained near historically low levels in 2005.

Unequal wage growth. Real wages at the top of the distribution have grown, while wages at the bottom have fallen. For example, from the end of 2000 to the end of 2004, the usual weekly earnings of full-time wage and salary workers in the middle of the earnings distribution grew by just 0.2 percent per year after inflation (**Chart 3**). Earnings near the top (the 90th percentile) rose by almost 1 percent per year after inflation, while earnings near the bottom (the 10th percentile) fell by 0.3 percent per year, on average. That sluggish and unequal growth in earnings contrasts sharply with the experience from the end of 1994 to the end of 2000, when real wage gains were substantial throughout the earnings distribution.

Chart 3



Most recently, real wages have fallen and some of the largest declines have been at the bottom of the distribution. For example, from the third quarter of 2004 to the third quarter of 2005, the real

usual weekly earnings of workers fell throughout the distribution, with declines of 3.0 percent at the 25th percentile and 2.7 percent at the 10th percentile. Real earnings at the 90th percentile fell by 2.2 percent. In the third quarter of 2005, median usual weekly earnings of full-time workers were $649. Earnings at the 90th percentile of the distribution were $1,484, while those at the 10th percentile were $306.

Energy Prices, Inflation, and Monetary Policy

Energy prices were already rising before the Gulf hurricanes hit, and, although prices abated somewhat from their storm-related spikes, energy prices in November 2005 were considerably higher than they were a year earlier. Prior to hurricane Katrina, the Energy Information Agency (EIA) expected the average retail price of regular gasoline to be $2.21 per gallon in the fourth quarter of this year, and to decline to $2.18 by the end of next year. In its December 2005 forecast, the EIA is expecting average gasoline prices in the fourth quarter to be $2.38 per gallon, with the same price expected to prevail at the end of next year. Natural gas prices rose sharply as well, and home heating costs are expected to be significantly higher in the winter of 2005-2006 than they were the previous year.

As a result of rising energy prices in 2005, the consumer price index (CPI) in November was 3.5 percent above its level a year earlier. However, the underlying rate of inflation—a measure that is more significant to the Federal Reserve's monetary policy decisions than the overall CPI—appeared to be little affected by the acceleration in energy costs. The core CPI (which excludes volatile food and energy prices) grew a moderate 0.2 percent in each of the last two months. In November, the core CPI was only 2.1 percent above its level a year earlier. That suggests that little if any of the rise in energy prices had so far translated into higher prices for non-energy consumer goods.

A stable underlying rate of inflation is a good thing for macroeconomic stability, but households must still pay their energy and food bills. The EIA currently expects that consumers will have to spend over 25 percent more to heat their homes this winter than they did last year. For those consumers whose homes are heated solely by natural gas (nearly 58 percent of U.S. households), the increase in winter heating expenditures is expected to be close to 40 percent.

Although core inflation has been tame, the Fed has been raising its target for the federal funds rate—the short-term interest rate it controls—since June 2004. For much of that period the Fed described its actions as “removing policy accommodation.” In other words, concern over the weakness of the recovery in 2003 and early 2004 had led the Fed to keep short term interest rates very low, but once the economy began to show stronger growth, the Fed began to raise rates at what it called “a pace that is likely to be measured.” The policy announcement accompanying the 13th rate hike in December 2005 changed that language. The Fed no longer described monetary policy as accommodative but it continued to signal the possibility of further rate hikes “to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.”

Rising energy prices could create a dilemma for the Fed if those increases begin to feed into core inflation while at the same time contributing to weaker household spending. In such a “supply-shock” scenario, the Fed would have to choose between tightening monetary policy (raising interest rates more than they otherwise would have) in order to keep inflation contained or loosening monetary policy (cutting interest rates or at least ceasing to raise them) in order to strengthen demand and keep unemployment from rising. To date, however, core inflation and inflationary expectations have remained contained.

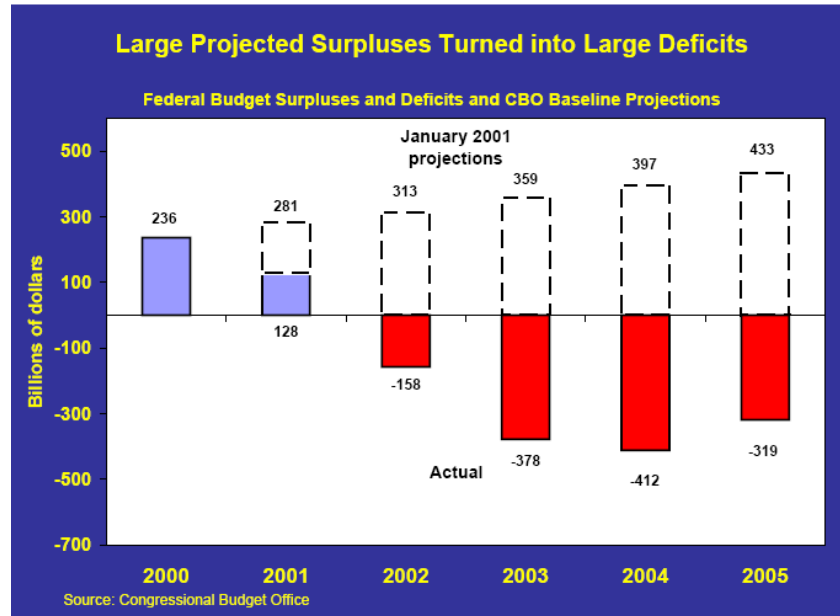
III. The Consequences of Irresponsible Fiscal Policy

When President Bush took office in January 2001, the Congressional Budget Office projected large and growing federal budget surpluses under existing laws and policies (the so-called baseline projection). Those surpluses were projected to cumulate to $5.6 trillion over the 10 years from 2002 to 2011. In fact, of course, the surplus was smaller than projected in 2001 and by 2004 a projected $400 billion surplus had turned into a deficit of over $400 billion (**Chart 4**).

The fiscal year 2005 budget deficit was $319 billion, which is much lower than was originally estimated in January of this year. While the improvement in the 2005 budget is welcome, a deficit of $319 billion is still very large and stands in marked contrast to the surplus of $433 billion that CBO was projecting in January 2001 when President Bush took office. Moreover, many analysts believe that the improvement in the 2005 budget reflects temporary factors that have

boosted revenue this year but that the long-term budget outlook is little changed and continues to show persistent large structural deficits.

Chart 4



Many factors have contributed to the return of large structural budget deficits after a strong economy and the fiscal discipline of the 1990s had restored the budget to surplus. For example, the 2001 recession caused a temporary cyclical increase in the budget deficit. But one of the main reasons for the re-emergence of large structural deficits is the tax cuts enacted over the past four years.

Defenders of the tax cuts argue that they were necessary to pull the economy out of the recession and that they will contribute to long-term growth. Some even argue that the tax cuts generate enough revenue to pay for themselves.

In fact, however, the tax cuts were poorly designed to generate short-term job-creating stimulus without adding to the long-term budget deficit. A wide range of economists recognizes that tax cuts increase the budget deficit. Dynamic analyses of the tax cuts by both the Congressional Budget Office and the Joint Committee on Taxation conclude that the negative effects of budget deficits tend to outweigh any positive benefits from the tax cuts on economic growth. A

Congressional Research Service analysis of the dividend tax cut reached the same conclusion.

Tax cuts and economic growth

Proponents of extending the 2001-2003 tax cuts argue that those tax cuts are responsible for the current economic recovery and that they need to be extended beyond their statutory expiration date in order to promote continued economic growth. While the immediate, one-time tax rebates that were part of the 2001 tax package provided needed economic stimulus in the short-term, extending the tax cuts beyond their scheduled expiration will do little to promote the saving and investment needed for sustained long-term growth. Rather, extending the tax cuts will increase the deficit, reduce national saving, and ultimately result in lower national income.

Effects of the tax cuts so far. Despite over $800 billion in cumulative tax cuts since 2001, economic growth in the period following the 2001 recession was not particularly strong, lagging behind the growth experienced in the recoveries following previous recessions. In the recovery following the 1990-91 recession, growth was more rapid than in the current recovery, even with the tax increases enacted in 1990 and 1993.

The 2003 tax cuts, which lowered the tax rate on dividends and capital gains and increased the amount of investment expense that businesses could deduct in the first year, were intended to promote saving and investment. Proponents of extending those tax cuts point to the increase in business investment that followed enactment of the tax cuts as evidence of their success. However, the increase in business investment that started in the second quarter of 2003 was not unexpected given the sharp drop in investment during the 2001 recession.

The increase in business investment in this recovery is not particularly strong when measured against previous business cycles. Business investment was only 5.8 percent higher in the third quarter of 2005 than it was in the first quarter of 2001. In contrast, business investment was almost 26 percent higher at a similar point in the recovery following the recession in 1990-1991.

Tax cuts do not "pay for themselves." Supporters of the Administration's economic policies claim that deficit-financed tax cuts are not a problem because tax cuts lead to increased federal revenues. Some suggest that the rapid growth in revenues in 2005 is evidence that "tax cuts can pay for themselves."

While revenues were higher than expected in 2005, the Congressional Budget Office (CBO) attributes little of the additional revenues to higher-than-expected economic growth. Real economic growth in 2005 was not stronger than projected by CBO or the Office of Management and Budget at the beginning of the year. Much of the recent revenue surprise is the result of strong corporate income tax receipts following the expiration of the enhanced investment expensing provisions enacted in 2002 and 2003. As CBO noted in its August 2005 update to its Budget and Economic Outlook:

"CBO now expects that when all revenues for 2005 are tabulated, corporate tax receipts will exceed its March projection by $53 billion. [Note: Receipts were actually $62 billion higher than the March projection.] *Only $1 billion of that difference can be attributed to the revised economic outlook.*

"...[T]he sources of the current strength in corporate tax receipts will not be known until information from tax returns becomes available in future years, but CBO anticipates that most of that strength will be temporary."

A comparison of actual revenues with revenue projections done in January 2001 prior to enactment of the tax cuts does not support the claim that tax cuts pay for themselves (**Table 1**). The revenue shortfall in 2003 through 2005 is almost $900 billion more than the projected cost of the enacted tax cuts.

It is important to keep in mind that even with the rapid growth in revenues in 2005, federal revenue expressed as a share of GDP was 17.5 percent in 2005, well below an average revenue share of 18.2 percent since 1960. Federal revenues fell to 16.3 percent of GDP in 2004, the lowest level relative to the economy since 1959. It is not surprising that the revenue share of GDP would grow as the economy recovers. However, if the 2001-2003 tax cuts are extended, the revenue share of GDP will drop below its current level after 2006.

Table 1
A Comparison of CBO Revenue Projections with Actual Revenues, 2003-2005
(Billions of dollars)

	2003	**2004**	**2005**	**2003-2005**
CBO revenue projection (January 2001)	2,343	2,453	2,570	7,366
Actual revenues	1,782	1,880	2,154	5,816
Revenue shortfall	**561**	**573**	**416**	**1,550**
CBO projected revenue loss from the 2001-2004 tax cuts	**179**	**265**	**211**	**655**

Budget Deficits, Trade Deficits, and Economic Growth

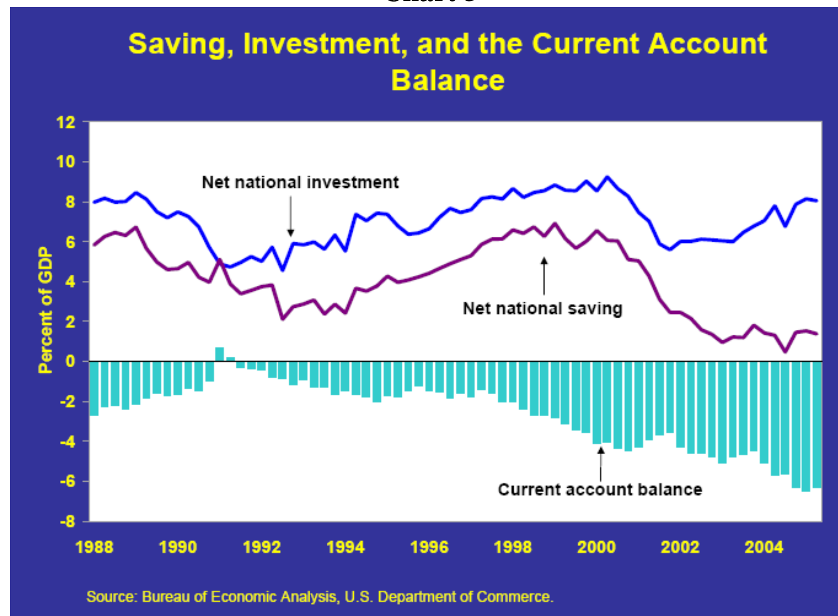
Large and persistent budget deficits have contributed to producing an ever-widening trade deficit that forces the United States to borrow vast amounts from abroad and puts the economy at risk of a major financial collapse if foreign lenders suddenly stop accepting U.S. IOUs. Even if an international financial crisis is avoided, continued budget and trade deficits will be a drag on growth in living standards.

Reduced national saving means lower national income. Large federal budget deficits have caused U.S. national saving to plummet since 2000. That decline in national saving has not translated into a similar decline in national investment, but only because the United States has run a large international trade deficit (**Chart 5**). Without the substantial purchases of U.S. Treasury securities by foreign central banks and others that have helped finance that deficit, U.S. interest rates would almost certainly be much higher than they are now and national investment would be much lower.

The relationship since 2000 among saving, investment, and the current account deficit contrasts sharply with the situation in the 1990s expansion. In the 1990s, U.S. net national investment exceeded net national saving, but both were growing as the improvement in the

federal budget contributed to higher net national saving. An increasing fraction of net national investment was being financed by U.S. saving and a diminishing fraction by foreign borrowing. After 2000, a growing fraction of U.S. net national investment was financed by foreign borrowing rather than U.S. saving.

Chart 5



If the United States continues to rely on foreign borrowing rather than its own national saving to finance investment, growth in national income will be curtailed. Maintaining investment through foreign borrowing contributes to higher productivity growth in the United States. However, the income from investment financed by foreign borrowing accrues mostly to the foreign lenders. As long as a high fraction of U.S. national investment is being financed by foreign borrowing, future U.S. national income will be reduced by the costs of financing and repaying those loans.

The trade and current account deficits are at record levels. The deficit in goods and services (the difference between U.S. imports of goods and services and U.S. exports of goods and services) rose to a monthly record of $68.9 billion in October. Both in dollar terms and as a share of GDP, the trade deficit will set another record in 2005. The broader current account deficit, which includes income flows as well as

goods and services, was 6.3 percent of GDP in the second quarter of 2005 (the latest data available) and is on track to set a record in 2005.

The United States had to borrow nearly $670 billion to finance its international payments imbalance in 2004. It is on track to have to borrow nearly $800 billion in 2005.

A depreciation of the dollar will not restore balance any time soon. After nearly three years of decline, the dollar rose in value against the currencies of its trading partners in 2005. However, many analysts believe that the rise in 2005 is temporary. More importantly, notwithstanding the recent increase, the value of the dollar in November 2005 was 11 percent lower than it was at its peak in February 2002 (based on the broadest trade-weighted exchange rate index, adjusted for differences in inflation among the various countries).

In principle, a fall in the dollar can improve the trade deficit by encouraging exports and discouraging imports. However, changes to imports and exports resulting from changes in the exchange rate can take some time to play out, and the trade deficit may initially worsen when the dollar depreciates (because the price of imports has gone up but the quantity purchased has not yet gone down).

Moreover, the central banks of some Asian economies where exports are viewed as an important source of economic growth have been resisting the appreciation of their currency (which would hurt their exports) by buying dollars. In recent years, for example, China has intervened heavily in the foreign exchange market by purchasing U.S. Treasury securities and other dollar-denominated assets to keep its currency from rising beyond its target exchange rate. In effect, governments that intervene to support their currency are helping to finance the U.S. trade deficit and limiting adjustment through the exchange rate.

Restoring fiscal discipline is one of the best ways to reduce the trade deficit and avoid problems from a weak dollar. Thus far, there has not been a flight from the dollar among foreign holders. However, private investors and foreign governments may suddenly decide that the benefits of holding dollars no longer justify the risks. A widespread dumping of dollar-denominated assets could precipitate an international financial crisis. But even an orderly further depreciation

of the dollar and reduction in foreign capital inflows is likely to be accompanied by inflationary pressures from rising import prices and a further tightening of monetary policy by the Fed.

Without an increase in national saving, any reduction in the current account deficit would also entail reduced national investment that would harm future growth. Private saving may rise some from its very depressed levels, but it would be imprudent to count on that. As many experts, including Federal Reserve Chairman Greenspan, have said, the best way to increase national saving is to reduce the federal budget deficit. That is also one of the best ways to reduce the trade deficit and to promote U.S. national investment and a rising standard of living.

Distorted Budget Priorities

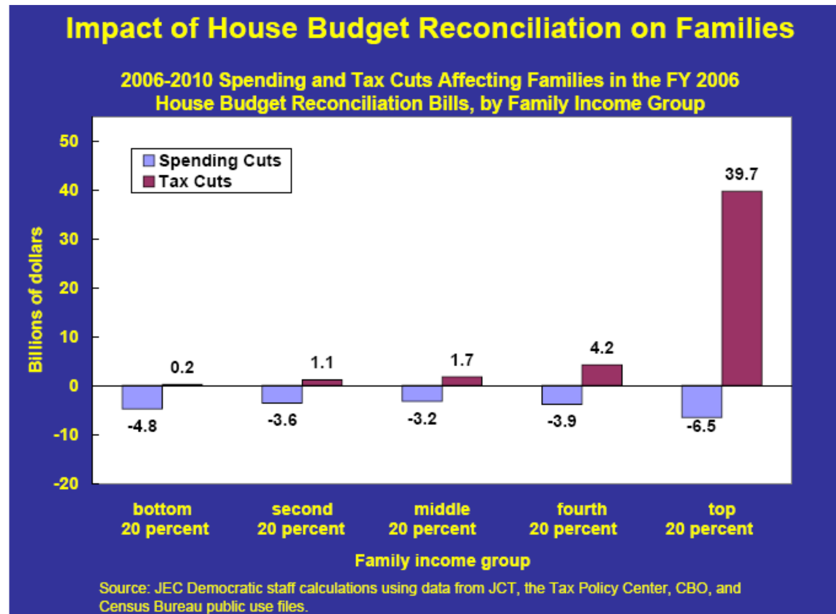
No matter what the budget situation, the challenge of dealing with the effects of Hurricanes Katrina and Rita would have put short-term strains on the federal budget. However, those strains would have been easy to absorb if U.S. budget and economic policies were sound.

Unfortunately, instead of sound budget policies aimed at preparing for the imminent retirement of the baby-boom generation, the Bush Administration and the Republican Congress have refused to adopt the kinds of budget enforcement rules that helped achieve fiscal discipline in the 1990s; have pursued an open-ended commitment to rebuilding Iraq that relies on supplemental appropriations rather than the normal budget process; and have remained committed to extending tax cuts that will add further to the budget deficit.

The end result is that policy priorities are distorted and programs that help ordinary Americans cope in a difficult economy become candidates for budget cutting in order to fund tax cuts. The budget reconciliation process this year illustrates these misplaced priorities. Congress was having difficulty completing the reconciliation process at the time this JEC annual report was completed, but the JEC Democrats' study, *The Impact on Families of the House and Senate Spending and Tax Reconciliation Provisions: A Preliminary Analysis*, shows how families in different parts of the income distribution would be affected by the plans under consideration.

The report compares the dollar value of the loss in benefits from cuts in spending that affect people directly with the gain in after-tax income from the tax cuts for families in each fifth of the income distribution. Using the House bills as a model, the analysis shows that families in the poorest fifth of the income distribution, which receive only 3 percent of total family income, would bear 22 percent of the cuts in spending directly affecting families and receive almost no benefit from the tax cuts. In contrast, families in the richest fifth of the income distribution would receive most of the benefits of the tax cuts, and those benefits would far outweigh any loss from the spending cuts (**Chart 6**).

Chart 6



The JEC Democrats' report, *The Impact on Families of the House and Senate Spending and Tax Reconciliation Provisions: A Preliminary Analysis*, can be found at: http://www.jec.senate.gov/democrats/Documents/Reports/budgetreconciliationdec2005.pdf

IV. Meeting America's Economic Challenges

The Joint Economic Committee Democrats issued several reports in 2005 analyzing America's economic challenges. In addition, they co-sponsored a forum at which distinguished policy experts

discussed those challenges in the wake of Hurricane Katrina. This section summarizes those reports and provides web links to them.

Democratic Economic Forum: Meeting America's Economic Challenges in the Wake of Hurricane Katrina

The JEC Democrats and the Democratic Policy Committee co-hosted a forum with distinguished economic policy experts Robert Rubin, Alan Blinder, Alice Rivlin, Roger Altman, Cecilia Rouse, and Bruce Bartlett to discuss the economic challenges posed by Hurricane Katrina and how working families are paying the price for misplaced budget priorities and other structural economic problems that existed before the hurricane and which remain unaddressed by the Bush Administration.

The panel generally agreed that the devastating impact of Hurricane Katrina will put short term strains on the federal budget, but a long-term economic disaster looms if the Bush Administration does not change course on economic policy. The panelists focused their remarks on the historically large budget and trade deficits; growing income disparities and the economic insecurity felt by the middle class; and providing adequate education and training. The panel assessed the economic challenges we face, evaluated current policies and how they differ from those implemented in the 1990s, and discussed policies we should pursue in the future.

Materials from the JEC Democrats/Democratic Policy Committee forum, *Meeting America's Economic Challenges in the Wake of Hurricane Katrina*, can be found at:
http://www.jec.senate.gov/democrats/hearings.htm.

Poverty, Family Income, and Health Insurance

Annual data released in 2005 by the Census Bureau show that the Bush administration's economic policies have not benefited most working families. During the first term of the Bush administration, income for the typical American household fell by $1,670, 5.4 million more people slipped into poverty, and 6 million more joined the ranks of those without health insurance.

The proportion of Americans living in poverty rose to 12.7 percent in 2004, up from 11.3 percent in 2000. Inflation-adjusted

median household income was $44,389 in 2004, down from $46,058 in 2000. The number of Americans without health insurance increased to 45.8 million in 2004, up from 39.8 million in 2000.

Key findings from the reports can be found in the following three JEC Demcratic studies:

Poverty Rate Increases for Fourth Consecutive Year
http://www.jec.senate.gov/democrats/Documents/Reports/poverty7sep2005.pdf

Household Income Unchanged in 2004, but Down Since 2000
http://www.jec.senate.gov/democrats/Documents/Reports/income7sep2005.pdf

The Number of Americans without Health Insurance Grew by 860,000 in 2004, Increasing for the Fourth Year in a Row
http://www.jec.senate.gov/democrats/Documents/Reports/healthinsurance7sep2005.pdf

Social Security Reform

Three reports by the JEC Democrats examined the negative impacts of the President's plan to replace part of Social Security with private accounts.

The Negative Impacts of Private Accounts on Federal Debt, Social Security Solvency, and the Economy finds that President Bush's plan to replace part of Social Security with private accounts would lead to a massive increase in federal debt, weaken the solvency of Social Security, and fail to increase national saving in preparation for the retirement of the baby boom generation. Furthermore, if the benefit cutbacks President Bush seems to favor were added to the plan, future generations would face the double burden of large cuts in their guaranteed Social Security benefits and paying down the higher federal debt.

What if President Bush's Plan for Cuts in Social Security Benefits Were Already in Place? finds that if President Bush's proposal for price indexing Social Security benefits had gone into effect in 1979 instead of the current method, middle-class workers retiring this year would receive a benefit 9 percent smaller than they would get under

current law. Benefit cuts would grow larger over time, and Social Security would replace an ever smaller share of workers' pre-retirement earnings. Indexing would hit middle-income workers much harder than upper-income workers, because middle-income workers rely on Social Security for a much larger fraction of their retirement income than do upper-income workers.

How the President's Social Security Proposals Would Affect Late Baby Boomers finds that the President's proposals for price indexing and the privatization tax accompanying private accounts would significantly cut guaranteed Social Security benefits for 40- to 50-year-olds. The guaranteed Social Security benefit after both price-indexing and the privatization tax would be 27 percent less than under current law for a 40-year-old worker who makes about $36,000 annually.

These three studies can be found at the following links:

The Negative Impacts of Private Accounts on Federal Debt, Social Security Solvency, and the Economy
http://jec.senate.gov/democrats/Documents/Reports/ssprivateaccountsapr05.pdf

What if President Bush's Plan for Cuts in Social Security Benefits Were Already in Place?
http://jec.senate.gov/democrats/Documents/Reports/ssprogindexingmay05.pdf

How the President's Social Security Proposals Would Affect Late Baby Boomers
http://jec.senate.gov/democrats/Documents/Reports/babyboomersreportmay05.pdf

Pension Reform

Two reports examined ways to improve defined contribution pensions for workers and reform the excesses of executive retirement packages.

Two-Tiered Pension System Protects Executives, But Not Average Workers argues that executives should have a stake in the fate of their companies' pension plans in order to improve corporate

governance. Too often, the executives of companies that default on their pension obligations escape with padded executive retirement packages while the average worker is left with little or nothing. Companies that underfund or default on their pension obligations should be prohibited from funding and paying out benefits from special executive pension plans.

Improving Defined Contribution Pension Plans examines the risks associated with the shift from traditional employer-provided pensions to defined contribution plans, where workers manage their own retirement savings. Despite some of the advantages to employees of defined contribution plans, most workers lack the experience and financial expertise to manage the risks and responsibilities of these plans. Low participation rates, low contribution rates, ill-informed investment decisions, and early withdrawals of funds all contribute to the increased retirement security risks associated with defined contribution plans.

These pension studies can be found at the following links:

Two-Tiered Pension System Protects Executives, But Not Average Workers
http://www.jec.senate.gov/democrats/Documents/Reports/twotieredpensions06oct2005.pdf

Improving Defined Contribution Pension Plans
http://www.jec.senate.gov/democrats/Documents/Reports/dcpensionplans06oct2005.pdf

Welfare Reform

Despite net increases in spending in both the House and Senate welfare reauthorization bills, those measures still fall well short of the amount needed to offset inflation and simply extend current welfare policy. The funding shortfalls are even greater after accounting for the significantly higher child care funding needs that would result from the increased work requirements under both bills.

The JEC Democrats' report, *Getting Real about Welfare Funding: The Costs of Sustaining Current Policy Are Not Program Expansions*, finds that this year the real value of the basic Temporary Assistance for needy Families (TANF) block grant was only 85 percent

of its fiscal year (FY) 1997 level. If funding remains fixed in nominal terms, the purchasing power of the TANF block grant will continue to erode, falling to just 75 percent of its original value by FY 2010. Furthermore, from FY 2006 through FY 2010, the increase in child care funding needed to offset inflation and higher work requirements would total between $5.4 billion and $8.3 billion, according to CBO data.

Getting Real about Welfare Funding: The Costs of Sustaining Current Policy Are Not Program Expansions can be found at the following link: http://www.jec.senate.gov/democrats/Documents/Reports/tanfreportjune2005.pdf

V. Conclusion

Despite solid economic growth and some improvement in the labor market, 2005 was another disappointing year for American families. Real wages fell in the face of rising energy prices and the economic recovery continued to benefit mainly those who were already well-off. Although the Gulf hurricanes focused attention on the many challenges, new and old, facing policymakers, it was business-as-usual for the President and the Republican Congress. Instead of focusing on issues of concern to working families, they continued to devote their energy to extending tax cuts for the rich. Meanwhile the problems of large budget and trade deficits and the economic insecurity felt by many American families remained unaddressed.