Testimony of
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Mr. Chairman, Ranking Member Gregg, and members of the Committee, I'd like to thank you for holding this hearing.

The Blinder-Zandi study

About two months ago, Mark Zandi and I published a controversial paper which estimated, among other things, that in the absence of the extraordinary policy measures taken in 2008 and 2009, there would be about 8½ million fewer jobs today, and we would be experiencing deflation.[1] Mark Zandi is here to speak for himself, but in my view, the two of us wrote the paper for a simple reason: The public, and especially the political, debate over the policy responses seemed long on rhetoric, short on analytics, and discordant with the facts. In particular, both TARP (the "Troubled Assets Relief Program") and the Recovery Act (ARRA--the "American Restoration and Recovery Act") were being branded as failures, or worse, while we viewed them as successes—albeit not without flaws. In a politically-charged atmosphere nearly devoid of quantitative appraisals,[2] prejudice and assertion seemed in danger of being accepted as fact and

[1] Alan S. Blinder and Mark Zandi, *How the Great Recession Was Brought to an End*, July 27, 2010.

[2] A few exceptions: The CBO had estimated the effects of the Recovery Act, and John Taylor had written several papers critical of both the fiscal and monetary stimulus. See CBO, *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from January 2010 Through March 2010*, May 2010; and John B. Taylor, *Getting Off Track* (Stanford: Hoover Institution Press), 2009; "The Lack of an Empirical Rationale for a Revival of Discretionary Fiscal Policy," *American Economic Review Papers and Proceedings*, May 2009, pp. 550-555); and others.

reasoning. It looked like there was a void to be filled and, judging by the volume of reactions to our study, there was.

Let me say, first, that while our study is widely viewed as a defense of the policies that were followed, we neither stated nor implied the Panglossian view that these policies were the best that could have been devised. In fact, we don't believe that, and both of us said so while the policies were being debated. Our paper claims only that they helped cure the financial stress, mitigate the recession, and hasten the recovery. Helped a lot, according to our estimates.

These estimates have been subject to both unwarranted praise and unwarranted criticism. Many of the attacks on our work are methodological in nature. (Many others are ideological.) So, even though this is neither the time nor the place for a technical disquisition, I want to say a few things about *methodology*. But I'll stick to plain English.

Zandi and I used a large-scale econometric model of the U.S. economy (the Moody's Analytics model, built and maintained by Mark Zandi) to estimate the effects of a lengthy list of fiscal and financial policies.[3] Such models are complicated beasts, but for present purposes only two aspects are important:

1. They are statistical representations of the economy *based on past history*.
2. At bedrock, they are complicated algebraic *renderings of the simple textbook models* that people like me teach in Economics 101.

A number of criticisms derive directly from these two points.

Models of the sort Zandi and I used are called "structural." They posit a *structure* of equations to describe the economy, including the channels through which policies might work, and then use *real historical data* to fill those equations with numbers. By the

[3] The list appears in Table 1 of our paper.

nature of their construction, these estimated structural equations are tied closely to the data. If the equations didn't "fit" past experience, they wouldn't be in the model.

Nonetheless, such models have been criticized on a variety of grounds—including that economists don't know the true structure, that policy interventions might change it, and that they don't handle expectations about the future very well. Our work inherited these generic criticisms, which have some validity. But what is the alternative? Some economists champion the use of purely statistical techniques that (allegedly) impose no structure at all, but simply "let the data speak for themselves." That may be a sensible approach when studying repetitive events, but not when studying phenomena that have never happened before.

It is true that models based on history may be poorly equipped to deal with events that are outside the range of previous experience--"out of sample," as statisticians put it. The sensible version of this criticism warns against placing too much confidence in out-of-sample results, and we agree. But what, other than displaying appropriate modesty, is to be done about it? The silly version of this criticism would ignore the discipline imposed by the data—*by the facts*--and simply *assert* answers based on *a priori* reasoning. This approach allows either ideology or technical fascination to triumph over (admittedly fallible) science.

Modern economic theory and econometrics offer a variety of alternatives to the brand of Keynesian economics embodied in the Moody's model and others. Some academics reject the Keynesian approach entirely--for reasons that need not detain us here—and that attitude has spawned several criticisms of our work as "old-fashioned." As I approach my 65th birthday, I feel compelled to point out that *old* ideas are not necessarily *bad* ideas. For example, both Adam Smith's invisible hand and the Declaration of Independence date from 1776.

Everyone agrees that all statistical models are fallible. So it is incorrect to say, as some of our supporters have, that Zandi and I have "proven" or "demonstrated" that the policies had large effects. No, we just *estimated* the effects to be large. Other empirical models might give quite different estimates, as thoughtful critics such as John Taylor have pointed out. That is precisely why we wrote, in the last sentence of our Executive Summary, that "we welcome other efforts to estimate these effects." We do.

One final methodological point: Some critics have argued that the counterfactual in our thought experiment ("What would have happened if there had been no policy responses at all?") is unrealistic or uninteresting--a kind of straw man. We disagree. In fact, every single policy initiative had opponents who argued strenuously against it. In fact, one such person is right here on the panel with us. If *laissez faire* is a straw man, there are plenty of straw men in America.

Which brings me to current policy.

Current policy

The recovery looks to be sputtering right now. Recent data may prove to be nothing more than one of those "pauses" that happen now and then during recoveries. I hope so, but I fear they may indicate something worse. Frankly, I'm less worried about the feared "double dip" recession than about the prospect that GDP growth will continue to undershoot potential. Starting from such a deep hole, we need to keep growth *well above* potential for a protracted period, for only that will reduce the unemployment rate over time. If potential GDP growth exceeds 3%, as I suspect, then actual GDP growth must exceed 4%, which doesn't seem to be on offer.

My conclusion is that monetary and fiscal policy should be spurring growth right now. Given the parlous state of the budget, it may seem natural to rely on monetary policy. The problem here, as I wrote in a recent *Wall Street Journal* column, is that the Federal Reserve has done so much already that it is down to relatively weak instruments.[4] Besides, the Federal Open Market Committee is so divided that it may not deploy even those.[5] If the Fed can't or won't do much more to spur growth, Congress should.

Now, I realize that this Committee is concerned about the budget deficit, as it should be. You all know that we are on an unsustainable *long-run* path that will require, for its correction, both more revenue and less spending down the road. But the deficit does *not* pose a *short-run* problem. The Treasury is now borrowing huge sums of money at extremely low interest rates. It can borrow more. Today, the jobs deficit is more urgent than the budget deficit.[6]

That said, the days of what I call the "Field of Dreams" strategy--*build a bigger GDP, and the jobs will come*—should be over. It's a sensible strategy in many contexts, but it has two serious drawbacks in the present situation. First, it is working very slowly because firms are so reluctant to hire. Second, it is expensive—in the neighborhood of $100,000 of government spending or tax cut for each new job saved or created. America needs more jobs *now*, and because of the large budget deficit, we need them *cheaper*.

[4] Alan S. Blinder, "The Fed Is Running Low on Ammo," *The Wall Street Journal*, August 26, 2010, A15.
[5] See Jon Hilsenrath, "Fed Split on Move to Bolster Sluggish Economy," *The Wall Street Journal*, August 24, 2010 and Ben S. Bernanke, "The Economic Outlook and Monetary Policy," remarks at the Jackson Hole Symposium, August 27, 2010.
[6] I do not mean to exclude enacting *now* budget reforms that will bring down the deficit *in the future*. Doing so might even increase spending now.

To me, those two considerations point toward two policies. One is a substantial broadening of what Congress did earlier this year with the HIRE ("Hiring Incentives to Restore Employment") Act: a temporary tax credit for new jobs. The other is temporary public employment centered on relatively low-wage workers. Simple calculations suggest that each of these options can create new jobs at a price tag of $30,000-$40,000 each. Given where we are and where we've been, that seems like a pretty good deal to me.

I have been advocating these two policies all year, though not to much avail.[7] But I haven't changed my mind. I still think they are the right things to do.

Thank you for listening.

[7] See Alan S. Blinder, "Getting the Biggest Bang for Job-Creation Bucks," *The Washington Post*, February 19, 2010, p. A17.