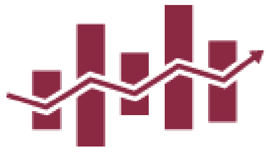

EPI TESTIMONY

TESTIMONY GIVEN BY

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IN A HEARING BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

"Monetary Policy and the State of the Economy"

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Thank you, Chairman Frank, ranking member Bachus, and members of the committee for the opportunity to testify today. I am Lawrence Mishel, president of the Economic Policy Institute.

I have three messages for you today:

1. The nation's current jobs crisis is severe and there will be continued high unemployment—perhaps as high as current unemployment—through the end of 2011. This is an unacceptable outcome, and we should not and need not accept it. Many localities and particular demographic groups, particularly the workforce in minority communities, can expect under current forecasts to be living in depression conditions for several years to come. Therefore, it is incumbent upon Congress to act on a scale that will produce millions of jobs in order to put unemployment on a steep downward path.

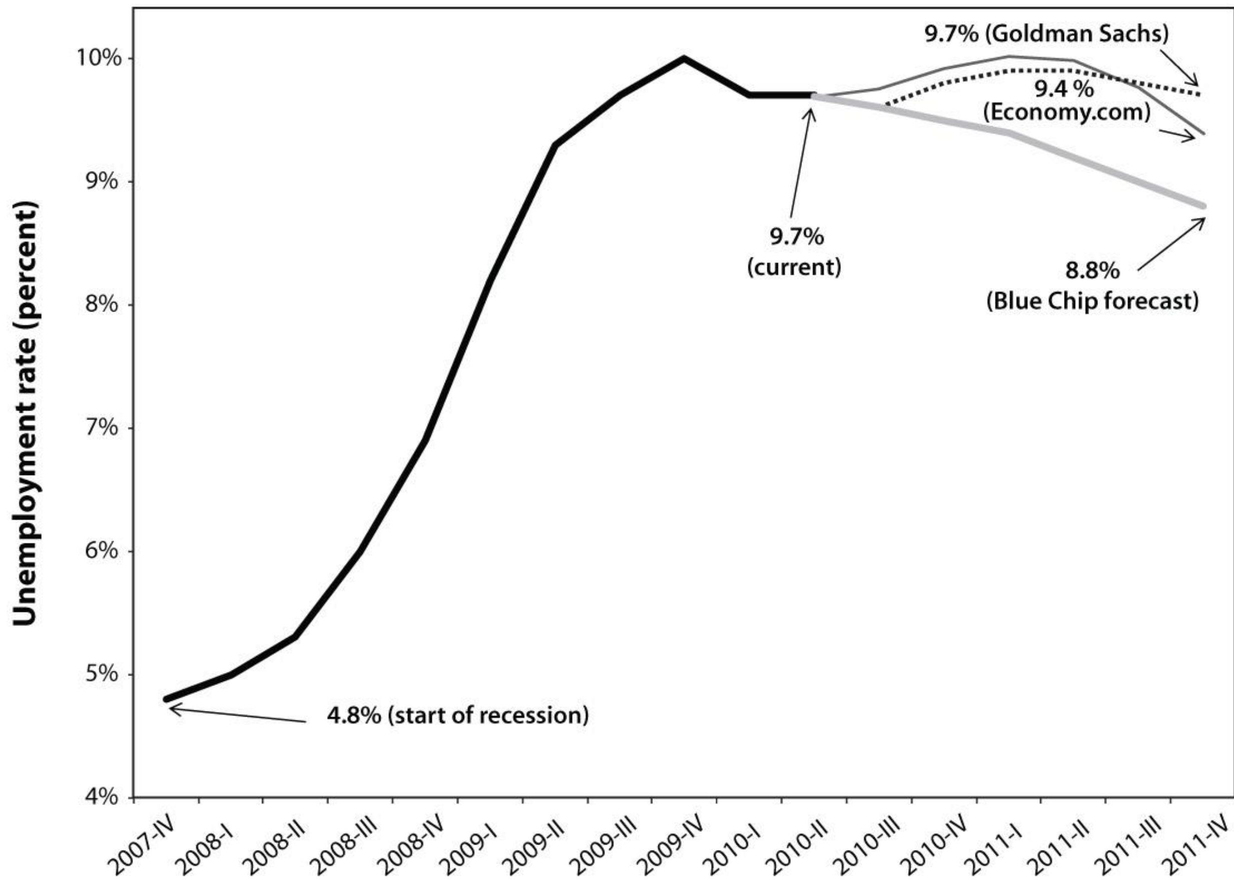
2. The only viable solution to this problem is an array of large and effective federal jobs initiatives, beginning with continued support for the unemployed, relief to state and local governments, direct job creation as provided in the Local Jobs for America Act and a commitment to a sizeable and ongoing program of public investment.

3. Deficit spending for the next few years under these circumstances is not just unavoidable, it is desirable. The main reason we have a large deficit is that we have a large recession that has reduced revenues and temporarily raised certain expenditures. Further efforts to generate jobs require spending to boost overall demand for goods and services, and any effort to offset that spending in the near term will only lessen the boost to demand. Therefore, the best policy approach is to provide some offsets that take effect in several years, such as the institution of a financial transactions tax, or to have no offsets at all. It should be noted that spending on items such as unemployment insurance will generate jobs and income and generate extra revenue and reduced expenditures as a result: the net impact on the debt is just 40% of the actual sticker price of the legislation.

THE JOBS CRISIS IS SEVERE AND THERE IS NO END IN SIGHT

The United States is undergoing the worst economic downturn in 70 years, and the damage and suffering it is causing will last many years beyond the official end of the recession. There are a few signs of hope: with the help of the Recovery Act, economic activity and employment are rising, although slowly; with federal assistance the auto industry has survived a near-death experience; and there is even a little growth in manufacturing employment. But we still have enormous problems. It is likely that unemployment will rise again before the year ends, and CBO forecasts that unemployment will average 9.5% next year, a rate historically associated with severe economic crisis. At the end of next year it is likely that the unemployment rate will be comparable to what we have now. As **Figure 1** shows, the Blue Chip forecast is for unemployment at 8.8% at the end of 2011. Some forecasters with strong track records—Goldman Sachs and Economy.com—suggest unemployment will be from 9.4 to 9.7% at the end of next year. Recall that unemployment started rising from its low level of 4.4% in the spring of 2007, reached above 9.0% in May 2009, and has stayed there ever since. Therefore, if unemployment remains above 9.0% at the end of 2011 it will have remained on that high plateau for over two and a half years (after having steadily risen for two years before that). Note that unemployment never exceeded even 8.0% in the last two recessions. The problem is that even though we have had economic growth since mid-2009, it has not been rapid enough to absorb all of the new

entrants to the labor force as the population expands (roughly 100,000-125,000 per month) or employ any significant portion of the unemployed. That appears to be the case going forward through the end of 2011 as well.



As you know, the current unemployment rate of 9.5% understates the extent of the distress in the labor market. Many workers are underemployed, including many working at part-time jobs though wanting a full-time job and some who have given up on looking for work and thus are not even counted in the official unemployment statistics. There were 25.8 million Americans underemployed in June—that is 16.5% of the labor force. The recession is even more severe among minority workers, with unemployment of 15.4% and 12.4%, respectively, for black and Hispanic workers. The Economic Policy Institute calculates that underemployment among minority workers is now roughly 24%. All the figures I am citing describe the number affected in a particular month. However, since there are flows into and out of unemployment each month, there are many more people affected over the course of a year. In 2010, I expect that roughly a third of the workforce and more than 40% of minority workers will be unemployed or underemployed at some point during the year. This experience will be repeated in 2011 as well under current projections. Last, the deep recession is also damaging those who remain employed, as wage growth descends to historically low levels and benefits are cut. Even actual cuts to wages themselves are becoming widespread.

There are still five jobless workers for every job opening—proof by itself that there is nothing most of the unemployed can do to find a job. Businesses aren't hiring because, as the Council of Economic Advisers has noted, there is still a huge shortfall in demand. The jobs just aren't there to absorb new workers and bring the needed reductions in unemployment. Even though job openings have increased lately, they still remain one-third below the number being generated on average in 2007 before the recession (during 2007, even with those job openings, unemployment rose throughout the year).

The result is record levels of long-term unemployment. In June, nearly half (45.5%) of all unemployed workers had been unemployed for over six months. That translates into 6.8 million long-term unemployed workers, by far the highest level since the Great Depression—the previous high was 26% in June 1983. Roughly one-fourth of the unemployed, 3.7 million workers, have been unemployed for more than a year.

We are now 7.5 million jobs below where we were when the recession started. And that enormous loss doesn't tell the whole story: because the population is growing all the time, we need to add jobs every month just to keep the unemployment rate from rising. Over the two years and six months since the recession began in December 2007, we needed to have *added* around 3.1 million jobs simply to keep up with population growth. The job shortage in the labor market is thus roughly 10.6 million jobs. To put this all in perspective, consider the following: in the boom of the late 1990s, the fastest year of employment growth was 2.6% in 1998. If we somehow achieve that extremely strong level of growth, month after month, from today onward, we would still not get unemployment rates down to pre-recession levels (5.0% in December 2007) until January 2015. Unfortunately, as of today no policy has been enacted that would allow us even to hope for that rate of job creation in the coming years.

The challenges ahead are well known and easy to specify. First, if the deficit reduction that is needed in the medium term is started prematurely—meaning this year or next—it will weaken the recovery. We recommend that deficit reduction, other than that occurring from a healing economy producing more jobs, more revenue, and less emergency spending, not begin until the economy achieves 6.0% or lower unemployment for at least six months. This would assure that there is sufficient momentum toward reaching full employment before undertaking deficit reduction that will offset some of the growth. Second, state and local governments as they move their budgets into balance could lay off hundreds of thousands of their employees and lead to an equal number of employment losses in the private sector. The combination of program cutbacks and revenue increases (which will lessen overall demand) undertaken by state and local governments will act as an 'anti-stimulus'. It is likely that there will be substantial employment reductions in the next six months as a consequence. Our research indicates that as many private sector as public sector jobs will be lost. This is because state and local governments provide many services through private firms, such as hospitals and nursing homes, but also because laid off public employees will curtail their spending in the private sector.

Third, the fiscal austerity being proposed in Europe will slow growth there and lessen our ability to export to them. Fourth, the economy is still wrestling with the substantial lost wealth from the housing and stock market crashes, the urge of households to deleverage—boost their savings rate and pay down debt—and a depressed construction sector. Final demand is still, as of the first quarter of 2010, more than 1% below the pre-recession level. Of course, we should have expected demand to grow by 2.5% to 3.0% each year. Thus, demand is still substantially reduced, unfortunately growing slowly now and in the foreseeable future. This shortfall in demand is the main impediment to growth and why the challenges to future demand growth just discussed—deficit reduction here and abroad, and cutbacks by state and local governments—are so dangerous.

Last, the poor performance of wage growth, which normally drives the growth in demand from consumers, will limit future demand growth. At this point wages are growing at a minimal rate and below the rate of inflation. This is despite a very fast growth of productivity. These trends have led to much higher profits, which aren't being reinvested

because of a lack of growing sales opportunities, in other words, a lack of demand. Profits have, in fact, bounced back to their pre-recession levels. Federal policy should focus on reducing unemployment and lessening the downward pressure on wages so we can have household consumption growth contribute to higher levels of demand and overall growth.

JOB CREATION REQUIRES MORE FEDERAL INTERVENTION

Obviously, what the economy and the unemployed need is job creation, and Congress has to take responsibility for creating it. Some policy makers may be getting tired of having to deal with job creation and unemployment, but it is surely true that American families are even more tired of having to endure extreme labor market distress with no real end in sight. Because so much wealth—$12 trillion—was lost in the twin financial disasters of the housing market and the stock market crashes, consumer purchasing power and demand for goods and services have been greatly reduced. Consumer demand is further reduced because 15 million workers are unemployed and surviving either on unemployment benefits that are a fraction of their previous income, or no benefits at all. Another 9 million workers have part-time jobs—with part-time incomes—even though they want full-time jobs. This reduced demand discourages business investment: why add extra employees or new equipment if consumers can't buy what you produce? To maintain or increase their profits, businesses have been increasing productivity, squeezing more out of their existing workforce while resisting additional hiring. This has allowed corporate profits to return to the levels prevailing before the recession, but it has not allowed for income growth for most workers or for rapid job generation.

To break this cycle, Congress should: (1) Continue providing support for the unemployed, including restoring the extra weekly supplement and the COBRA subsidies that were not included in the recently passed legislation; (2) Provide relief to the states both for health and education, continuing the provisions included in the Recovery Act; (3) Provide robust support for infrastructure, including school modernization, and transportation investments that can fuel job growth going forward; and (4) Pass the Local Jobs for America Act, H.R. 4812, which Rep. George Miller has introduced in the House, along with 165 co-sponsors. Economic forecasters have been assuming the extension of the UI/COBRA program and fiscal relief to the states in their forecasts, so failure to do so means that the unemployment horizon will be more severe than I have already described. With the difficulty of enacting such measures, specifically unemployment insurance and state relief, forecasters have now begun to revise downward their estimates of economic growth and revise upward their estimates of unemployment.

If Congress does not want to accept the unacceptable, then it will need to enact the Miller bill and other measures to generate jobs. The Miller bill, for example, would distribute $100 billion in grants to state and local governments over the next two years to retain public safety and education employees, create new local government jobs, and help local non-profits create hundreds of thousands of jobs doing work that would improve their communities—everything from environmental clean-up to child care. The funds would be distributed by formula to every major jurisdiction based on unemployment and poverty to ensure that the areas that need help the most get the most help. Scores of organizations, led by the National League of Cities and the U.S. Conference of Mayors, have called on Congress to enact this legislation, which builds on a long history of successful public service job creation efforts dating back to the New Deal, but also including the Nixon Administration's Emergency Employment Act of 1971.

THE DEFICIT IS NOT A REASON TO FAIL TO ACT

The initiatives I have outlined above necessitate increased spending or lower revenue over the next couple of years, and thus they will add to the federal debt in the short run. While we do face longer-term budgetary challenges, we cannot be paralyzed into inaction—deficits are both necessary and appropriate with unemployment at current levels.

In fact, the best way to get our fiscal house in order is to ensure we have a vibrant, growing economy and enough jobs and taxpayers so that we as a nation can start to address the long-term budget. In other words, a major job creation initiative is complementary to any strategy for addressing our future fiscal imbalances.

Experts agree deficits are appropriate and desirable in recessions.

During times of economic contraction and/or high unemployment, deficits will naturally increase. As incomes and profits fall, tax revenues will decline as a share of the economy. Greater unemployment and lower wages will increase spending on a variety of social supports, including unemployment insurance and Medicaid. These "automatic" reactions to recessions imply that deficits will increase. Furthermore, policies enacted specifically to combat recession (through, e.g., infrastructure spending or tax cuts) will have an impact on the deficit as well, at least for the time-limited existence of such efforts.

Textbook economics as well as expert opinion are in agreement that deficits that arise from both the automatic reactions as well as from deliberate, counter-cyclical policy changes are appropriate and desirable to reduce the size and duration of the recession. See examples below for illustrations from experts who are thought to be "deficit hawks":

David Walker, President and CEO of the Peter G. Peterson Foundation: "I think it's very important to separate the short term from the structural. It's understandable to run deficits when you have a recession, a depression, or unprecedented financial services and housing-type of challenges and crises that we've had. That's not what I'm concerned about."[1]

Gene Steuerle, Senior Fellow, The Urban Institute, and co-director of the Urban-Brookings Tax Policy Center: "Contrary to much debate, getting the long-term budget in order does not require avoiding stimulus in bad times; it only means reasonable reductions in those levels in good times."[2]

Greg Mankiw, Harvard Professor and Former Chairman of the Council of Economic Advisors under George W. Bush: "It is a textbook principle of prudent fiscal policy that deficits are an appropriate response in times of war and recession."[3]

Isabel Sawhill, Senior Fellow, Brookings: "It is important to stimulate the economy now and not worry about the deficits needed to do this, but we should simultaneously be enacting legislation that will gradually phase in spending cuts and revenue increases over the next decade."[4]

Concord Coalition: "It may be appropriate for government to spend more than it taxes during downturns in the business cycle. The Concord Coalition has always recognized the importance of fiscal stimulus, so long as the stimulus is timely, targeted, and temporary."[5]

In fact, David Walker, president of the Peterson Foundation and a well-known deficit hawk, wrote an op-ed with me in February arguing that our short-term deficits should not be the focus of concern: rather, it is the longer-term structural deficits that we need to address. We argued that job creation is the immediate priority and that this will necessarily mean higher deficits in the short term. Since measures taken now to generate jobs have very little effect on our long-term imbalances, one should not invoke worries about future deficits as a reason to avoid creating jobs now. In fact, these are complementary strategies, creating jobs and more taxpayers now is the way to move the fiscal situation to a healthier place. In testimony before the Deficit Commission, Walker argued that deficit reduction should wait until unemployment falls below 7%, close to my recommendation that the target be 6% for six months.

A Potent Example of Job Creation and Helping the Victims of the Recession: the macro-economy of unemployment insurance.

The debate over the renewal of unemployment insurance was rather misguided from my perspective. While there is variation in "bang-for-the-buck" estimates of different types of stimulus spending, among economists there is a generally accepted hierarchy of the economic benefits of various stimulus provisions. CBO and other analysts base their GDP and unemployment projections on the fact that, aside from food stamps, government spending on extending unemployment insurance provides the greatest economic benefit to the economy of any form of stimulus spending. In other words, extending and expanding unemployment insurance benefits are among the most efficient things the government can do to generate jobs. The reason extending unemployment insurance is such good stimulus is that it gets money to people who are the most likely to have depleted their savings and thus tend to have no choice but to quickly spend essentially every dollar they receive on necessities found in their local economy. In other words, virtually every dollar spent on extending unemployment insurance benefits goes directly, and immediately, toward the purchase of local goods and services, providing an extremely efficient demand boost. Not only is extending and expanding UI benefits the right thing to do for the people hurt most by this economic downturn, it is also excellent economic policy.

We have estimated that the expansion of unemployment compensation since 2007, both the receipt of regular benefits during the first 26 weeks and the special extensions of weeks and extra weekly benefits, supported an additional 1.7 million full-time equivalent jobs in early 2010 that would not have been there otherwise. This helped offset the employment decline during the recession. This program has not only been effective at helping people and generating jobs, it has also done so at a bargain price. The ultimate impact of the accumulated debt is only 40% of the "sticker price" because the jobs and output generated by the spending bring in revenue and lessen the need for other safety net expenditures, such as Medicaid and food stamps. The result is that the spending creates jobs for the meager cost of about $37,000 per job. Unfortunately, the recent legislation excluded two provisions—COBRA subsidies and the weekly supplement to benefits—which provided about 300,000 jobs in early 2010. The result is that the renewal of the unemployment compensation program will provide more jobs than would be there otherwise, but fewer jobs than were being provided in early 2010. The cutbacks in the program, which were enacted for symbolic purposes to appear fiscally responsible, have in fact cost us jobs that could have been provided at a very reasonable cost.

Conclusion

Thank you very much for the opportunity to offer my perspective on the job challenges ahead and what can be done to address those challenges.

Endnotes

1. January 11, 2009, Interview with National Public Radio at http://www.npr.org/templates/story/story.php?storyId=122436097&ft=1&f=3
2. November 30, 2009, National Journal Experts Blog at http://economy.nationaljournal.com/2009/11/obama-and-the-deficit-1.php
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5. December 19, 2002, "A More Responsible Fiscal Course" at http://www.concordcoalition.org/issues/facing-facts/more-responsible-fiscal-course.