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Testimony to the Joint Economic Committee

The Impact of the Recovery Act and the Economic Outlook

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Chairwoman Maloney, Vice Chairman Schumer, Ranking Member Brownback, Congressman Brady, it is a pleasure to be with you today to discuss two issues of interest to both the Joint Economic Committee (JEC) and the Council of Economic Advisers (CEA). One is the economic impact of the American Recovery and Reinvestment Act of 2009. As part of the unprecedented transparency and accountability provisions of the Act, the CEA provides a report to Congress about the Act each quarter. In the Fourth Quarterly Report released this morning, we not only find that the Act has had a substantial effect on output and employment, but that it is leveraging private capital and making important investments in the future productivity of the country.

The second topic I will discuss is the economic outlook. The Recovery Act and other actions have helped to turn the economy from freefall to recovery. But, much work obviously remains to return the economy to full health. I will discuss the role that the targeted actions currently being discussed by Congress could play in counteracting some of the headwinds to growth that have become more apparent in recent weeks and, by doing so, in accelerating the rate of recovery.

Impact of the Recovery Act

Let me begin by discussing what the CEA's new report finds about the impact of

the Recovery Act as of the second quarter of 2010. With the Chair's permission, I would like to enter a full copy of the report into the record.

The Changing Composition of Recovery Act Stimulus. Congress designed the Recovery Act both to begin spending out quickly and to provide crucial support to the economy over a two-year period. It has met and is continuing to meet these goals. The state fiscal relief, payments to seniors, and the emergency unemployment insurance benefits went out almost immediately, and started aiding the economy in the spring and summer of 2009. The tax cuts also went into effect immediately, but it has been during tax season (the first two quarters of this year) that many Americans have seen concrete signs in the form of reduced tax payments and increased tax refunds. The Internal Revenue Service estimates that more than 95 million households received the Making Work Pay tax credit from the Recovery Act and that average tax refunds were up by over $200 from last year in part because of this and other Recovery Act tax provisions. In previous CEA Recovery Act reports, we have highlighted the state fiscal relief and the tax cuts and income support provisions of the Act, and found evidence of their effectiveness.

In today's quarterly report, we highlight the public investment spending in the Recovery Act. This is the project spending that not only creates jobs in the short run, but leaves us with an expanded and improved ability to create high-paying jobs in the future. The Recovery Act includes $319 billion of public investment on everything from basic infrastructure such as roads and bridges to twenty-first century infrastructure such as a smarter electrical grid and universal broadband. It invests in community health centers, health information technology, education, and job training to improve the health and skills of our citizens—our human capital. And, it makes unprecedented

investments in basic scientific research to enhance innovation and so help retain our competitive edge. All of these investments will help increase the long-run productivity of our economy and the standard of living of ordinary Americans.

The public investment components of the Recovery Act were always expected to spend out more gradually, because they typically require planning and are often awarded through a rigorous competitive process. But as of the end of June, roughly two-thirds of the public investment funds included in the Act had been obligated, and more than $86 billion had been outlayed. Public investment outlays increased by more than 50 percent between the first and second quarters of this year, which explains why the Vice-President has named this summer the "Summer of Recovery." In the area of transportation infrastructure alone, nearly 14,000 projects had been awarded as of the first quarter of 2010. Importantly, as the other stimulus in the Recovery Act gradually winds down over the next few quarters, the public investments will continue at a rapid pace, providing continued support to the economy.

Leverage Provisions of the Act. An innovative feature of the Recovery Act is its focus on partnering public investment with private and other funds. Much of the Recovery Act investment spending takes the form of matching grants, loan guarantees, interest subsidies, and tax incentives that support and encourage outside investment. For example, the 48C Advanced Energy Manufacturing Credit gives private firms that pass the Department of Energy's competitive process a 30 percent tax credit for their investments in factories to produce solar panels, wind turbines, and other clean energy products. The Broadband Initiatives Program provides grants and loans to firms and regional authorities to bring internet access to rural communities. And, the Build America Bond program subsidizes the interest cost of state and local government

borrowing for schools, transportation, and other vital projects, so that these entities are encouraged to invest in local infrastructure.

The CEA's report collected information from 15 agencies on the nature and extent of these leverage provisions in the Recovery Act. We find that roughly $100 billion of Recovery Act funds use leverage, and that these provisions are encouraging co-investment in a wide range of areas. The greatest use of these innovative provisions are in the areas of clean energy, economic development, and building construction. We estimate that the $100 billion of Recovery Act funds will partner with close to $300 billion of other funds, the majority of which are from the private sector. That is, $1 of Recovery Act funds is matched by $3 of other funds. All told, the $100 billion investment from the Recovery Act will support more than $380 billion of total investment spending.

A detailed examination of the incentives for wind energy production suggests that such leverage provisions can have a significant impact on private sector investment behavior. Thus, the Recovery Act appears to be stimulating private investment and job creation at a time when the economy needs it most.

Jobs Impact. In our report, we estimate the impact of the Recovery Act on job creation in two ways. One is a model-based approach, similar to that used by the Congressional Budget Office. This approach uses multiplier estimates based on the historical record to estimate how the Recovery Act tax cuts and outlays to date likely translate into employment effects. Importantly, when we apply this approach, we err on the side of caution and consider only the effects of the government expenditures and tax cuts; we do not include the employment effects from the private investment spending that may have been leveraged by the innovative features of the Act.

The second approach that we use to estimate the employment impact of the Act does not depend on policy multipliers estimated from past history. Instead, it uses statistical procedures to project the likely path of employment based on the information available through the end of the first quarter of 2009, when the Recovery Act was passed. It then compares the actual path of employment with the forecasted baseline. This projection approach implicitly takes into account features such as the innovative leverage provisions that may have caused the Recovery Act to have impacts different from previous fiscal actions. At the same time, it is important to realize that this approach also captures any unusual influences on the economy, either positive or negative, other than fiscal policy.

The model-based approach indicates that the Recovery Act has raised employment relative to what it otherwise would have been by 2.5 million jobs as of the second quarter of 2010. Of these jobs saved or created, more than 800,000 are due to the public investment outlays that have occurred so far. The projection approach yields a substantially larger number: it suggests that employment as of the second quarter is 3.6 million higher than it otherwise would have been. By this estimate, the Recovery Act has met the President's goal of saving or creating 3.5 million jobs—two quarters earlier than anticipated.

Our review of a wide range of other estimates of the employment effects of the Act shows that our model-based estimate is similar to that of outside experts. Our projection-based estimate is higher than other estimates, though very similar to the Congressional Budget Office's high-end estimate of 3.4 million. There is obviously a great deal of uncertainty around any jobs estimate, and I suspect the true effects of the Act will not be fully analyzed or fully appreciated for many years. But, our compendium

of outside estimates shows that respected analysts across the ideological spectrum, as well as the non-partisan Congressional Budget Office, agree that the Act has had a significant beneficial effect on employment and output over the past year.

Economic Outlook

Let me turn to the second topic I want to discuss today—the state of the U.S. economy and the outlook for the future.

Current Conditions. First, and most obviously, the economy is doing much better today than it was when I last testified to the JEC in October 2009. At that point, we were just beginning to see the signs of recovery. We now know that GDP began to grow again in the third quarter of 2009, and has been expanding at a moderate pace since then. In October 2009, we were still losing jobs, although at a much slower rate than in the depths of the crisis. Since the beginning of 2010, we have been consistently adding jobs: private sector employment is up nearly 600,000 since the start of the year. In October 2009, the unemployment rate hit 10.1 percent. It has fallen six-tenths of a percentage point since then, to 9.5 percent in the most recent report.

While conditions are much improved from last October, and dramatically better than they were in the dark days of late 2008 and early 2009, the economy remains far from fully recovered. The financial crisis and the ensuing recession inflicted a terrible toll on American families and workers, and much work remains to be done to repair the damage left after the storm.

Some might see a conflict between my earlier discussion of how useful the Recovery Act has been and the fact that economic conditions are still very tough. But there is none. The Recovery Act is doing what the Administration and other analysts

said it would do: it has increased employment greatly relative to what it otherwise would have been. It has helped to fill some of the shortfall in demand, and has played a fundamental role in the dramatic change in the trajectory of the economy. But, because the deterioration of the economy was so severe in late 2008 and early 2009, even with this essential aid, the economy remains troubled. It is surely little comfort to families that are still struggling to hear that without the Recovery Act conditions would have been far worse. But it is, nevertheless, true.

What can we expect for the economy in the months ahead? The past few weeks have seen more mixed economic reports than we saw in the spring. Following the troubles in Europe associated with the Greek debt crisis, stock prices have declined noticeably and financial markets have been subject to greater volatility than we had seen for more than a year. Perhaps related to this financial sector unease, some measures of consumer confidence have fallen somewhat. Also, housing sales and building permits took a decided drop in May, suggesting that a self-sustaining recovery has not yet taken hold in the housing sector.

Importantly, despite these troublesome developments, many areas of the economy are continuing to show strength. The fact that personal consumer expenditures grew in May suggests that consumer spending, the largest source of aggregate demand, is continuing at a solid pace. The data on shipments of capital goods in May indicate that business investment in equipment and software continues to grow rapidly. Also, industrial production has expanded strongly, particularly in the high-tech manufacturing sector, where production is up 18 percent since May of 2009. Manufacturing jobs are growing at their strongest pace since 1998.

The Headwinds We Face. As we look forward, it is clear that the economy

continues to face some strong headwinds. The dire situation of state and local budgets means that without additional Federal aid, state and local governments will continue to shed jobs and act as a contractionary force on overall economic activity. Though credit conditions have ceased tightening, both recent statistics and reports from market participants suggest that many borrowers, particularly small businesses, still find it difficult to get loans. This obviously hinders small business growth and job creation. Finally, the housing bubble and bust has left many homeowners over-indebted and the U.S. economy with a substantial oversupply of housing. As a result, the prospects of a rapid growth in residential investment, as we have seen in previous recoveries, are slim.

Because of these persistent headwinds and the recent spate of mixed indicators, most private forecasters are predicting continued growth and job creation, but at a somewhat more subdued pace than the robust growth that looked possible a few months ago. Without further aid, the economy will continue to grow, but the rate of recovery will likely continue to fall short of the rapid expansion that is needed to bring the unemployment rate down quickly.

The Need for Targeted Actions. It is for this reason that the additional targeted actions that the President recommended last winter are even more important today than when he first proposed them. Each of the actions is designed to counteract some of the headwinds that we face, and by doing so, to increase the speed of recovery.

The most fundamental of these targeted actions is an extension of emergency unemployment insurance benefits. According to the Department of Labor, 2.1 million Americans have already seen their unemployment insurance benefits stop because of the failure to extend the program. This number will rise to 3.2 million by the end of the month. It will be devastating to both the families affected and the overall economy if

this support is not renewed. Studies by the Congressional Budget Office and private analysts identify emergency unemployment benefits as one of the most cost-effective programs for supporting output and employment. At a time when the unemployment rate is 9.5 percent, there can be little question that such support is deeply needed.

Support for small business lending is another essential program to counteract the headwinds we face. This is an exceptionally low-cost measure that promises to materially increase the availability of credit to the small firms currently struggling. Such credit support, together with the small business tax cuts and bonus depreciation included in the bill, will be a much needed shot in the arm for small businesses. Such support will help them to expand and create jobs.

The third targeted measure that will help ensure more rapid recovery is additional aid to state and local governments. There has been much discussion in the past weeks of innovative ways to structure this aid so that it encourages beneficial reforms or pays for itself over time. Many variations have merit, and the Administration is anxious to work with Congress to pass a sound plan. But some form of meaningful state fiscal relief is necessary both to prevent widespread layoffs of teachers, firefighters, and police officers, and to accelerate job growth throughout the economy.

We are all keenly aware of our large budget deficit and the long-run fiscal challenges that we face. The President is committed to meeting those challenges. That is why he worked with Congress to pass health care reform that will lower the deficit by more than $1 trillion over the next two decades. It is why his budget includes a three-year freeze in nonsecurity discretionary spending, and why he established a bipartisan commission to forge the necessary consensus for sensible, serious deficit reduction. It is also why the Administration has pursued a wide range of low-cost measures to spur

growth, such as export promotion and public-private partnerships that have proven successful in leveraging private sector investment through the Recovery Act.

But not taking additional targeted actions, many of which are fully paid for over the budget window, because of concern about the deficit would be misguided. Allowing the unemployment rate to remain severely elevated for an extended period runs the risk of permanently lowering labor force participation and worker skills. Such permanent damage would not only be terrible for the workers involved, it would be terrible for our long-run budget situation.

Our report today contains the latest evidence that the Recovery Act has been highly effective at helping to turn the economy from freefall to growth. It also describes how, through its innovative investment programs, it has helped to support private investment and rebuild the public, private, and human capital stocks of the United States. What we need to do now is take some targeted, fiscally responsible additional steps to speed the recovery, and finally return the economy to health after the wrenching events of the past few years.

A Longer-Run Perspective. Much of my discussion this morning has appropriately focused on the recovery and the need to jump-start job creation. Nothing is as important as getting Americans back to work. But in closing, let me take a minute to look both further back and further into the future.

Even before the financial crisis and the recession that followed, the United States was facing economic stress. As documented in the *Economic Report of the President* from last February, health care costs were rising rapidly, squeezing both families and businesses; we were failing to invest as much as we should in education and R&D; and our financial regulatory structure had failed to keep up with the technological and

behavioral changes in the industry. These developments were leading to stagnating incomes for middle class families, less innovation, and excesses in our financial system that set the stage for the crisis.

Over the past 18 months, the President and Congress have not only taken unprecedented steps to deal with the recession, but have also made great progress in facing these longer run challenges. The Patient Protection and Affordable Care Act passed last March will slow the growth rate of health care costs by improving both the efficiency and the quality of our current system. The investments in education and basic scientific research started in the Recovery Act and continued in other legislation will build the skills and knowledge base essential for raising standards of living and competing in world markets. And, the financial regulatory reform legislation on the verge of completion will help prevent a repeat of the terrifying meltdown of the financial system that we experienced in the fall of 2008.

By working to both rescue the economy in the short run and rebuild the fundamental sources of productivity and stability in the long run, the President and Congress are charting a path not only back to normal, but to a better normal than we had before.