# EPI TESTIMONY

**TESTIMONY OF**

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**RAYBURN HOUSE OFFICE BUILDING**

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## Introduction

The U. S. economy remains mired in a prolonged jobs crisis with no substantial improvement in sight. More than 25 million Americans are unemployed or underemployed, poverty is on the rise, and economic insecurity abounds.

Rather than address the crisis at hand, many in Washington are obsessed with a nonexistent fiscal crisis, at the expense of job creation. A political crisis created by conservatives' refusal to raise the statutory debt ceiling last summer led to the passage of the Budget Control Act (BCA), which made significant cuts to discretionary spending and created the Joint Select Committee on Deficit Reduction. Better known as "the supercommittee," this group is tasked with finding at least an additional $1.2 trillion to $1.5 trillion in deficit reduction. Unfortunately, the supercommittee was not explicitly charged with addressing the more pressing economic problem—the ongoing job crisis.

As the deadline for the supercommittee's recommendations approaches, public reports confirm that the committee is not focusing on the pressing job of boosting growth and employment.

Congress must change the course of fiscal policy; failure to do so risks prolonged high unemployment and long-term economic scarring that will impede economic growth and international competitiveness. Congress should pass meaningful job-creation policies to address this real crisis.

## Unemployment and underemployment

In October, 13.9 million people were unemployed. Employment growth has not been strong enough to address the enormous scope of the unemployment problem. Indeed, the economy would need to create roughly 11 million jobs *today* to bring the unemployment rate back down to its pre-recession rate; this massive shortfall in employment is referred to as the labor market gap. Of those 11 million jobs, 6.5 million were lost during the recession, and 4.5 million were needed to keep pace with the growth in the working-age population but were not created (EPI 2011a).

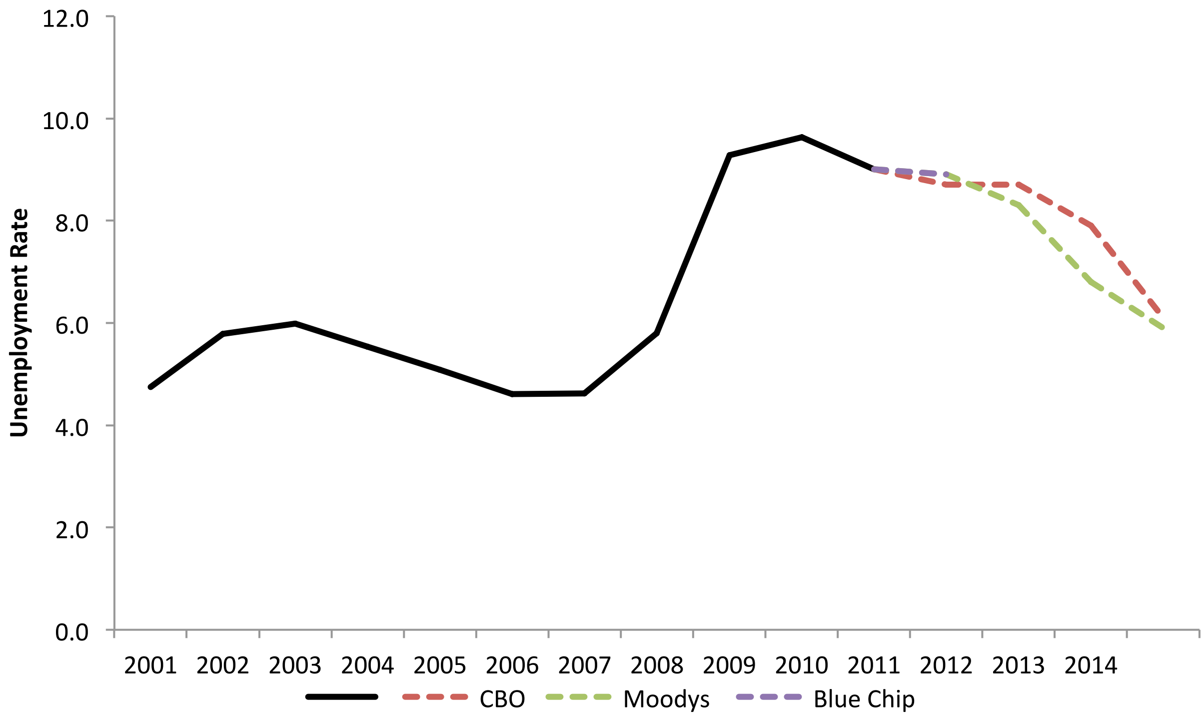
Closing this labor market gap by 2014, while keeping up with growth in the working-age population, would require adding approximately 400,000 jobs each month. Closing the gap in five years—by the fall of 2016—would mean adding around 280,000 jobs each month (Shierholz 2011). Our economy is far from this level of job growth. Over the last six months, the average monthly job gain has been about 90,000 jobs. The job growth in October was even lower, at 80,000 jobs. While positive job growth is certainly a welcome change from the steep job losses in 2008 and 2009, 90,000 jobs a month is about a third of what we need to return unemployment to prerecession levels in five years; clearly much faster employment growth is needed to help the backlog of unemployed workers.

Beyond the troubling official unemployment levels are the millions of *underemployed* workers. These are workers who are either unemployed, marginally attached (jobless workers who want a job and are available but have given up seeking work) or involuntary part-time (workers who would like full-time jobs but have had to settle for part-time work). The underemployment rate is currently 16.2 percent, and around 25.4 million workers are either unemployed or underemployed (Shierholz 2011). The underemployment rate has been particularly high for racial and ethnic minorities. While the white underemployment rate is 13.3 percent, Hispanic underemployment is 22.5 percent and black underemployment is 26.2 percent (EPI 2011b).

The picture for job seekers is equally distressing. Since the fourth quarter of 2009, around 6 million people—or 43 percent of the unemployed—have been unemployed for six months or longer. Over this period, there have been well over four unemployed workers for every job opening. And while this job-seekers ratio has steadily declined since the fourth quarter of 2009, it still remains well above where it was at any point since December 2000, including during the 2001 recession. Because the job-seekers ratio has remained above 4-to-1 for so long—approximately 2 years, 9 months—the extended unemployment insurance benefits available to jobless workers remain especially crucial (Gould 2011a).

In October 2009, the unemployment rate reached 10.1 percent, its highest level of the economic downturn. Although it has since fallen to 9.0 percent, during the same period, the labor force participation rate dropped from 65.1 percent to 64.2 percent—a decline of around 2.3 million workers. Had these workers remained in the labor force and been counted among the unemployed, the unemployment rate today would be 10.4 percent, instead of 9.0 percent (Shierholz 2011).

**Figure A. Past and projected unemployment rates, 2001–2015**




**Note:** Solid line indicates past unemployment rate. Blue Chip projections only run through 2012.

The outlook remains weak. The Congressional Budget Office forecasts that the unemployment rate will remain a stubbornly high 8.5 percent through the fourth quarter of 2012. As **Figure A** depicts, CBO projects calendar-year unemployment averages to remain above 8.7 percent through 2012, and to drop to 7.9 percent in 2014 and 6.1 percent in 2015 (CBO 2011b). Moody's Analytics' projections are only slightly more favorable, with unemployment falling to 6.8 percent in 2014 and 5.9 percent in 2015. The Blue Chip Economic Indicators consensus forecast, which only has projections through 2012, projects unemployment to remain high at 8.9 percent, only marginally better next year than it is today.

**Poverty**

This depressed economic environment has been devastating for many American families. The poverty rate stood at 15.1 percent in 2010, up from 14.3 percent in 2009. This means an additional 2.6 million people are living in poverty, bringing the total number to 46.2 million. The poverty rate for children in 2010 was 22 percent, or 16.4 million kids. More than one-third of people living in poverty are children (Gould and Shierholz 2011).

While the ranks of the poor are swelling, the poor are also getting exceedingly poorer. Deep poverty refers to those who live below half of the poverty line. In 2010, 6.7 percent of the overall population, and nearly 1-in-10 children, were living in deep poverty. The share of the population living in deep poverty has been growing steadily since 2007, and is the highest it has been in 35 years (Gould 2011b).

**Economic scarring**

High unemployment and underemployment rates can have severe scarring effects on individuals and on the economy. Children who grow up in poverty are more likely to have lower earnings later in life. Additionally, they are more likely to commit crimes and have poor health (Irons 2009). Childhood poverty costs the economy an estimated $500 billion per year (Holzer, Duncan, and Ludwig 2007).

Individuals who experience a period of unemployment can suffer from a number of long-run consequences, with scarring effects in the following four areas: educational achievement, opportunity, private investment, and entrepreneurial activity and business formation (Irons 2009). Unemployment and income loss can threaten a child's access to proper nutrition and a supportive learning environment, and can delay or even rule out the ability to go to college. The opportunities for children who are affected by recession-induced job and income losses can be severely limited, which can pose long-lasting costs for the economy.

For families, the recession and slack labor market will mean lower lifetime earnings and savings; income loss can persist for years after an economy has recovered. Along with directly affecting earnings, high unemployment can also lead to diminished retirement security, reduced educational achievement and opportunity, and limited entrepreneurial activity. Furthermore, recessions have scarring effects on the productive potential of an economy, as innovation and investment suffer along with the credit crunch and the reduction in consumer demand.

The defunding of public investments that has accompanied the budget cuts passed over the last six months will likewise create a long-run drag on the economy and depress living standards for generations to come. These public investments, in areas such as education, research and development, and infrastructure, are vital to economic growth and global competitiveness—they boost the economy's stock of human, physical, and knowledge capital, raising productivity. A recent and comprehensive review of the literature on this topic finds that a sustained 1 percent increase in the public capital growth rate (in other words, expanding public investment spending) translates into a 0.6 percentage-point increase in the growth rate of private-sector gross domestic product. Certain investments—such as those in early childhood education—provide an even greater bang for the buck (Heintz 2010).

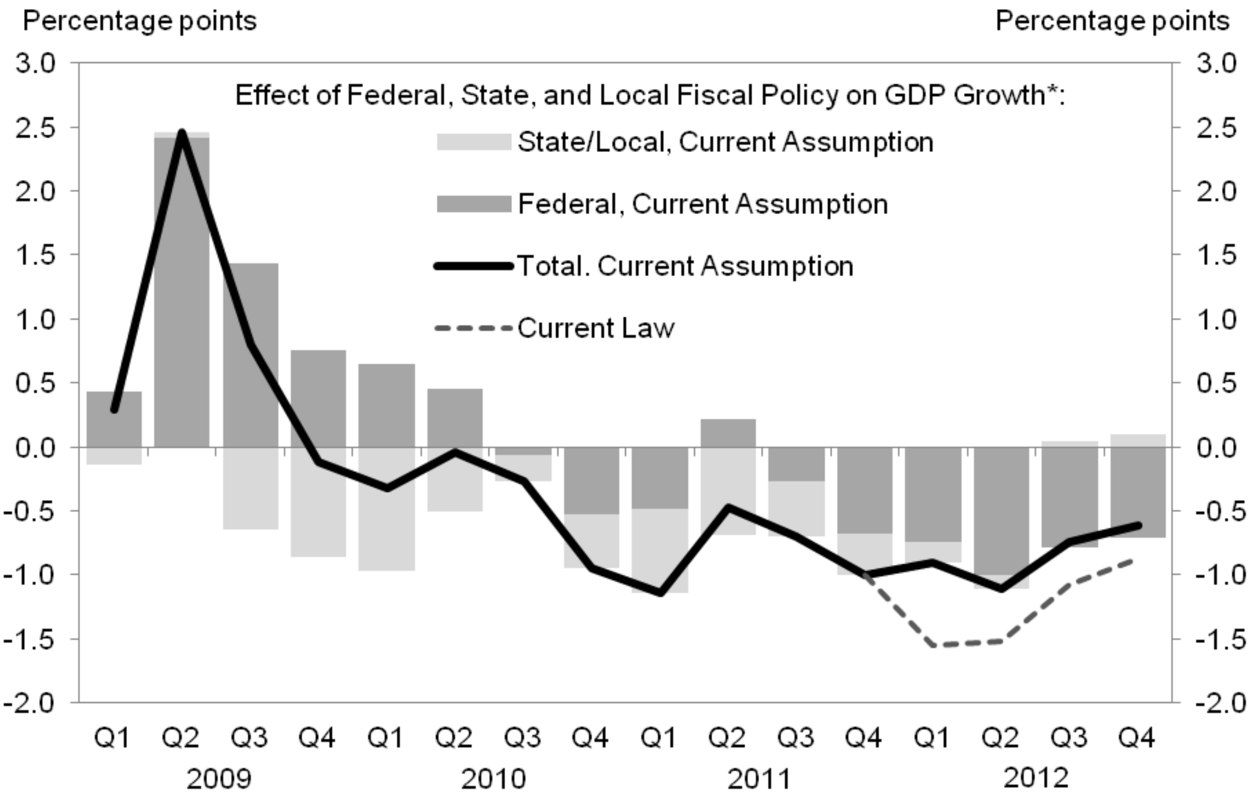
Despite the evidence, public investment as a share of the economy had already fallen near a 60-year low by 2009 (Pollack 2011a). While the Recovery Act partially reversed this trend, it was temporary, and the Full-Year Continuing Appropriations Act of 2011 and Budget Control Act cut public investments even further. Although no projections of public investments currently exist, the portion of the budget known as nonsecurity discretionary (NSD), half of which is composed of public investments, is projected to decline from 3.5 percent in 2011 to 2 percent of GDP in 2021. The Budget Control Act sequestration process, were it to be triggered, would bring NSD down further, to 1.7 of GDP (Fieldhouse and Pollack 2011).

These cuts would have damaging consequences for future generations, who would be left with a smaller public capital stock and less human capital. Weaker economic growth also threatens future employment opportunities and wage growth. Leaving future generations with an unsustainable fiscal trajectory is irresponsible, but so is bequeathing to them a crumbling infrastructure, or an insufficient education that makes them unable to compete in the global economy, or an environment barren of the same natural resources that undergirded past generations' prosperity. Cuts to public investments do not actually reduce overall debt burdens, they merely shift the burden from the present to future generations.

**Fiscal drag**

During any recession, the public sector both boosts and drags on economic growth. On the one hand, at the federal level, automatic stabilizers such as unemployment insurance and food stamps expand as more people qualify for safety-net programs. On the other hand, state and local governments must balance their budgets, and the precipitous fall in revenues that usually accompanies recessions forces budget cuts or tax increases. In this recession, states have faced nearly $500 billion in shortfalls, and local governments have faced billions more (McNichol 2011). The Recovery Act offset some of this natural contraction on the state and local level, but by the third quarter of 2009 the overall impact of fiscal policy across all levels of government turned contractionary, and has consistently dragged on economic growth over the last two years (Pollack 2011b).

**Figure B. Goldman Sachs' estimates of the fiscal policy impact of government policies on GDP growth**




* Annualized; excludes second round effects.
Source: GS Global ECS Research.

Federal policy is poised to turn sharply contractionary come January 1, 2012, unless Congress Acts. First, the Budget Control Act of 2011 cut discretionary spending by an estimated $30.5 billion in 2012. Second and third, last year's tax deal extended emergency unemployment insurance benefits and swapped the Making Work Pay tax credit (a targeted tax credit included in the Recovery Act) for a more costly 2 percentage-point reduction in workers' Social Security payroll taxes. Assuming those two provisions aren't extended by the end of the year, their cessation represents another $163 billion worth of fiscal contraction. These three factors alone will slow the economy in 2012 by 1.5 percentage points, and cost 1.8 million jobs (Fieldhouse and Pollack 2011). In addition, over the next two years state budgets are facing another $150 billion in shortfalls, forcing further contraction and job loss.

**Policy prescriptions**

First and foremost, Congress must adhere to the "do no harm" principle. That means staving off the impending fiscal drag by extending emergency unemployment insurance benefits and the payroll tax cut, or even better, replacing the payroll tax cut with a more targeted, efficient refundable tax rebate. But doing so will just prevent backwards progress without accelerating inadequate GDP growth. As a rule of thumb, the economy needs to grow roughly 2.5 percent to keep the unemployment rate from rising. Over the last year, however, real GDP growth has averaged only 1.6 percent. The Blue Chip Economic Indicators consensus forecast pegs growth at 2.2 percent for 2012, again too sluggish to dent the stubbornly high unemployment rate. As the result of anemic growth following a deep economic shock, the U.S. economy is currently running $895 billion (-5.6 percent) below potential economic output—the level of economic activity that would be associated with full employment and higher levels of industrial capacity utilization (CBO 2011a). In other words, the United States is presently forgoing almost a trillion in national income on an annual basis.

Failure to actively close the output gap risks an adverse equilibrium of slow growth and high unemployment; potential output could fall and converge with a depressed level of actual output producing the macroeconomic scarring equivalent to long-term unemployment's scarring effect on individuals. According to the Congressional Budget Office, the financial crisis and depressed economic output have already lowered potential output by roughly 2 percent in the second half of next decade (CBO 2011b); more costly economic scarring will be incurred if the faltering recovery is not bolstered.

The large output gap also means that expansionary fiscal stimulus is highly effective and partially self-financing. Research by Auerbach and Gorodnichenko (2011) on the impact of fiscal policy across the business cycle has found that fiscal multipliers are highly dependent on the output gap. They estimate that a dollar of government spending would have generated $1.75 in economic activity in 2009. Fiscal stimulus remains highly effective in light of the substantial, persistent output gap; estimates by the CBO and Moody's Analytics further support this assessment (CBO 2011c, Zandi 2011). And by generating a higher level of economic activity, fiscal stimulus will increase tax revenue and decrease safety-net spending, partially defraying its sticker tag price. Bivens and Edwards (2010) found that the cyclical component of the budget deficit is roughly 37 percent of the output gap, implying that fiscal stimulus is increasingly self-financing in light of larger fiscal multipliers and weaker economic conditions (largely through the revenue channel). The flipside to this, of course, is that spending cuts are particularly damaging in a depressed economy and largely counterproductive, because decreased economic activity will further depress revenue levels.

In other words, expansionary fiscal policy packs a big punch and is partially self-financing in these depressed economic conditions. Fiscal consolidation will prove much more effective and less costly if it is delayed until the output gap has closed significantly. Optimal fiscal policy necessitates larger deficits in the short run.

**A meaningful jobs program**

In addition to extending emergency unemployment benefits and the payroll tax cut, Congress should enact a substantive job creation program that will significantly reduce unemployment. A serious jobs plan must create a sizeable number of jobs over the next two year; we need jobs *today*, not a decade from now. It should be an effective and efficient use of resources, emphasizing high bang-per-buck policies. An effective jobs plan should be deficit-financed in the near-term or paid for in later years when the economy has strengthened, in order to avoid offsetting the employment impact with counterproductive spending cuts or broad-based tax increases in a weak economy. Lastly, a jobs bill must be sufficiently large to sizably shrink the output gap. Halving the output gap would require an additional $320 billion *on top of extending the current payroll tax cut and emergency unemployment benefits, and maintaining current levels of discretionary spending.*[1]

- **Invest in America's infrastructure.** Congress should immediately reauthorize the Surface Transportation Act at the higher spending levels requested by President Obama. The president's request would increase transportation investments by $213 billion over the next decade, including $30 billion for an infrastructure bank and $50 billion in upfront investments. These investments would add 350,000 job-years of employment over 2012–14 (Eisenbrey et al. 2011). With interest rates at historically low levels, this is an opportune time to address the buildup of unfunded surface transportation investment needs (Pollack 2011c), estimated at $3.0 trillion by the American Society of Civil Engineers (ASCE 2011). Beyond creating jobs today, transportation investments increase the public capital stock and produce the foundation for economic growth.

- **Strengthen Medicaid and help states with high unemployment.** Over the last three years, employment by state and local government has fallen by more than 600,000, with 288,000 job losses in the last year alone. This means fewer first responders on the streets and teachers in classrooms. The state budget crises prompting these layoffs are expected to intensify this year as federal support from the Recovery Act all but disappears. The fastest way to address the state budget crises and stem these job losses would be to reinstate higher federal Medicaid matching rates from the Recovery Act, which could close roughly 40 percent of the states' budget shortfalls (Eisenbrey et al. 2011). Doing so could boost employment by 440,000 jobs; federal aid to states also packs a high bang-per-buck (Zandi 2011). Reinstating a moratorium on interest payments for the Federal Unemployment Account loans, or outright debt forgiveness, would also shore up states' finances and strengthen the unemployment insurance safety net.[2] Grants to states to reemploy first responders and teachers would also directly address these particular layoffs.

- **Direct public employment program.** The federal government can and should directly put millions of Americans back to work (as was done during the Great Depression) while addressing unmet public needs, such as park improvements, school repairs, and child and health care services. Several good public service employment plans have already been proposed by members of Congress. For example, Rep. Jan Schakowsky's Emergency Jobs to Restore the American Dream Act would spend $227 billion to increase employment by 2.2 million jobs, putting people to work repairing public school buildings, establishing a national corps of child care workers, putting hundreds of thousands of teachers back in the classroom, hiring police and firefighters, adding staff in the National Parks and creating

[1] Updated calculation from (Eisenbrey at al. 2011) for 2011Q3.
[2] Outstanding loans to 27 states totaled $37.4 billion as of November 9, 2011 (Department of Labor 2011).

youth service corps (Schakowsky 2011). Rep. Keith Ellison's Put America to Work Act would provide states, cities, and Indian tribes with targeted assistance to hire unemployed workers to rehabilitate public buildings, expand food banks and Head Start programs, provide child care, improve recreational facilities and provide recreational programs, remediate or demolish abandoned or vacant buildings, and address other locally determined needs. The additional $350 billion in grants over the next two years would create 2.1 million jobs in 2012 and 1.5 million jobs in 2013 (Fieldhouse 2011a).[3] Congress could also pursue more narrowly targeted direct jobs programs such as Fix America's Schools Today!, a proposal to put 600,000 people to work repairing our 100,000 public schools (Filardo, Bernstein, and Eisenbrey 2011).

- **Renewable energy and energy efficiency investments.** The Recovery Act included unprecedented investments in renewable energy and energy efficiency improvements, but much more can be done to make the transition to a cleaner economy. Establishing renewable electricity and energy efficiency standards, green manufacturing tax credits, renewing the Home Star program, and adopting the president's Better Buildings Imitative could create millions of manufacturing jobs, decrease energy costs for businesses and households, and reduce the trade deficit and dependence of foreign oil. Each $10 billion spent over the next year on these projects would generate more than 100,000 jobs (Eisenbrey et al. 2011).

- **Job creation tax credit.** A well designed tax credit could encourage businesses to hire and retain more workers. Ideally, a credit would be calculated based on net increases to Social Security payroll levels to encourage firms to add employees, increase hours, and raise the wages of rank and file workers (without rewarding executive compensation). Spending $180 billion on a well-designed tax credit could increase employment by up to 2.4 million jobs over two years (Eisenbrey et al. 2011).

- **Push against foreign currency manipulation.** Pressuring China to realign its currency could create millions of American jobs without adding a penny to the deficit (in fact, increased growth and employment would reduce the deficit). Over the last decade, the U.S.-China trade deficit has displaced and/or eliminated an estimated 2.8 million jobs (Scott 2011). The Senate recently passed the Exchange Rate Oversight Reform Act (S. 1619), which would be a good first step toward addressing manipulation. A bill threatening across-the board sanctions, similar to the Schumer-Graham China Free Trade Bill of 2005, would be even more effective at curbing currency manipulation and narrowing the trade deficit.

- **The American Jobs Act.** Many of these proposals were included in the president's American Jobs Act (AJA), which would boost employment by 1.9 million and lower the

[3] Both the budgetary and employment impact are measured in fiscal years.

unemployment rate by 1.0 percentage point, according to Mark Zandi of Moody's Analytics (Zandi 2011). The AJA emphasized many high bang-per-buck programs, particularly $49 billion for unemployment insurance, $60 billion for infrastructure spending and infrastructure bank, $30 billion for modernizing schools, and $35 billion for rehiring teachers and first responders. The AJA also proposed increasing the payroll tax cut for workers (from 2.0 percentage points to 3.1 percentage points) and expanding it to the first $5 million in business payroll with a payroll tax holiday for firms increasing payroll. The American Jobs Act would turn the impending fiscal drag into a tailwind, create a sizeable number of jobs over the next two years, be gradually paid for over a decade, and sizably shrink the output gap.

**Addressing the root cause of deficits at the right time**

A stronger economy is a prerequisite to successful deficit reduction. Over half of this year's budget deficit can be attributed to the weak economy and deliberate policies to boost employment (Fieldhouse 2011b). If Congress stimulates economic growth and the output gap shrinks sizably, the cyclical contribution of the budget deficit will also shrink. As noted earlier, every dollar reduction in the output gap reduces the budget deficit by roughly 37 cents (Bivens and Edwards 2010).

Deficit reduction will be most successful in an economy running at full employment, whereas deficit reduction will be largely counterproductive in an economy with mass underemployment. Budget cuts and tax increases will impose much less of a drag on economic growth (Auerbach and Gorodnichenko 2011).

For these reasons, I have proposed a "six-for-six" trigger: Unemployment should reach 6 percent and remain below that rate for six consecutive months, when the economy is much closer to full employment, before any net fiscal contraction should be implemented (Irons 2010). The Congressional Budget Office projects that the unemployment rate will average above 6 percent through 2015; sustained levels of investment and job creation programs will be needed for years to come. The "six-for-six" trigger is not to suggest that Congress should not enact long-term deficit reduction at present, merely that net fiscal consolidation should be delayed until it will not severely undermine the faltering economic recovery and feeble labor market.

Over the longer term, the United States faces real fiscal challenges that will eventually have to be addressed, notably inadequate revenue and spiraling health care costs. A comprehensive approach to the long-term fiscal imbalances is presented in Demos, EPI, and The Century Foundation's *Investing in America's Economy* (2010).

**Conclusion**

We do face a crisis today. But, as just about anyone outside the Beltway knows, it is a jobs and economic crisis that imperils our future, not an immediate fiscal crisis. Recessions and financial crises of the magnitude we have experienced are not like minor injuries from which the economy can quickly recover to full health, but rather like a serious illnesses that, even after nominal recovery, will continue to weaken the economy for decades to come. Congress has failed to adequately address this problem.

It is somewhat ironic that Congress has chosen to focus so narrowly on fiscal issues at the expense of economic issues because the two are by no means inherently at odds. Our fiscal challenges include medium-term structural deficits driven by tax cuts and war spending, and long-term deficits driven by rising private health-care provider costs. Job creation in the near-term only helps put us on a sounder fiscal path, and certain job-creation measures like infrastructure investment help raise long-run economic growth, thus making the long-term fiscal gap even more manageable.

But this is not the debate we are having. The supercommittee wasn't charged to come up with a plan to ensure a prosperous future for this country, it was only charged with hitting an arbitrary savings target. This narrow approach must be changed, and it starts by addressing the jobs crisis.

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