

**THE 2010 JOINT ECONOMIC
REPORT**

R E P O R T

OF THE

**JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES**

ON THE

**2010 ECONOMIC REPORT
OF THE PRESIDENT**

TOGETHER WITH

**MINORITY
AND
ADDITIONAL VIEWS**



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[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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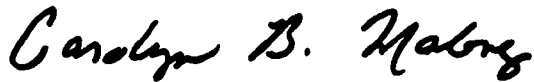
LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC, July 15, 2010.

HON. NANCY PELOSI,
*Speaker of the House, House of Representatives,
Washington, DC.*

DEAR MADAM SPEAKER: Pursuant to the requirements of the Employment Act of 1946, as amended, I hereby transmit the 2010 Joint Economic Report. The analyses and conclusions of this Report are to assist the several Committees of the Congress and its Members as they deal with economic issues and legislation pertaining thereto.

Sincerely,

A handwritten signature in black ink that reads "Carolyn B. Maloney". The signature is written in a cursive, flowing style.

Carolyn B. Maloney,
Chair.

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THE 2010 JOINT ECONOMIC REPORT

July 15, 2010.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

MRS. MALONEY, from the Joint Economic Committee,
submitted the following

REPORT

together with

MINORITY AND ADDITIONAL VIEWS

Report of the Joint Economic Committee on the 2010 Economic Report of the President

CHALLENGES AND OPPORTUNITIES FOR JOB CREATION IN THE AFTERMATH OF THE GREAT RECESSION

OVERVIEW

America is slowly climbing out of the longest, deepest recession since the Great Depression. Output has risen since the middle of 2009 and the labor market has improved consistently since February 2009. In the first half of 2010, the private sector added nearly 600,000 jobs. The performance of the economy in the first half of 2010 is consistent with the Council of Economic Advisers' projected employment growth of about 100,000 jobs per month, as reported in the 2010 Economic Report of the President (ERP). Despite signs of recovery, the economy remains fragile with sluggish hiring by small businesses, stagnant sales

of new and existing homes, and significant budget gaps facing state and local governments. The budget problems of state and local governments are particularly troublesome since they may lead to additional employment losses and service cuts at a time when these services are in greater demand.

While the labor market has stabilized and unemployment is down slightly from its October 2009 peak of 10.1 percent, it will take significant, sustained job creation to regain the nearly eight and a half million jobs lost from the start of the recession in December 2007 to December 2009. Policymakers face the additional dilemmas of record long-term unemployment and high rates of underemployment.

The Administration and Congress enacted a number of successful policies since early 2009 that have created jobs, supported those without jobs, and laid the groundwork for economic expansion. However, taking additional action to sustain economic recovery is particularly challenging because of concerns over the deficit. While cutting wasteful spending to lower the deficit is always appropriate, cutting targeted government spending — especially spending focused on creating jobs and ensuring that the economy does not slip back into recession — could have the opposite effect on the deficit and actually slow economic recovery and thereby increase the deficit in the short term. These views were clearly articulated in the 2010 ERP, which stated that “[a] moderate period of large deficits in a weak economy will speed recovery in the short run and leave the government with only modestly higher deficits in the long run.” The need to continue short-term fiscal stimulus has been echoed by many other economists as well.

A focus on the short-term deficit today ignores the long-term returns on investments from government spending. Moreover, while the deficit grew in 2010 because of these investments, the vast majority of our nation’s projected shortfalls stem from policies that pre-date the Obama administration: unfunded war spending, massive tax cuts, and the economic downturn itself. This Bush-era spending and the deficit it created hampered the nation’s ability to overcome the perfect storm of a housing market collapse and a financial crisis that led to the Great Recession.

Policies that pre-date the Obama administration and the 111th Congress are responsible for nearly the entire projected federal budget deficit over the next ten years. Bush-era tax cuts and the wars in Iraq and Afghanistan account for almost \$7 trillion in projected deficits between 2009 and 2019. In contrast, the recovery policies put in place by the Obama administration in response to the nation's worst economic crisis since the Great Depression account for \$1.1 trillion in projected deficits over the 2009 to 2019 period. Moreover, the recession itself has caused a sharp deterioration in the budget outlook. Indeed, the impact of the recession on the nation's deficit projections would likely have been far more severe had Congress and the Administration not acted swiftly with recovery spending to stem further economic losses.

A long-term strategy to reduce the nation's deficit is essential to a strong economy for generations to come. Efforts to translate this need into cuts in spending in the near term, however, would imperil the growth of our fragile economy. Policymakers need to resist the political siren call of short-term cuts and instead heed the economic imperative of job creation, the core component of a robust economic recovery.

Targeted Congressional actions improved the health of the labor market in 2010, and the economy has added private-sector jobs in each of the first six months of 2010. To ensure that the economic climate continues to improve and benefit all workers requires additional actions. Temporary funding to help cash-strapped state and local governments may prevent layoffs. Programs to spur lending to small businesses may also help boost job creation. New approaches are needed to fuel hiring, link job training to the sectors of the economy that offer the best growth opportunities, scale training programs that deliver the best results, and target skill-enhancing initiatives to those communities with stubbornly high rates of unemployment.

The Joint Economic Committee (JEC) has focused on creating jobs and reducing unemployment through the first half of 2010, holding a series of hearings and issuing a number of reports on these topics. These hearings and reports have highlighted the most cost-effective job creation strategies and have examined how innovation will fuel growth in emerging sectors of the economy. The Committee has also shed light on the segments of the population hit hardest by the Great Recession

and identified targeted policy actions that could benefit these workers. In addition, the JEC has analyzed possible barriers to future growth, including rising oil prices, tighter credit standards, and inadequate investment in basic research. As the economy recovers from recession, the JEC continues to focus on fiscally responsible policies that will help strengthen the economy and ensure that the employment and income gains from the next economic expansion will reach all workers.

The following Majority Staff report examines the employment challenges stemming from the Great Recession and describes the recovery now underway. It explores how the recovery varies by region, sector and demographic group. The report also discusses the major pieces of legislation passed in 2009 and 2010 that have led to increases in employment and output. Finally, the report identifies the ongoing obstacles to sustained growth, steps needed to overcome them and areas where more action is needed.

REPRESENTATIVE CAROLYN B. MALONEY

Chair

SENATOR CHARLES E. SCHUMER

Vice Chairman

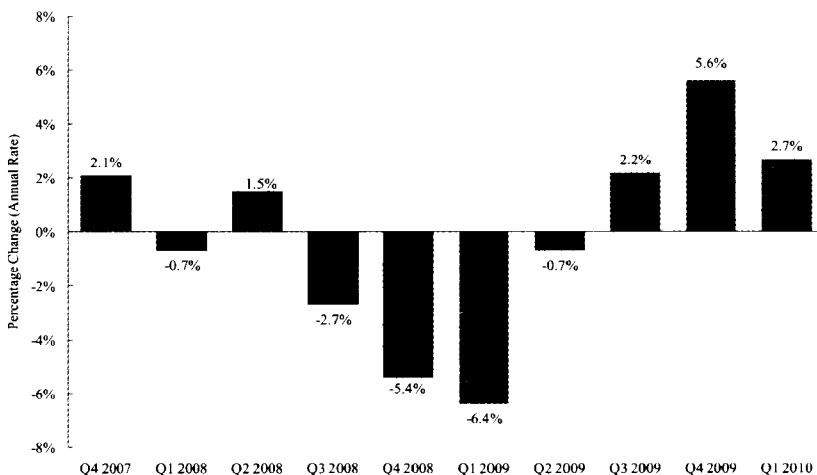
MAJORITY VIEWS

CHALLENGES AND OPPORTUNITIES FOR JOB CREATION IN THE AFTERMATH OF THE GREAT RECESSION

SIGNS OF RECOVERY IN 2010

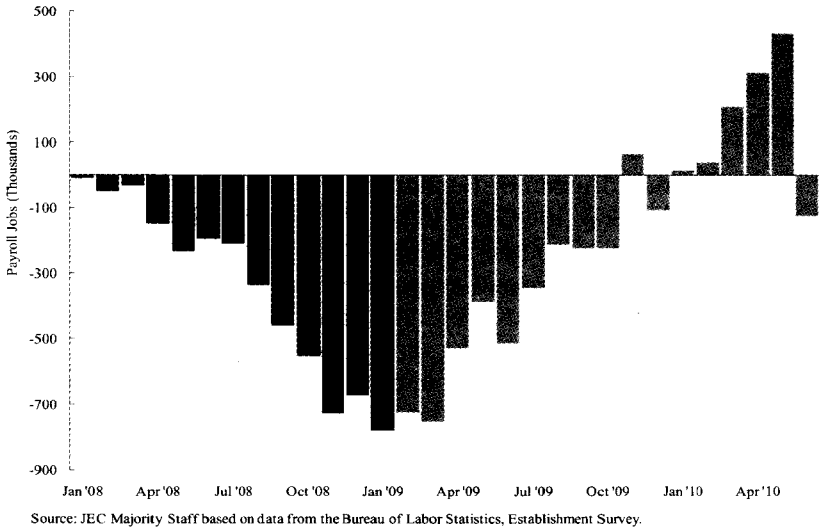
While the National Bureau of Economic Research has yet to announce the official end-date of the Great Recession, the broad economy began showing signs of stabilization and recovery during the second half of 2009. Following four consecutive quarters of contraction, the economy finally grew in the third quarter of 2009; gross domestic product (GDP) has expanded in each of the past three quarters. (See **Figure 1**) That positive economic growth has coincided with job growth. The labor market stabilized in the late months of 2009 as job losses petered out, and employment finally grew in January 2010. However, total nonfarm job creation in 2010 has been mixed with temporary hiring for the 2010 Census. Total nonfarm payrolls expanded in the first five months of 2010 but fell in June due to the winding down of Census employment. (See **Figure 2**)

Figure 1. Percentage Change in Real Gross Domestic Product
Q4 2007 to Q1 2010 (Seasonally Adjusted Annual Rate)



Source: JEC Majority Staff based on data from the Bureau of Economic Analysis.

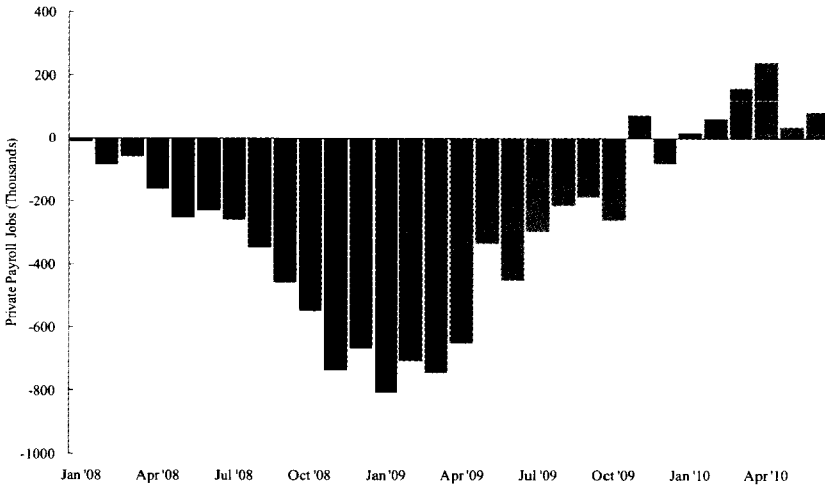
Figure 2. Monthly Change in Total Nonfarm Payrolls
January 2008 - June 2010 (Seasonally Adjusted)



Employment Growth across Industries

While Census 2010 hiring has significantly affected recent months' job gains, the private sector added jobs in each of the first six months of 2010, which combined for a total of 593,000 private-sector jobs in the first half of 2010.¹ (See **Figure 3**) During the height of the economic downturn, job losses in the private sector were widespread, though uneven, across industries. (See **Figure 4**) Now that the economy has turned the corner, the employment situation is gradually improving across industries. In particular, job growth has been strongest in the manufacturing, professional and business services, and leisure and hospitality sectors. (See **Figure 5**)

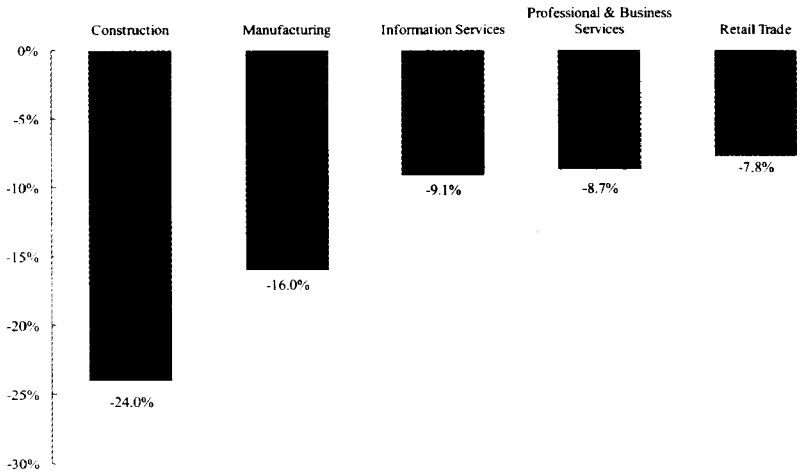
Figure 3. Monthly Change in Private Payrolls
January 2008 - June 2010 (Seasonally Adjusted)



Source: JEC Majority Staff based on data from the Bureau of Labor Statistics, Establishment Survey.

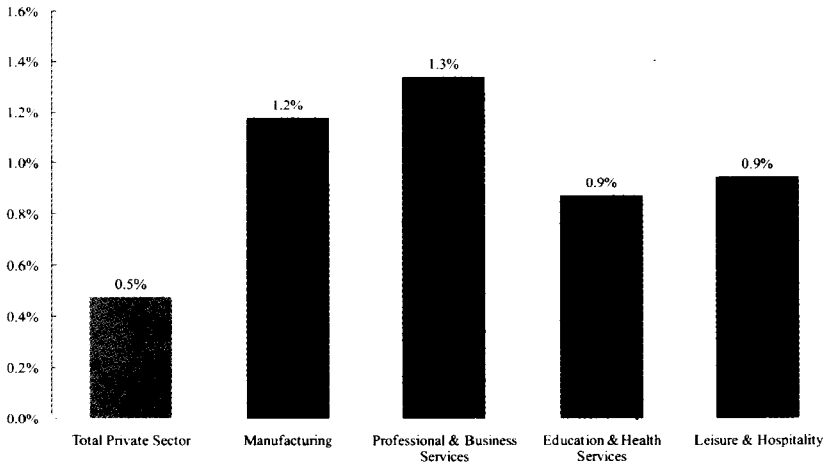
Manufacturing. Since the start of 2010, manufacturers have added 136,000 jobs; it is the largest six-month employment gain in the sector since 1998.² Manufacturers reduced their payrolls by 16 percent (2.2 million jobs) between December 2007 and December 2009, with the largest losses concentrated among manufacturers of durable goods.³ Among all durable goods manufacturers, employment shrank by over 19 percent during that period; employment among manufacturers of nondurable goods shrank by 11 percent.⁴ However, employment has increased in 8 of the 10 major subsectors of durable goods since January 2010.⁵ Employment has expanded most rapidly at primary metal manufacturers. In addition, fabricated metal products, machinery, transportation equipment, and electrical equipment and appliance manufacturers have all added jobs since January.⁶

Figure 4. Employment Losses by Sector
 Percent Change in Nonfarm Payrolls in Selected Sectors, December 2007 - December 2009 (Seasonally Adjusted)



Source: JEC Majority Staff calculations based on data from the Bureau of Labor Statistics.

Figure 5. Employment Gains by Sector
 Percent Change in Nonfarm Payrolls in Selected Sectors, December 2009 - June 2010 (Seasonally Adjusted)



Source: JEC Majority Staff calculations based on data from the Bureau of Labor Statistics.

Employment in nondurable goods manufacturing has essentially held flat since January 2010.⁷ Small employment gains over the past five months in manufacturing of plastics and rubber, petroleum and coal, paper and textiles have been offset by continuing declines among textiles and apparel, printing, chemical, leather and beverage and tobacco manufacturers.⁸ Much of the boost in manufacturing employment to date may be due to manufacturers' need to restock inventories. These inventory levels became low as manufacturers satisfied demand with existing inventories during the recession.

Professional and Business Services. Employment in the professional and business services sector, which includes the temporary services sub-sector, has increased monthly since October 2009.⁹ Employment growth in the temporary help sector can signal increased willingness among employers to hire in the near term. Employment in the temporary help sector began steadily contracting several months prior to the start of the Great Recession and before job losses started permeating throughout the economy. Now with the recovery underway, employers who are hopeful, but somewhat uncertain, about future economic conditions may be boosting payrolls with temporary help before hiring permanent employees. Temporary help employment began growing in October 2009 and added 379,000 through June 2010.¹⁰ Mr. Jeffrey Joerres, CEO of Manpower International, a global temporary staffing company, notes that temporary employment experienced "materially deeper contraction during the current recession than [in] either of the prior two recessions."¹¹ According to Mr. Joerres, prior experience shows that the low point in temporary employment typically comes a month or two following the end of an official recession, which would date the recovery to mid-2009.¹² However, Mr. Joerres also predicts a "jobless recovery" because "companies have become more sophisticated in their ability to assess their workforce needs" and will wait for "clear signals of increased demand before making permanent hiring decisions."¹³

Leisure and Hospitality. Employment in the leisure and hospitality sector contracted by four percent (544,000 jobs) between December 2007 and December 2009, far less than in the hardest hit sectors of the economy. However, in recent months the sector has started to rebound as the overall level of confidence in the economy improves and people return to spending money on more than necessities. In the first six

months of 2010, leisure and hospitality employment grew by 123,000 jobs, led by hiring in the food service and drinking places category.¹⁴

Other Sectors. Large, persistent job losses have subsided throughout the economy, and employment has shown signs of improvement in almost all industries. Natural resources and mining employment has increased by 51,000 jobs since November 2009.¹⁵ Employment in the wholesale trade sector has grown by 15,400 jobs over the past four months. At the height of the recession, wholesale trade employment fell by between 30,000 and 50,000 jobs each month.¹⁶ In the retail trade sector, job losses topped 100,000 in November 2008. However, employment in the retail trade sector has grown by 75,800 jobs since January, with employers adding jobs in four of the last six months.¹⁷ Job losses also have slowed in the financial activities and information sectors.¹⁸ Despite temporary improvement in the housing sector, employment in the construction industry, which was devastated by the collapse of the housing market, has continued to decline, with large drops in May and June.¹⁹

Recovery at the State Level

As the economy recovers from the Great Recession, the pace of recovery will vary across the states. States whose economies were heavily reliant on those industries hit hardest by the recession have suffered greatly. However, as job losses have given way to job gains, states with large manufacturing, professional and business services, and leisure and hospitality sectors stand to enter recovery sooner than those reliant on industries yet to expand.

Several states already are experiencing consistent private-sector job growth. The most current state data show that sixteen states added private-sector jobs for three consecutive months (March, April and May), and six states of those states added private-sector jobs in February, March, April, and May.²⁰ Three states — Massachusetts, Tennessee and Texas — experienced private-sector job creation for each of the first five months of 2010. Massachusetts and Texas experienced smaller private-sector job losses than many other states, so a labor market rebound in these two states is not surprising.

Job growth in Tennessee, Texas, Massachusetts, Indiana, Kansas, and Hawaii is closely tied to expanding sectors of the economy. The recent job gains in Tennessee have been dominated by hiring in the professional and business services sector, as well as in manufacturing. Indiana and Texas also have registered job gains in the manufacturing and professional and business services sectors in each of the first five months of 2010, while hiring in education and health services, the only sector that had employment growth over the recession, has driven employment gains in Massachusetts. Hiring in leisure and hospitality has fueled job gains in Hawaii; Kansas payrolls have increased due to four months of hiring in the manufacturing sector coupled with recent job gains in leisure and hospitality.

In addition to Texas and Tennessee, five states (Florida, Indiana, Minnesota, New Hampshire, and Wisconsin) have experienced employment gains in manufacturing employment in each of the first five months of 2010. During that time, California and Indiana, in addition to Texas and Tennessee, had five straight months of job gains in professional and business services.

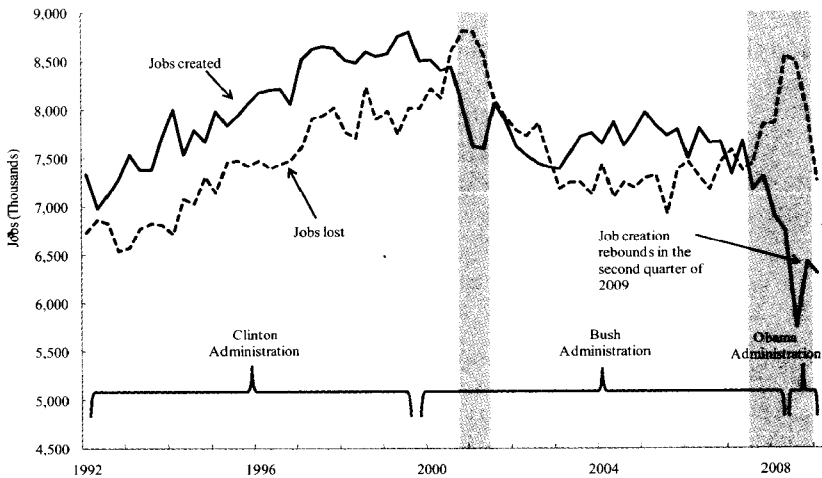
While a handful of states appear to be on the front end of the labor market and economic recovery, employers are hiring, rather than firing, throughout much of the country as well. Over half of all states (27) had private-sector job gains in May 2010; twenty-three states had gains in both April and May. As job creation in the private sector strengthens through the second half of 2010, labor market conditions in all states will continue to improve.

UNEMPLOYMENT AND JOB LOSS DURING THE GREAT RECESSION

While the nascent recovery led to improved labor market conditions in 2010, the Great Recession was characterized by near record-high levels of joblessness.²¹ Deep problems endure in the labor market even as the economy has begun to grow again. Understanding the depth of the difficulties in achieving a full labor market recovery requires extending the lens of analysis beyond the current recession and into the “jobless recovery” of the last recession and near-collapse of the financial system, both presided over by the Bush administration.

From December 2007 through December 2009, 8.4 million payroll jobs were lost. Even with robust growth in employment, the road to recovery in the labor market will be prolonged and difficult. During the recession, the job creation engine stalled at the same time that job destruction was rising. The total number of jobs created fell precipitously from the start of the recession during the last quarter of 2007 to the second quarter of 2009, when gross job creation bottomed out at 5.7 million jobs. In contrast, the total number of jobs lost rose from 7.4 million in the final quarter of 2007 before topping out at 8.5 million jobs lost in the final quarter of 2008. (See **Figure 6**)

Figure 6. Gross Job Flows
Gross Private Sector Job Gains and Gross Private Sector Job Losses, Q3 1992 - Q3 2009



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Source: JEC Majority Staff calculations based on quarterly data from the Bureau of Labor Statistics, Business Employment Dynamics.

Both the freefall in job creation and the jump in job losses turned a corner in mid-2009, but the fallout left the labor market with long-lasting scars. In order to return to pre-recession employment conditions, the average increase in payrolls would have to be nearly 100,000 jobs greater than the average increase in monthly payroll employment during the Clinton Administration (237,000 jobs). Given the extraordinary level of net job creation that must occur every month, and considering the large pool of long-term unemployed workers who will have difficulty transitioning back to the labor force, job growth of this magnitude is unlikely to occur. Conditions in the labor market may not return to normal until well past January 2014. Indeed, by the end of

2012, the Federal Reserve projects that the unemployment rate will be between 6.6 percent and 7.5 percent, while the Congressional Budget Office (CBO) forecasts that the average annual unemployment rate between 2012 and 2014 will be 6.5 percent.²² These unemployment rates are well above the 4.7 percent unemployment rate in November 2007, before the recession started.

Heading into Recession: An Unwanted Economic Inheritance

Understanding the depths of the labor market's current difficulties requires a longer-term perspective. The new administration worked quickly with Congress to pass legislation to stimulate the economy in early 2009 as the economy teetered on the brink of depression. The housing bubble had burst, and a financial crisis had rippled through every part of the economy. Dr. Christina Romer, Chair of the Council of Economic Advisers (CEA), stated in October 2009 that "the shocks that hit the U.S. economy were, by almost any measure, larger than those that precipitated the Great Depression."²³ Stock prices were more volatile than they were during the onset of the Great Depression and the yield spread between the least-risky (AAA rated) corporate bonds and riskier, but investment-grade (BAA rated) bonds rose by much more in Fall 2008 than during the panic just before the Great Depression.

The near collapse of the financial system, by itself, caused a great deal of economic hardship for American families. But years of economic mismanagement by the Bush administration further diminished the ability of American households, particularly lower- and middle-income households, to weather an economic storm of epic proportions.

The once-vibrant labor market sputtered during the Bush administration, as the job creation engine stalled out. While an average of 8.1 million total jobs per quarter were created during the Clinton Administration, only 7.6 million total jobs per quarter were created during the Bush administration. (See **Figure 6**) Controlling for the impact of the two recessions during the Bush administration does not improve the private-sector job creation story. Even during the expansion that followed the 2001 downturn, the Bush administration created just 7.7 million jobs per quarter, leading most economists to refer to the period immediately preceding the current Great Recession

as a “jobless recovery.” Average annual employment rose only 0.2 percent during the Bush administration, the lowest of any administration since the Hoover administration.²⁴

Moreover, the private-sector job creation that did occur during the Bush administration likely came at great cost to the American economy. According to Nobel laureate Joseph Stiglitz, private-sector job creation during the Bush-era expansion was fueled by a bubble in housing prices and overleveraging by households, which artificially inflated consumption and hiring.²⁵ This flimsy foundation for job creation may be a key cause of the precipitous job loss that has characterized the Great Recession.

Among the unemployed, even those who put in tremendous effort to find a job faced a labor market that was growing more strained by the year. For each job opening, there was one unemployed worker at the start of the Bush administration growing to four unemployed workers by the end of his administration.²⁶

That the labor market has made significant steps toward recovery in the first half of 2010 is all the more remarkable in light of the deeply troubled state of the economy just a year and a half ago. However, the positive developments in the labor market during the first half of this year occurred in the shadow of an extraordinarily deep recession that, in many ways, left the labor market weaker than it has ever been in the post-war era. Several particularly troubling elements of the current labor market will make this recovery all the more challenging, specifically:

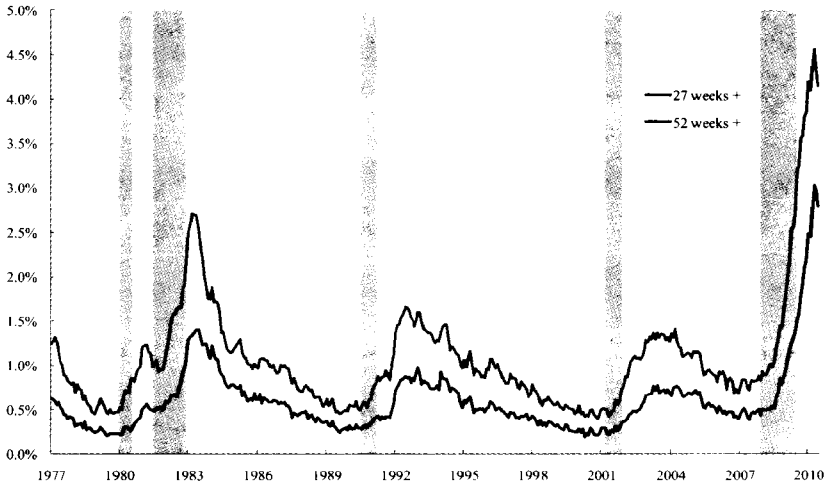
- The unprecedented rise in long-term unemployment;
- The paucity of job openings per unemployed worker;
- And, the historically low rate at which workers have exited unemployment.

Jump in Long-Term Unemployment

Perhaps the defining feature of the current labor market is the magnitude of long-term unemployment. There has been extraordinary growth in the number of long-term unemployed workers — those unemployed for 27 or more weeks — and the median duration of unemployment. As **Figure 7** shows, the long-term unemployment rate jumped from 0.8 percent in December 2007 to 4.1 percent in June

2010, exceeding the previous post-war peak of 2.7 percent in March 1983. Moreover, the percentage of the labor force that has been unemployed for over a year has risen six-fold, from 0.4 percent in December 2007 to 2.8 percent in June 2010.

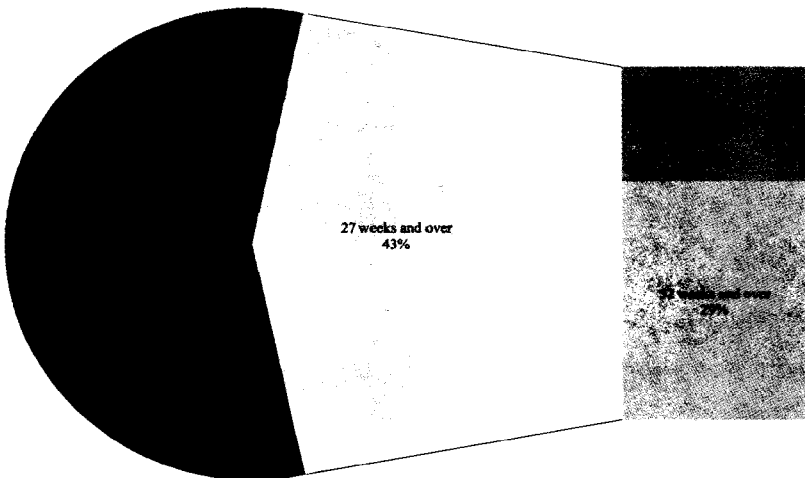
Figure 7. Long-Term Unemployed as Percent of Labor Force
Unemployed for 27 Weeks and Over and 52 Weeks and Over (Not Seasonally Adjusted)



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Source: JEC Majority Staff calculations based on data from the Bureau of Labor Statistics, Household Survey.

The overall pool of unemployed workers is heavily concentrated with the long-term unemployed. In June 2010, workers unemployed 27 or more weeks constituted 43 percent of all unemployed workers, and workers unemployed for 52 or more weeks comprised 29 percent of all unemployed workers. (See **Figure 8**)

Figure 8. Unemployed Workers by Duration of Unemployment
June 2010 (Not Seasonally Adjusted)



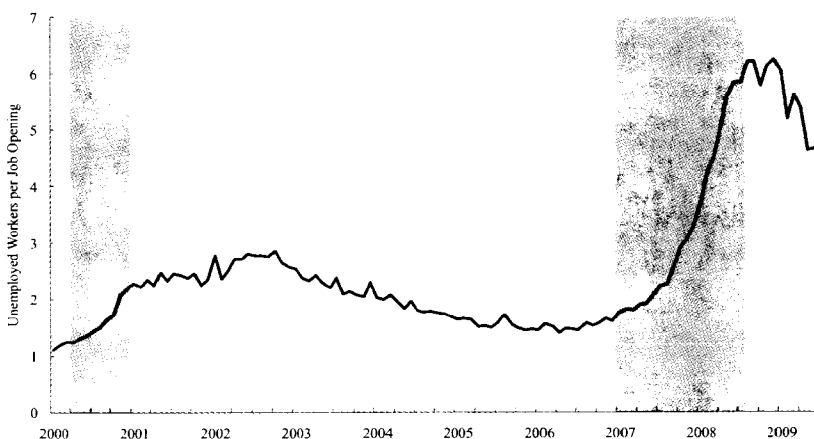
Source: JEC Majority Staff based on data from the Bureau of Labor Statistics, Household Survey.

Accompanying the record rise in the long-term unemployment rate is the substantial increase in the length of the typical unemployment spell, which rose from 8.4 weeks in December 2007 to 25.5 weeks in June 2010. In other words, the typical unemployed worker has spent close to half a year searching for work.

Few Job Openings per Unemployed Worker

The tightness of the labor market is reflected in data on the number of unemployed workers relative to the number of job openings. As **Figure 9** depicts, there were 1.76 unemployed workers per job opening in December 2007, but that ratio more than tripled in the third and fourth quarters of 2009, when there were six or more unemployed workers for every opening. In the first half of 2010, that ratio fell and by May 2010, there were fewer than five unemployed workers per job opening. Despite the lower ratio, unemployed workers are still facing substantial competition for jobs. The scarcity of jobs can explain part of the surge in long-term unemployment and median duration of unemployment.

Figure 9. Unemployed Workers per Job Opening
December 2000- May 2010 (Seasonally Adjusted)

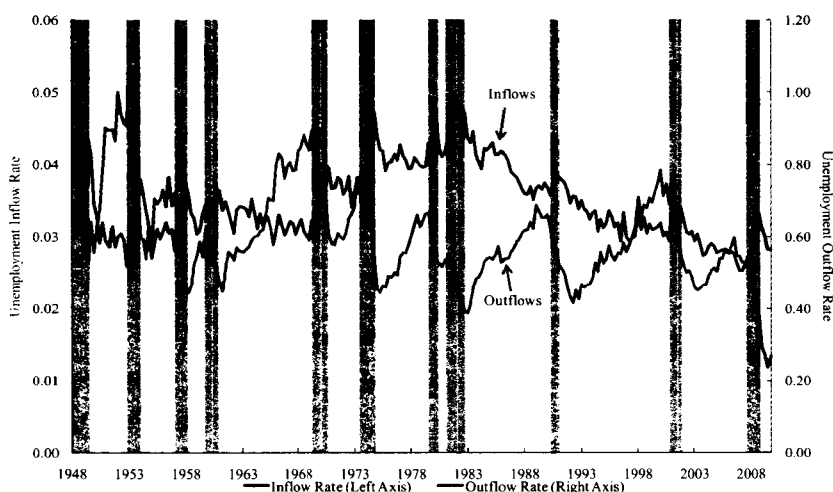


Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Source: JEC Majority Staff calculations based on data from the Bureau of Labor Statistics, Household Survey and Job Openings and Labor Turnover Survey.

Historically Low Rate of Exit from Unemployment

Another distinguishing feature of current labor market dynamics is the dramatic fall in the rate at which unemployed workers exit, or flow out of, unemployment.²⁷ Changes in the number of unemployed workers reflect the difference between the number of workers flowing into unemployment and the number of workers flowing out of unemployment. Although the unemployment inflow rate is similar to that seen in previous severe recessions, the unemployment outflow rate plunged to an historic low of 24 percent in the third quarter of 2009.²⁸ (See **Figure 10**) The historically low unemployment outflow rate suggests that workers are having a harder time finding jobs than in the past and that unemployed workers are jobless for longer stretches of time.

Figure 10. Unemployment Inflow and Outflow Rates
 Estimated Quarterly Averages, Q1 1948 -Q4 2009



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.

Source: JEC Majority Staff based on calculations from Elshy, Hobijn, and Sahin (2010) using data from the Bureau of Labor Statistics.

Part of the reason for the increase in the unemployment rate, especially the long-term unemployment rate, is due to the sizeable number of laid-off workers among the unemployed.²⁹ Workers who lose their jobs traditionally find work much more slowly than workers who quit their jobs, who are new entrants or who are re-entrants to the labor market.

Consequences of the Great Recession on the Labor Market Recovery

The three challenges highlighted above — long-term unemployment, the imbalance between job openings and job seekers, and the historically low rate of exit from unemployment — combine to make labor market recovery a heavy lift. In particular, the high rate of long-term unemployment that characterizes the labor market in the aftermath of the Great Recession poses a serious hurdle moving back to full employment.

The 6.8 million workers who have been unemployed for 27 weeks or more, as of June 2010, will suffer from far more than their immediate drop in income. Dr. Till von Wachter, an economist at Columbia University who has written extensively on the short- and long-term consequences of layoffs and unemployment, has detailed the myriad

economic and human costs of job displacement.³⁰ Although he and other economists have conducted research focusing on the long-term consequences of losing a job and becoming unemployed, he emphasized that “these costs are likely to be greater for the long-term unemployed.”³¹ These costs include:

- Long-Term Drop in Earnings. Following job displacement, workers are derailed from the long-term earnings trajectory they were following and suffer significant declines in lifetime income. Dr. von Wachter and co-authors found that even 15 to 20 years after job loss, displaced workers earned 20 percent less than a similar group of workers who did not lose their jobs.³² No demographic group is immune to the long-term drop in earnings. According to Dr. von Wachter, “reductions occurred for job losers in all age ranges, in all industries, for men and women, and throughout the earnings distributions” and were “not limited to particular regions of the country.”³³ As he pointed out, these earnings reductions are probably even more severe for the long-term unemployed.
- Deterioration in Health. Accompanying the drop in long-term earnings is a decline in health status. Job and earnings instability can place a heavy psychological and physical toll on workers. Economists have found that, in the short term, “layoffs and unemployment are associated with an increasing incidence of stress-related health problems, such as strokes or heart attacks.”³⁴ Indeed, Dr. von Wachter and co-authors estimates that in severe economic downturns, job losers may experience “significant reductions in life expectancy of 1 to 1.5 years.”³⁵
- Costs to Workers’ Families. Unemployment spells among household heads can also have negative intergenerational effects. For example, Dr. von Wachter discusses how “in the short-run parental job loss reduces schooling achievement of children,” and in the long run, “it appears that a lasting reduction in the earnings of fathers also reduces the earnings prospects of their sons.”³⁶ The incidence of divorce may also rise after a worker is laid off.³⁷ The intergenerational effect of unemployment on children’s schooling and future earnings, as

well as on family structure, will weaken the workforce of the future. Longer spells of unemployment will likely intensify these effects.

The unemployment rate may remain stubbornly high if long-term unemployed workers face difficulty finding work even when job creation picks up. Long-term unemployed workers face a variety of problems in the labor market that may make them unattractive to employers. For example, the skills — including technical and interviewing skills — of these workers may have deteriorated, and employers may prefer to hire workers with shorter gaps in their resumes. As would be expected, the chances that an unemployed worker finds a new job declines as his unemployment spell stretches, and this would slow the rate at which unemployment falls.³⁸

Future economic growth may also suffer if the productivity of the long-term unemployed has fallen due to skill deterioration. Unemployed workers are an untapped resource, and the longer they take to find a job, the longer it will take for the economy to operate at its full potential.

Impact of the Great Recession on State and Local Governments

States and local governments are facing serious budget problems. The Great Recession translated into the steepest decline in state tax receipts on record, and, even after making deep spending cuts over the last two years, state governments continue to face severe budget gaps. At least 46 states face or have faced shortfalls in the coming fiscal year, while 48 are contending with shortfalls in their current budgets.³⁹ Because every state (except Vermont) has some form of a balanced-budget law, states must offset budget shortfalls with a combination of spending cuts, withdrawals from reserve funds, revenue increases, and the use of federal stimulus dollars. As states continue to struggle to find the revenue needed to support public services, hundreds of thousands of government jobs remain at risk, and government hiring is likely to remain sluggish in the coming years.

The depth of the labor market problems suggests that state budgets will remain in trouble for some time, which in turn bodes poorly for state government hiring. Continued high unemployment will keep state

income tax receipts at low levels, and increase demand for essential services provided by states (e.g. Medicaid). High unemployment and continued economic uncertainty depress consumption, which translates into low sales tax receipts for states. As a result, at precisely the time that demand for state services is rising, state budgets remain under continued duress. Stressed budgets make hiring unlikely, which makes it doubtful that state government hiring will be a major factor in jump-starting employment.

Since the bulk of funding for public education comes from states and not the federal government, it will be difficult for the federal government to fill in the funding gap for education. This is a worrisome development since the strength, resilience, and dynamism of the U.S. economy, and its labor market, rests on a well-educated workforce. However, short-term budget problems are hampering the ability of states to invest in the future through education, which will leave workers more vulnerable to employment and income instability.

K-12 Education. Many states — at least 30 — have already slashed funding for K-12 education due to budgetary pressure.⁴⁰ Michigan, one of the states that suffered most during this recession, reduced its fiscal year 2010 budget by \$382 million through reductions in its school aid budget.⁴¹ Early childhood education programs, which support children during the most critical stage of their intellectual development, have also faced funding cuts. Illinois, for example, lowered funding for early childhood education by 10 percent.⁴² At a time when U.S. students, as a whole, are lagging behind many European and Asian countries in the crucial areas of math and science, Maryland has instituted cuts in math and science programs as well as professional development programs for principals and educators.⁴³

Higher Education. The recession has particularly hurt funding for higher education. California's multi-tiered higher education system, which is the most extensive in the nation, has suffered extraordinary slashes in funding. The University of California — the nation's premier public university — increased tuition by 32 percent and reduced the incoming class of freshman by 2,300 students.⁴⁴ The California State University system — where a large fraction of California students receive their bachelor's degrees — plans to decrease enrollment by 40,000 students, and the governor has proposed

cutting funding for K-12 and community colleges by \$1.5 billion.⁴⁵ Florida, one of the states most devastated by the housing market collapse, has reduced funding for universities and community colleges and imposed a 15 percent tuition increase for the 2009-10 school year at its 11 public universities.⁴⁶ In addition, Georgia has slashed education funding by \$151 million, which will raise undergraduate tuition at its public research universities by 16 percent and increase tuition at community colleges by \$50 per semester.⁴⁷

Higher levels of education reduce, but do not eliminate, a worker's probability of becoming unemployed. Cuts in funding not only reduce the quality of education, but also decrease the number of students able to access education. This is occurring at the exact moment when many economists are looking to the education system to facilitate recovery in the labor market, especially for young or displaced workers. As Dr. Lawrence Katz, a Harvard economist, explains, "The economic returns to further education and training at community colleges that lead to degrees and certificates are...high for dislocated workers."⁴⁸ Moreover, he points out, "The economic returns to post-secondary education remain extremely high for young workers...."⁴⁹ Similarly, Dr. Harry J. Holzer, an economist at Georgetown University, argues that for young people in college, "a range of curricula improvements and support services could improve completion rates in both certificate and degree programs."⁵⁰

Funding cuts in education will not only harm the long-term path of the U.S. economy, but they will also slow down the pace of recovery in the labor market by removing opportunities for young or displaced workers to develop the skills necessary to find a quality job.

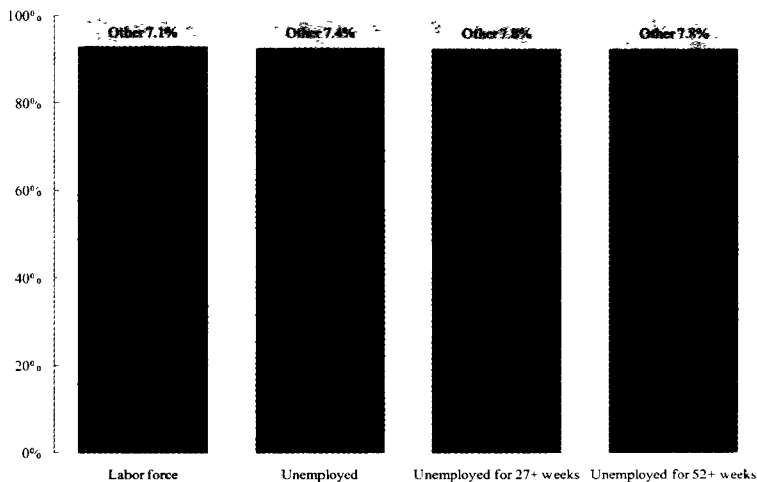
Labor Market Harm Is Spread Unevenly Among Demographic Groups

Although the recession hurt the labor market prospects of workers across the demographic spectrum, the impact was not uniform. In particular, workers in the African American, Hispanic, and youth (ages 16 to 24) communities suffered serious setbacks.

African American workers. African American or black workers are faring worse than the overall labor force along nearly all dimensions. For example, as Figure 11 illustrates, even though African Americans

comprised 11.6 percent of the labor force in June 2010, they accounted for 18.8 percent of the unemployed and 20.8 percent of the long-term unemployed.⁵¹

Figure 11. Labor Force, Unemployed, and Long-Term Unemployed
Distribution by Race, June 2010 (Not Seasonally Adjusted)



Source: JEC Majority Staff calculations based on unpublished data from the Bureau of Labor Statistics, Current Population Survey

African American workers have higher unemployment rates among all age groups.⁵² It is particularly worrisome that the unemployment rate among African American teenagers (ages 16 to 19) stood at a troubling 39.9 percent in June 2010.⁵³

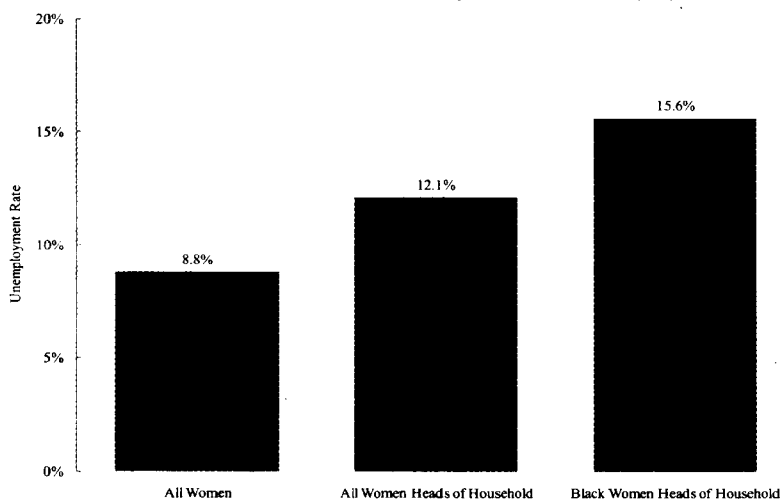
African American men and women also have significantly higher unemployment rates than males and females in the overall labor force. While the unemployment rate among men has risen 5.4 percentage points since December 2007, African American men saw their rate — which has always been much higher than the overall male rate — jump 8.5 percentage points by June 2010.⁵⁴

The same story holds for African American women, who had an unemployment rate of 12.6 percent in June 2010, 4.5 percentage points higher than the unemployment rate for all women in the labor force.⁵⁵

Particularly troubling is that African American women heads of household, who often bear the sole financial responsibility for their

families, had an even higher unemployment rate of 15.6 percent.⁵⁶ (See **Figure 12**) The loss of income and financial security may have long-term consequences for the educational attainment and behavioral stability of their children.⁵⁷ Women heads of households also face obstacles when they try to find employment. They may have to find child care when they go on a job interview, and even if they do find a job, the costs of child care could eat a substantial chunk of their earnings.⁵⁸ If they need to take part-time jobs because of family obligations — one-in-four employed women worked part-time in 2009 — they will face a variety of problems.⁵⁹ Longer durations of part-time work can contribute to lower hourly earnings in the long run, and many part-time workers do not receive the same health benefits, paid time-off for vacation or sick leave, or pension benefits that full-time workers receive.⁶⁰

Figure 12. Unemployment of Women Heads of Household
Rates by Race and Marital Status for Selected Groups, June 2010 (Not Seasonally Adjusted)

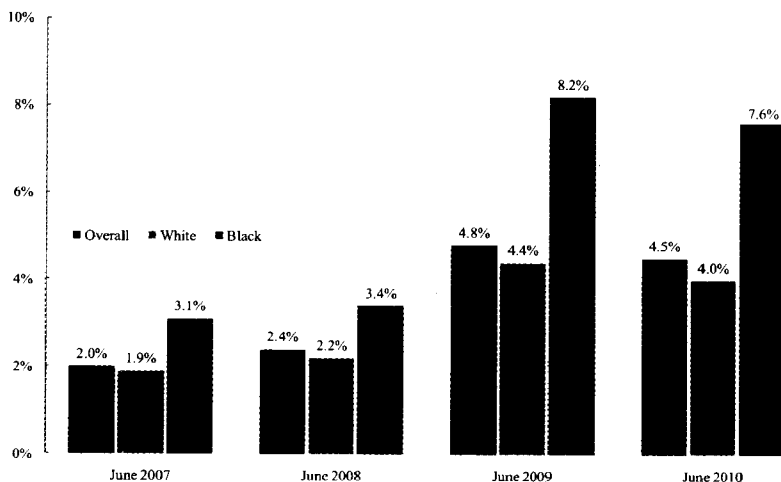


Source: JEC Majority Staff based on unpublished data from the Bureau of Labor Statistics, Current Population Survey.

Moreover, a college education offers African American workers less protection than it does for the overall labor force. In June 2007, just before the start of the recession, 3.1 percent of college-educated African Americans were unemployed, compared to an unemployment rate of 2.0 percent for the overall college-educated labor force. (See **Figure 13**) However, as the economic downturn progressed, the

unemployment rate for college-educated African Americans rose much more rapidly than for the overall college-educated labor force. By June 2009, 8.2 percent of college-educated African American workers were unemployed, while 4.8 percent of the overall college-educated labor force was unemployed. (See **Figure 13**) Thus, in a span of two years, the gap in unemployment rates between college-educated African Americans and the overall college-educated labor force jumped from 1.1 percentage points to 3.4 percentage points. As the labor market begins to heal, it remains to be seen how African Americans workers will fare relative to other workers. Most recently, black college-educated workers faced an unemployment rate of 7.6 percent, compared to an overall rate of 4.5 percent for all college graduates.

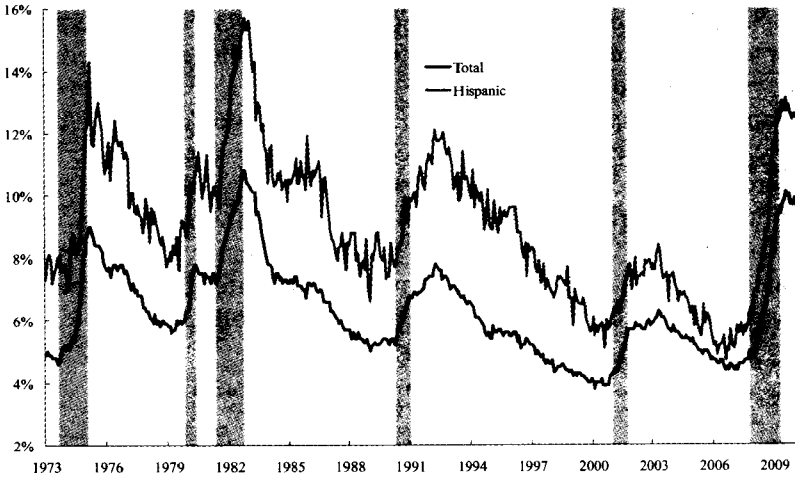
Figure 13. Unemployment Among College Graduates
Unemployment Rates by Race (Not Seasonally Adjusted)



Source: JEC Majority Staff based on data from the Bureau of Labor Statistics.

Hispanic workers. The unemployment rate for Hispanic workers rose more quickly than the overall unemployment rate during the recession. (See **Figure 14**) In June 2010, Hispanic workers had an unemployment rate of 12.4 percent, much higher than the overall unemployment rate of 9.5 percent.

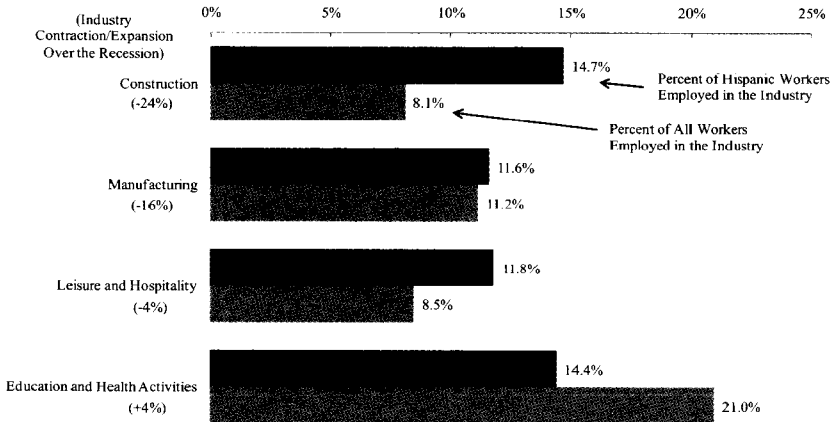
Figure 14: Unemployment Rate by Hispanic Ethnicity
 March 1973 - June 2010 (Seasonally Adjusted)



Note: Grey areas represent recessions as classified by NBER.
 Source: JEC Majority Staff based on data from the Bureau of Labor Statistics.

Much of the increase in the Hispanic unemployment rate could be due to the crumbling of the housing market and the associated contraction in the construction industry. Prior to the recession, Hispanic workers were heavily concentrated in the construction industry, which was one of the industries whose fortunes were closely tied to positive developments in the housing sector and which shed millions of jobs during the recession. In 2007, 14.7 percent of Hispanic workers were employed in the construction industry, compared to 8.1 percent for the overall labor force.⁶¹ This disproportionate representation made the Hispanic workforce particularly vulnerable to the severe contraction in the construction industry that occurred through the course of the recession. Employment in the construction sector reached a peak of 7.7 million workers in August 2006, but plunged to 5.6 million by February 2010, before employment declines slowed.⁶² In 2007, Hispanic workers were also concentrated in other industries that contracted during the recession — such as leisure and hospitality services — and less concentrated in industries that expanded, such as education and health services. (See **Figure 15**)

Figure 15. Distribution of Hispanic Employed Persons and Total Employed Persons in Selected Industries
2007 Annual Averages

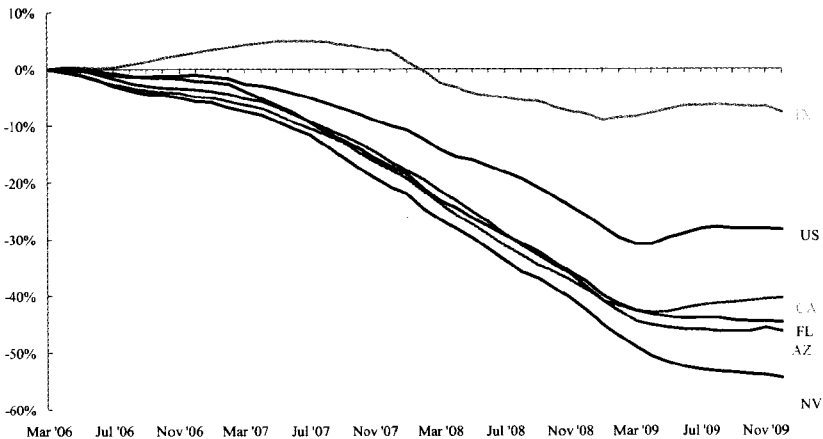


Note: Numbers in parentheses represent the percent change in employment within the industry over the recession (December 2007 to December 2009).

Source: Joint Economic Committee Majority Staff calculations based on data from the Bureau of Labor Statistics.

Additional evidence of the link between the rise in Hispanic unemployment and the bursting of the housing bubble comes from the geographic differences in job loss for Hispanic workers. Hispanic workers were heavily represented in the states most devastated by the collapse of the housing market — Nevada, Arizona, Florida, and California — where home prices plunged dramatically. (See **Figure 16**) However, another state with a large Hispanic workforce — Texas — experienced a much more modest drop in home prices and has a much lower unemployment rate than Nevada, Arizona, Florida, and California.

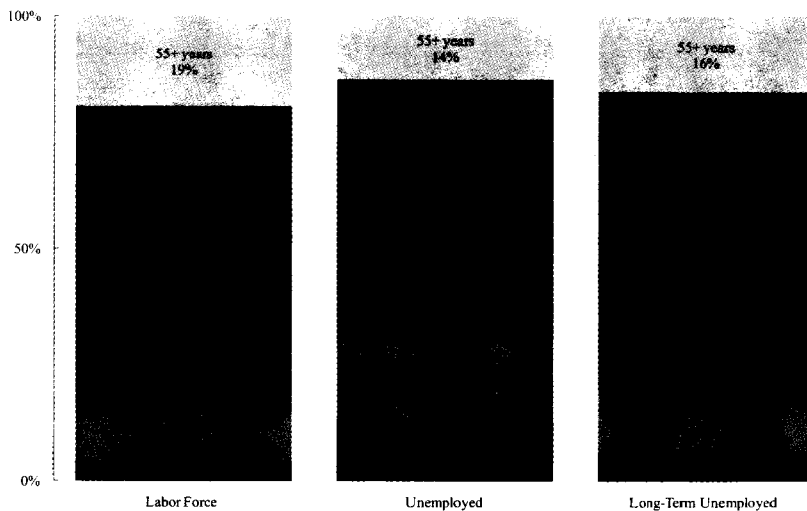
Figure 16. Decline in House Prices of Selected States
 Percent Change in House Price Index, March 2006 - December 2009



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
 Source: JEC Majority Staff calculations based on data from the Loan Performance House Price Index (Seasonally Adjusted by Haver Analytics).

Youth. Young workers (ages 16 to 24) have also encountered particular difficulty during the course of the recession. Young workers make up a disproportionate share of the unemployed: In June 2010, they comprised 14 percent of the labor force but made up 30 percent of the unemployed and 19 percent of the long-term unemployed (numbers not seasonally adjusted).⁶³ (See **Figure 17**)

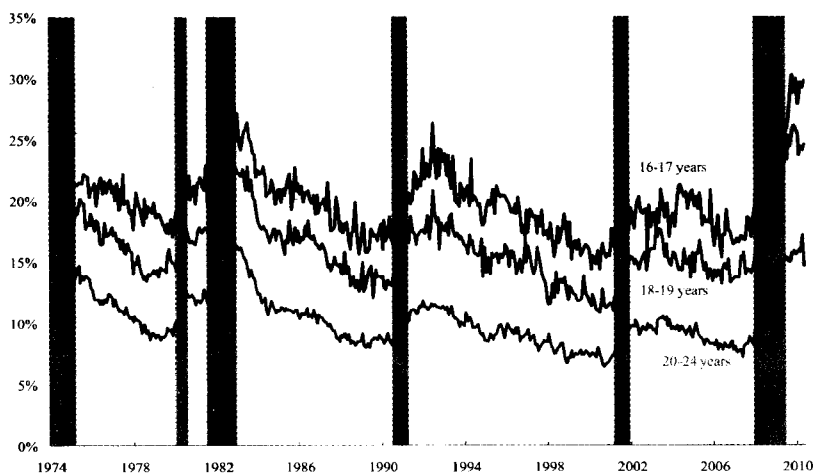
Figure 17. Labor Force, Unemployed, and Long-Term Unemployed
Distribution by Age, June 2010 (Not Seasonally Adjusted)



Source: JEC Majority Staff based on data from the Bureau of Labor Statistics, Household Survey.

Differences also exist within those categorized as young workers, with younger workers faring worse than older workers in that category. (See **Figure 18**)

Figure 18. Unemployment Rates Among Young Workers
Unemployment Rate by Age, 1974 to 2010 (Seasonally Adjusted)



Note: Grey areas indicate recessions as classified by NBER.

Source: JFC Majority Staff based on data from the Bureau of Labor Statistics, Household Survey.

Young teen workers (ages 16 and 17) had an unemployment rate of 29.2 percent in June, with the vast majority (93 percent) lacking a high school diploma.⁶⁴ For older teens (ages 18 and 19), the unemployment rate was 24.0 percent.⁶⁵ Young adults (ages 20 to 24) had the lowest unemployment rate among workers between the ages of 16 and 24; their unemployment rate was 15.3 percent.⁶⁶

A combination of work experience and education may account for much of the difference in unemployment rates among those classified as young workers, since the older workers tend to be more educated and experienced than the younger workers. Unemployment rates for young workers fall dramatically as their education level rises.⁶⁷ Graduating high school seems especially important: Among workers 16 to 24 who are not currently enrolled in school, the unemployment rate gap between those without a high school diploma and those with only a high school diploma has widened over time, from a gap of 7.1 percent in June 2007 to 9.2 percent in June 2010.⁶⁸

For example, young workers without a high school diploma had an unemployment rate of 30.9 percent in June 2010, significantly higher than the 13.0 percent rate of unemployment among workers 25 years

and older without a high school diploma. Even the well-educated are facing labor market difficulties, however. The unemployment rate for young workers with at least a bachelor's degree was 11.2 percent in June, compared to an unemployment rate of 4.5 percent for similarly educated workers who are 25 years or older.⁶⁹ While much of the discrepancy is due to the lower levels of work experience among young workers compared to workers older than them, young workers entering the labor market are facing particular difficulty in finding jobs.

Policymakers should be especially concerned about this because the lifetime earnings trajectories of youth depends heavily on their first experience in the labor market, which may be particularly negative given the weak labor market. The ramifications can be dramatic. Dr. von Wachter argues, "The consequences of entering the labor market in a recession are severe in both the short and the long run."⁷⁰ In fact, when young workers enter the labor market during a large recession, it may take them between 10 and 15 years for them to finally earn what they would have made had they entered the labor market when economic conditions were better.⁷¹ Moreover, even if the labor market improves following their entry in the labor force, young workers still suffer from significant long-term effects of entering the labor market during a severe recession.⁷² This arises partly because many youths entering the labor market accept wage offers that are more depressed than they would have been during an economic boom, which would start them off at a lower point on their earnings trajectory.⁷³ Moreover, workers need to make adjustments to get their earnings back to normal — such as "obtaining outside job offers, changing jobs, or moving to different regions" — but "many face obstacles to such adjustment, often due to family commitments."⁷⁴

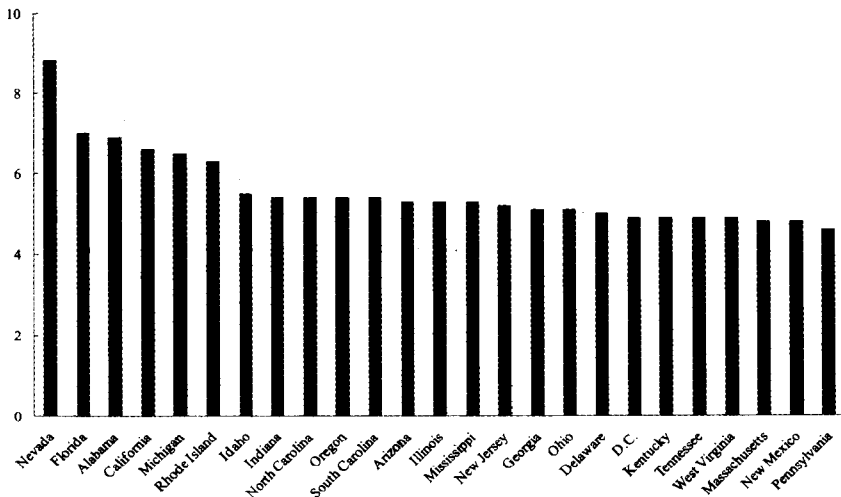
Young workers may also detach from the labor force altogether when faced with the difficulty of finding a job during a severe recession. Dr. Holzer argues that many disadvantaged and less-educated youth are "'disconnecting' from both school and the labor market together."⁷⁵ Mr. David R. Jones, President and CEO of the Community Service Society, points out that "unemployment rates do not even show the complete picture of this crisis, in that they only show those who are actively seeking work. Far more young people have become

discouraged in this labor market, and are even further on the sidelines.”⁷⁶

The Impact of the Housing Bubble on Employment Across States

While the aggregate figures paint a picture of widespread economic distress, the impact of the Great Recession has been quite varied. Some sectors of the economy have been hit far harder than others. Likewise, some states have been battered by the economic storm while others remain relatively unscathed. For example, the unemployment rate in Nevada nearly tripled, rising from 5.2 percent in December 2007 to 14.0 percent in May 2010 (8.8 percentage point increase). Other states experiencing large unemployment rate increases since December 2007 include: Florida (7.0), Alabama (6.9), California (6.6), Michigan (6.5), and Rhode Island (6.3). (See **Figure 19**) On the other hand, the unemployment rate in North Dakota rose only 0.6 percentage points from December 2007 to May 2010, in South Dakota 1.8 percentage points and in Nebraska 2.0 percentage points.

Figure 19. Change in Unemployment Rate For States Experiencing Largest Increases
Percentage Points Increase, December 2007 - May 2010



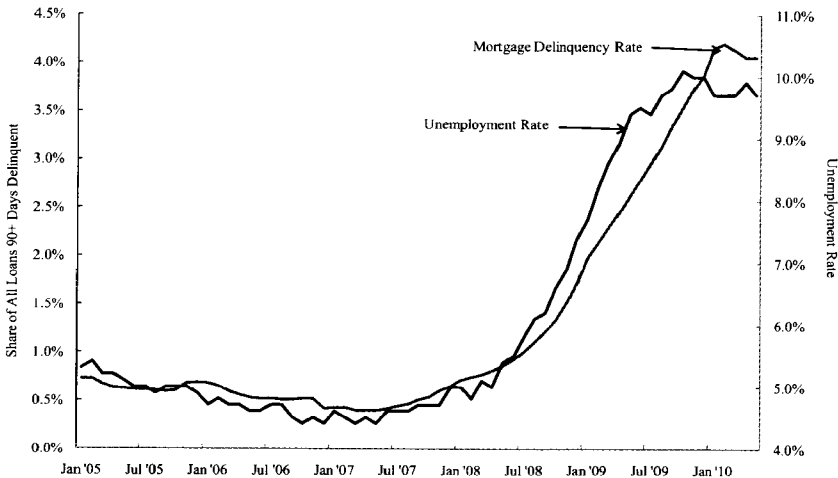
Source: JEC Majority Staff calculations based on data from the Bureau of Labor Statistics.

Part of the reason for the rise in unemployment rates in certain states can be attributed to the collapse of the housing market, which spelled

serious trouble for employment in the housing sector of the economy. However, in recent months, employment in this sector has stabilized somewhat, especially relative to the dramatic declines during the first two years of the recession. Construction employment fell by 2 percent between December 2009 and June 2010, as compared to a 24 percent drop between December 2007 and December 2009. Employment in real estate, rental, and leasing finance fell by just over 1 percent between December 2009 and June 2010, as compared to a 9 percent drop between December 2007 and December 2009. Similarly, employment in furniture manufacturing has fallen by less than 1 percent in the first half of 2010 as compared to a 29 percent decline between December 2007 and December 2009.

The unemployment rate has tracked closely with mortgage delinquency rates since January 2005, suggesting a relationship between the housing bubble and the unemployment problem. (See **Figure 20**) Moreover, states rattled by the housing crisis have seen declines in employment. A negative relationship between employment levels and a variety of indicators of housing market trouble may exist. For instance, subprime foreclosures are negatively correlated with changes in employment.⁷⁷

Figure 20. Unemployment Rate vs. Mortgage Delinquency Rate
January 2005 - May 2010



Source: JEC Majority Staff based on data from Freddie Mac and the Bureau of Labor Statistics.

The aftermath of the housing bubble may slow the speed of recovery by creating a geographic mismatch between workers and jobs. A persistently weak housing market may make relocation more difficult, as housing prices remain depressed and sales volume remains low. An unemployed worker who sees new job opportunities in faster-growing regions of the country may be unable to relocate because a weak housing market makes it impossible to sell his home in a region with high unemployment and few buyers. The resulting decrease in mobility may reinforce high levels of unemployment in hard-hit regions of the country as unemployed workers are tethered to their homes and unable to move on to new opportunities.⁷⁸

CONGRESSIONAL AND ADMINISTRATION ACTIONS TO HELP THE LABOR MARKET

The actions taken by Congress and the Administration in 2009 — especially the passage of the American Recovery and Reinvestment Act of 2009 (P.L. 111-5, referred to as the Recovery Act) — staved off impending economic disaster, but policymakers headed into 2010 to continue the follow-up task of working on economic recovery. One of the major priorities of Congress in 2010 was to extend cost-effective measures that supported unemployed workers and stimulated the economy, as well as enacting new policies to deal with problems afflicting the labor market. A summary of major legislation is summarized in the table below.

Public Laws Passed in the Second Session of the 111th Congress			
Public Law Number	Bill Title	Date Became Public Law	Summary
P.L. 111-139	Statutory Pay-As-You-Go Act of 2010	February 12, 2010	Requires that direct spending and revenue legislation enacted into law not increase the deficit and instructs the Comptroller General to conduct routine investigations aimed at eliminating duplicative and wasteful spending.

P.L. 111-144	Temporary Extension Act of 2010	March 2, 2010	Extends various social safety net provisions of the Recovery Act that were set to expire, such as unemployment insurance extensions (April 5, 2010), COBRA eligibility (March 31, 2010), and loan guarantees for small businesses (March 28, 2010).
P.L. 111-147	Hiring Incentives to Restore Employment Act	March 18, 2010	Provides a payroll tax credit of up to 6.2 percent for workers unemployed 60 days or longer, plus an additional \$1,000 if employees are retained for one year; and doubles the amount that small businesses can write off for capital investments, from \$125,000 to \$250,000.
P.L. 111-148	Patient Protection and Affordable Care Act	March 23, 2010	Reforms health care, including expanded Medicaid eligibility, insurance premium subsidies, providing incentives for businesses to provide health care benefits, prohibition of denial of coverage based on pre-existing conditions, establishment of health insurance exchanges, and greater support for medical research.
P.L. 111-150	To permit the use of previously appropriated funds to extend the Small	March 26, 2010	Makes up to \$40 million of funds appropriated for the business loan program

	Business Loan Guarantee Program, and for other purposes.		of the Small Business Administration (SBA) under the Consolidated Appropriations Act of 2010 available to reduce or eliminate fees on small business loans or SBA-guaranteed loans , as authorized in the Recovery Act.
P.L. 111-152	Health Care and Education Reconciliation Act of 2010	March 30, 2010	Makes a number of health-related financing and revenue changes to the Patient Protection and Affordable Care Act and modifies higher education assistance provisions.
P.L. 111-157	Continuing Extension Act of 2010	April 15, 2010	Extends various social safety net provisions that were set to expire including unemployment insurance extensions (June 2, 2010), COBRA eligibility (May 31, 2010), and loan guarantees for small businesses (May 31, 2010).
Legislation Passed by the House of Representatives			
Bill Number	Bill Title	Date Passed	Description
H.R. 4849	Small Business and Infrastructure Jobs Tax Act of 2010	March 24, 2010	Allocates \$20 billion over a decade to extend the Build America Bonds program, excludes investments in small businesses from capital gains, increases the tax deduction for start-up

			expenditures, and provides other incentives for job creation.
H.R. 4899	Supplemental Appropriations Act, 2010 (formerly the Disaster Relief and Summer Jobs Act)	March 24, 2010	Provides emergency supplemental appropriations for FEMA's disaster relief fund and the SBA for the business loans program account. Also provides funds for the Department of Labor for the Employment and Training Administration.
H.R. 5019	Home Star Energy Retrofit Act	May 6, 2010	Establishes incentives for consumers who renovate their homes to become more energy-efficient.
H.R. 4213	American Jobs and Closing Tax Loopholes Act of 2010	May 28, 2010	Institutes incentives to support business innovation, provides tax cuts for families with college-bound children, and provides disaster relief for states. Additionally, the bill adds approximately 350,000 summer jobs for young people.
H.R. 5116	America COMPETES Reauthorization Act of 2010	May 28, 2010	Establishes, revises, and extends specified science, technology, education, and mathematics (STEM) programs, as well as engineering, research, and training programs.
H.R. 5486	Small Business Jobs Tax Relief Act of 2010	June 15, 2010	Increases the capital gains tax cut for those who invest in small

			businesses this year, fixes a tax shelter disclosure penalty disproportionately impacting small businesses, and increases to \$20,000 (from \$5,000 in current law) the deduction for start-up expenditures in connection with investigating the creation of a business.
H.R. 5297	Small Business Lending Fund Act of 2010	June 17, 2010	Delivers loans to small business through a new \$30 billion lending fund for small and medium sized community banks (\$10 billion or under) that could leverage up to \$300 billion in lending.

Legislation Passed by the Senate

Bill Number	Bill Title	Date Passed	Description
H.R. 4213 ⁷⁹	America Jobs and Closing Tax Loopholes Act of 2010	March 10, 2010	Provides incentives to support business innovation, establishes tax cuts for families with college-bound children, and provides disaster relief for states. Adds approximately 35,000 summer jobs opportunities for young workers. Also extends unemployment insurance benefits through December 31, 2010.
H.R. 4899 ⁸⁰	Supplemental Appropriations Act, 2010	May 26, 2010	Provides emergency supplemental appropriations

			FEMA's disaster relief fund and the SBA for the business loans program account. Also provides funds for the Department of Labor for the Employment and Training Administration.
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The Recovery Act

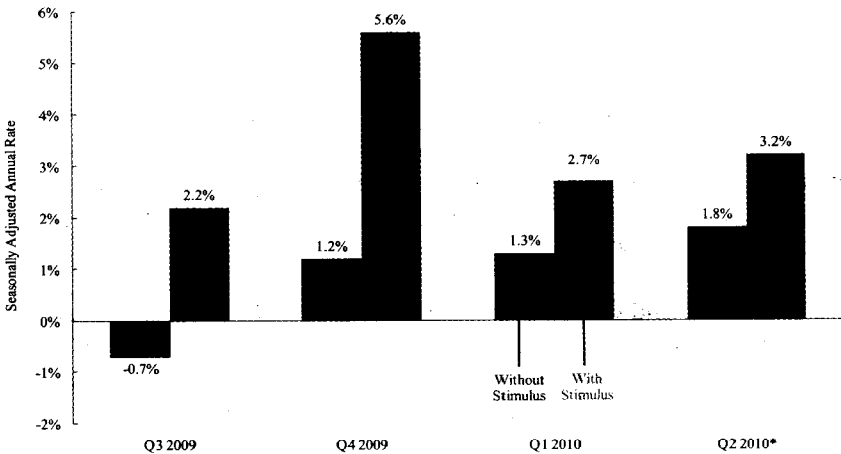
In 2009, Congress and the Administration passed the largest countercyclical fiscal stimulus in history, the Recovery Act, in order to bring the economy back from the brink of depression. Because of this overwhelming response, economic depression was averted in 2009, and the economy, although still reeling from numerous problems, is now on the path toward recovery.

Both the CBO and CEA have estimated that the Recovery Act has been effective at raising GDP and boosting employment. The CBO, for example, estimated that, in the first quarter of 2010, GDP was between 1.7 percent and 4.2 percent higher than it would have been without the Recovery Act.⁸¹ On the employment front, the CBO estimated that the unemployment rate was between 0.7 percentage points and 1.5 percentage points lower and employment was between 1.2 million and 2.8 million jobs greater than they otherwise would have been in the first quarter of 2010 in the absence of the Recovery Act.⁸² In fact, projections by the CBO indicate that the unemployment rate will be between 0.8 percent and 2.0 percent lower and that employment will be between 1.4 million and 3.7 million jobs higher in the third quarter of 2010 because of the Recovery Act.

The CEA's fourth quarterly report on the economic impact of the Recovery Act also credits the Recovery Act with spurring economic growth and raising employment. They estimate that GDP in the second quarter of 2010 was between 2.7 percent and 3.2 percent higher than it would have been without the Recovery Act.⁸³ Likewise, the CEA estimates that the Recovery Act contributed 0.7 percentage points to GDP growth in the second quarter of 2009; 1.4 percentage points in the third quarter of 2009; 2.5 percentage points in the fourth quarter of

2009; and 2.9 percentage points in Q1 2010.⁸⁴ (See **Figure 21**) Moreover, the CEA estimates that the Recovery Act raised employment by between 2.5 and 3.6 million jobs during the second quarter of 2010.⁸⁵ As of June 30, 2010, \$420 billion (53 percent) of the \$787 billion stimulus had either been spent on contracts, grants, and loans; entitlements; and tax benefits.⁸⁶

Figure 21. Impact of Stimulus on Gross Domestic Product
Estimated GDP Growth With and Without the Recovery Act, Q3 2009 - Q2 2010



* Q2 2010 GDP growth with stimulus is based on an estimate coming from Blue Chip Consensus as of July 10, 2010.
Source: JEC Majority Staff based on data from the Council of Economic Advisers, the Bureau of Economic Analysis.

According to the CEA, the tax relief and income support provisions of the Recovery Act accounted for as much as half of its positive impact on GDP and employment.⁸⁷ Low- and middle-income households benefited disproportionately from the Recovery Act's tax relief and income support provisions. The CEA results suggest that government support of these households can make significant contributions to economic growth and employment, reinforcing the case for further assistance. The sizeable impact of these and other tax relief and income support programs could be attributed to the immediate jolt to the economy arising from increased spending by low- and middle-income households. Since they are likely to be cash-strapped and credit-constrained, many of these households immediately spend funds received from the government, which provides quick stimulus to the

economy as their spending trickles through the economy and creates a cascade of further spending.

The public investment spending provisions of the Recovery Act raised aggregate employment by more than 800,000 jobs as of the second quarter of 2010, according to the CEA.⁸⁸ The largest impacts of public investment spending on employment were in the clean energy, human capital, and transportation infrastructure categories. A critical feature of the public investment programs in the Recovery Act is that many of them are leveraging outside private funds. The CEA estimates that roughly \$100 billion of the Recovery Act fund have leverage provisions, and these funds will ultimately support \$380 billion of total investment spending. In other words, every \$1 of Recovery Act funds invested into leverage programs is partnered with about \$3 of outside investment spending.⁸⁹ The majority of these co-investors are from the private sector.⁹⁰ These leverage programs, many of which are directed at public investment spending, are making government money go even further toward rescuing today's and rebuilding tomorrow's economy.

Extensions of Unemployment Insurance and COBRA Subsidies

The Recovery Act contained a number of key provisions affecting unemployment benefits. It temporarily increased benefits by \$25 per week, extended the availability of Emergency Unemployment Compensation (EUC) through the end of 2009, and provided 100 percent federal financing for the Extended Benefits (EB) program. In the intervening months, Congress and the Administration have taken additional actions to ensure that unemployment benefits remain available to jobless workers. The Temporary Extension Act of 2010 (P.L. 111-144) extended all of the unemployment insurance-related provisions from the original stimulus bill through April 5, 2010. The Continuing Extension Act of 2010 (P.L. 111-157) extended these provisions through June 2, 2010. The House of Representatives passed legislation that would extend these provisions through the end of 2010; the Senate is still debating an extension.

Unemployment insurance benefits are crucial to helping millions of American workers continue to put food on the table and pay the bills. But unemployment benefits also have a significant impact on the strength of the American economy as a whole. Workers receiving

unemployment benefits are typically cash-strapped and will spend their benefits quickly. This spending generates a “multiplier” for the economy as a whole, whereby every dollar of unemployment benefits that a recipient spends sets off a cascade of spending by others, providing a significant and immediate jolt to the nation’s economy. Indeed, the CBO estimates that increased aid to the unemployed is the more cost-effective at boosting economic growth and employment than a variety of other policy options under consideration.⁹¹

The extension of unemployment benefits also serves an important purpose in keeping individuals attached to the labor market. Dr. von Wachter argues that extensions in unemployment insurance benefits “prevent some workers from applying to other government programs not intended to smooth short-term economic shocks, such as Social Security Disability Insurance or Old Age and Survivors Insurance. In particular, benefits provided under disability insurance can be very costly, especially if provided to younger or middle aged workers with low-mortality impairment.”⁹² The extension of unemployment benefits and COBRA support through the end of 2010 could save the federal government \$23.5 billion by avoiding a lifetime of Social Security Disability Insurance for currently unemployed disabled workers.⁹³

The principal purpose of the unemployment insurance program is to provide workers with a safety net in the event that they lose their job. However, some worry that unemployment insurance benefits may inhibit unemployed workers from vigorously looking for or accepting a new job. Those fears are unfounded. The best evidence suggests that during this current economic downturn both the unemployment rate and duration of unemployment were minimally impacted by unemployment insurance benefits and the extensions of benefits. One recent study suggests that just 0.4 percentage points of the nearly 6 percentage point increase in the national unemployment rate over the past few years is due to the extension of unemployment benefits.⁹⁴ This small uptick in the unemployment rate attributable to the extension of unemployment insurance benefits may reflect a positive consequence of an extension of benefits: Unemployment insurance may be providing an enormous social benefit by preventing people from dropping out of the labor force altogether (and often permanently), relying instead on more costly programs like disability benefits.

Job loss can also mean the loss of health insurance coverage. Without health insurance coverage, many jobless workers may incur large medical bills that add to their financial distress. The 111th Congress has passed legislation that temporarily addresses this problem by providing a 65 percent subsidy for the purchase of COBRA health benefits for unemployed workers. COBRA benefits allow laid-off workers to continue to purchase health insurance through the group insurance offered by their former employer, but the cost of buy-in is often prohibitively high for laid-off workers. Indeed, the average family COBRA premium costs \$1,137 a month, about 83 percent of the average monthly unemployment insurance benefit.⁹⁵ The COBRA benefit subsidy included in the Recovery Act was designed to help make this purchase more affordable for financially-stressed unemployed workers. Congress has extended the expiration date on this subsidy several times since the initial enactment, most recently via the Continuing Extension Act (P.L. 111-157), which made the COBRA subsidy available through May 31, 2010. Congress is currently debating bills that would extend these provisions through the end of 2010.

According to the CBO, the extension of the COBRA benefit subsidy results in an increased demand for health care services, and increases the income available to purchase other goods and services. This increased demand for goods and services translates into a cost-effective mechanism for bolstering economic growth and employment, according to the CBO.⁹⁶

Tax Incentives for Hiring

Heading into 2010, the creation of private-sector jobs — which accounted for 82.5 percent of all payroll jobs in June 2010 — was one of the most important challenges facing policymakers.⁹⁷ One proposal advocated by the Administration was an employer tax credit to provide tax incentives for businesses to hire workers. The employer tax credit also received an endorsement from Princeton University economist Alan Blinder, who is the Co-Director and Founder of Princeton's Center for Economic Policy Studies.⁹⁸ Dr. Douglas W. Elmendorf, Director of the CBO, reports that of the various policies to spur job creation and economic growth, the CBO considers an employer tax credit for firms that increased their payroll to be among the most cost-

effective ways of boosting job creation and growth.⁹⁹ In addition, instituting an employer tax credit was one of many recommendations that came from a survey that asked Fortune 100 companies for suggestions on what Congress and the Administration could do to create jobs and spur hiring.¹⁰⁰

Congress and the Administration established an employer tax credit with the enactment of the Hiring Incentives to Restore Employment Act (P.L. 111-147, referred to as the HIRE Act) on March 18, 2010.¹⁰¹ The HIRE Act exempts employers from paying the 6.2 percent payroll tax for any worker who had been unemployed for at least 60 days (and met other qualifications).¹⁰²

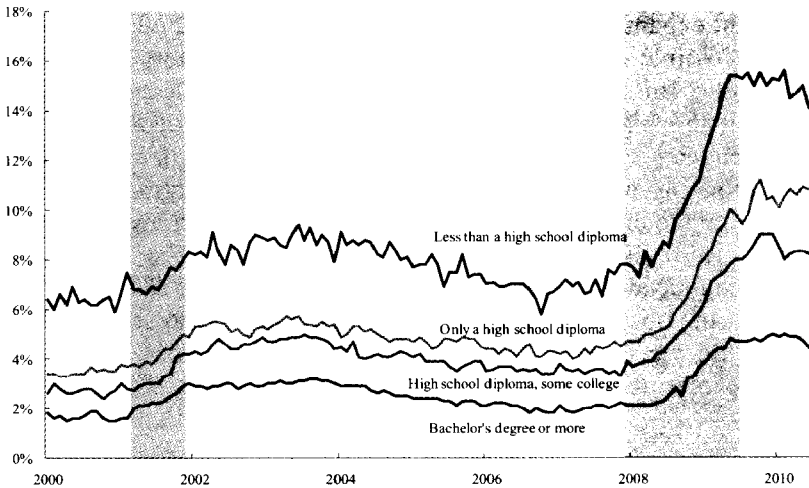
Education and Job Training

Government policies that encourage businesses to hire more workers are most effective when job applicants have the skills employers are looking for. Unfortunately, features of the labor market documented previously suggest that skill erosion and mismatch may be worse now than in previous economic downturns, which leaves scarce job openings unfilled because employers can't find workers with the right skill set.¹⁰³ If skill deterioration is left unchecked, even more job openings will remain unfilled, hurting both workers and employers. The mismatch problem makes greater investment in worker skill development and job training programs more urgent now than ever before.

Traditional job training programs will likely be insufficient to prepare workers for new jobs and new employment opportunities, however. Innovative approaches are needed to strengthen job training programs and to ensure that these programs reach those who need them. Economists and leaders from the private, non-profit and public sectors agree that there is no magic bullet. To make significant progress, multiple, targeted programs and initiatives are required to provide workers with the education, skills and experience needed to compete in today's global economy. Rigorous evaluation based on comprehensive and reliable data will be critical. Those programs that boost the long-term employment prospects and earnings of participants should be expanded while those unable to show positive outcomes must be improved or ended.

As noted previously, educational attainment helps reduce the probability of being unemployed. In June 2010, the unemployment rate for those with a college degree was 4.4 percent, compared to 14.1 percent for those without a high school diploma.¹⁰⁴ (See **Figure 22**) However, the benefits of a college degree are not uniform. For example, the unemployment rate for black college graduates 25 and older was 7.6 percent in June 2010; the unemployment rate was even higher among young black college graduates.

Figure 22. Unemployment Rates by Educational Attainment
January 2000 - June 2010 (Seasonally Adjusted)



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Source: Joint Economic Committee Majority Staff based on data from Bureau of Labor Statistics, Household Survey.

During the recession, as job prospects worsened, an increasing share of Americans pursued higher education. The Bureau of Labor Statistics recently reported that the country has attained a record rate of college enrollment among 2009 high school graduates — 70.1 percent.¹⁰⁵ In 2010, Congress and the Administration made the largest investment in student aid in the nation's history, an investment which may enable additional future gains in college enrollment.¹⁰⁶ The Health Care and Education Affordability Reconciliation Act of 2010 increases the maximum annual Pell Grant to \$5,550 in 2010 and, beginning in 2013, indexes the Pell scholarship to the Consumer Price Index, so that it keeps pace with inflation; channels all new federal lending to the Direct Loan program, saving taxpayers money; invests more than \$2.5

billion in historically black colleges and universities; and invests \$2 billion in community colleges through a competitive grant program that will help strengthen career training programs.¹⁰⁷

Community colleges are important parts of pathways to training and employment opportunities and community college enrollment has increased significantly in recent years.¹⁰⁸ These two-year institutions are often very close to local employers, understand their hiring needs, and have developed degree and certification programs that build skills which are in demand in their community.¹⁰⁹

The recent expansion of financial aid programs makes higher education more accessible to all young people, opening important doors of opportunity. But the need for educational investment and reform is needed at the high school level as well. Career academies combine strong academics with workforce training, targeting a particular sector of the economy which offers solid labor market opportunities, such as information technology, health, financial services or renewable energy. Students learn skills that prepare them to work in these fields while also taking academic courses that prepare them to continue their studies at the post-secondary level, if they choose to do so. Dr. Holzer argues, "So we have to rebuild, not old-fashioned voc-ed, but high-quality career technical education linked to strong sectors of the economy."¹¹⁰

Education, as important as it is, is not enough. Young college graduates who entered the workforce after December 2007 began their work lives in the worst recession since the Great Depression. It will take, on average, 10-15 years for these graduates to reach the earnings level of peers who entered the workforce during an economic expansion.¹¹¹ To regain the lost ground, these young workers will need to be mobile across occupation and region. Policies targeted at these recent college graduates could help them gain employment and build their skills. Dr. Richard Berner, Chief Economist for Morgan Stanley, proposed a Job Training Corps that would put to work recent college graduates along with unemployed teachers to help build core skills for other unemployed workers.¹¹² It would both develop new skills and reduce unemployment. Additionally, a Job Training Corps would provide those just out of college and unemployed teachers with ways to engage

meaningfully during their unemployment and provide an opportunity to build new — or refine existing — skills of their own.¹¹³

Similarly, targeted training programs are needed to help workers, across age groups, reattach to the workforce and regain their footing in the challenging labor market. In many cases, unemployed workers will be forced to find new jobs outside of their previous industry and will require assistance and training to make that transition.¹¹⁴ These workers will need both new skills and help presenting old skills in ways that fit a new industry.¹¹⁵ Additionally, they will need access to timely, understandable information on labor market trends. With the record long-term unemployment of the past two years, the need to help jobless workers recast themselves has never been greater. CBO Director Elmendorf observes that the gains in employment following the Great Recession will “probably rely more than usual on the creation of new jobs, possibly in new firms that are located in different places and require workers with different skills than those needed in the jobs that have disappeared.”¹¹⁶

Effective job training must be targeted to those sectors of the economy which offer future employment opportunities. Sectoral employment programs are built on that exact premise. Sectoral programs identify those sectors that offer strong growth opportunities in a community and then work with intermediary organizations and private-sector employers to craft programs that build skills that will be in demand. Successful programs have been undertaken in manufacturing, allied health, and information technology.

Sectoral programs have shown positive outcomes, with participants more likely to get and retain employment than those who have not received such training.¹¹⁷ Employers are closely involved in the design and implementation and participants receive industry-specific skills as well as general job readiness training. A potential barrier to scaling these industry-focused programs is that they require up-front investment in understanding the employment opportunities in a particular area in order to create programs that align with these opportunities. The partnerships that work in one community are not easily replicated in another. Yet, these sectoral employment programs are getting the highest rates of return today among job training programs and figuring out how to effectively scale them could pay significant future dividends. Explains Dr. Katz, “But we do know with

creativity and the combination of employers having the incentive of getting good workers, local communities working with them, and workers really getting the support to go through training that leads somewhere, the best evaluations show things like 20 percent, 30 percent persistent earnings increases from such programs.”¹¹⁸

Labor market information on sectors and industries that guides the development of sectoral training programs should also be widely shared with those entering or considering a broad range of job training programs. Trainees currently receive too little guidance about the skills that are needed, the courses they should take, and the opportunities that are likely to exist when they complete the training program. While the Bureau of Labor Statistics and Census Department provide information that indicates growing sectors and regions, it is not well-organized, can be difficult to find, and is not easily used by people unfamiliar with labor market terminology. This information could be pulled together in one area and simplified for broader consumption.¹¹⁹

Better connecting job training to placement in a job is an area for improvement. The hand-off between job training and job placement is difficult to execute well. Ensuring that training is tied to occupations in growing industry sectors, where jobs are immediately available, would ensure that training would not take place in a vacuum. Using strategies such as customized training, on-the-job training or transitional job programs would ensure that an employer has a specific need for the employee being trained, and that the training is specific to the needs of the job.¹²⁰ Put another way, the training would lead to a specific job with a specific corporation.

While virtually all groups of workers have been hit hard during the Great Recession, young adults and teens have been hit especially hard, facing record unemployment in the spring of 2010 and unemployment rates far higher than the national average throughout the recession. Congress has taken recent action to address the high rate of joblessness among the youngest workers. At the time of publication, the House of Representatives had passed legislation supporting 350,000 summer jobs for young people.¹²¹

There is a broad consensus that summer youth employment programs offer an important introduction to the world of work for many

teenagers, while also providing needed money during the summer months. But there is also recognition that more year-round work opportunities are needed, especially for young people who are no longer connected to school or work. Similarly, more rigor is needed in the summer employment programs to help young people build skills, and to better understand on-the-job expectations. Young people should have to come to work on time and they should be evaluated at the end of the summer, argues Mr. Jones, who earlier in his career ran New York City's summer youth employment program. Summer employment can be transformed so that it is a step to additional employment and to future skill-building.¹²²

Unlike the job training policies previously mentioned, which concentrate on preparing a worker for a new job, work-share seeks to provide employers and employees with additional flexibility during periods of reduced demand to prevent an employee from losing his or her job in the first place. With work-share, an employee works fewer hours and receives less compensation from the employer during periods of weak demand. Unemployment insurance, or a form of it, makes up for the cut in the employee's hours. Such a work-share program could retain employment at higher levels than they would otherwise be during recessions. For example, instead of firing 20 percent of its workers, the employer could reduce hours for all of its workers by 20 percent. Because research shows that periods of unemployment significantly reduce earnings, even 15 to 20 years later, policies such as work-share could reduce the number of people impacted by unemployment, thereby reducing the negative impact on future income and output. Seventeen states have adopted some form of work-sharing policies.¹²³

Unemployment solutions must also address the needs of older workers, who may face different training and employment challenges than those of younger workers. Longtime employed older workers may have felt secure in their careers, only to be laid off during the height of the recession. Furthermore, the severe decline in household wealth forced many workers nearing retirement to remain in the labor force, and drew some retirees back to the workforce. With stiff competition for each job opening, older workers may have difficulty finding new employment opportunities if their current skills are not well-matched to jobs in an ever-changing labor market. Such workers could benefit

from work-share programs, allowing them to receive on-the-job training, acquire new skills, and refine their existing skill set, while keeping them attached to the labor force until full-time work opportunities increase. Such work-share programs would also give older workers much needed flexibility in order to juggle employment with their dual-caregiving duties of caring for elderly parents while simultaneously providing for their own families. The Joint Economic Committee will examine the employment challenges facing older workers in a forthcoming Majority Staff report.

NEED FOR FURTHER ACTION

The fragile state of the current economic recovery means that an overemphasis on trimming the nation's deficit is seriously misguided. In tenuous economic times, deficit spending is a necessary, positive step toward revving the economic engine back into high gear. Federal spending fuels job growth, and provides critical services that both prevent hardship for families and saves the government additional spending down the line. Cutting off this necessary lifeline in order to "trim the deficit," as some argue is a necessary step, would have devastating results on the economy and American families would suffer. Moreover, the vast share of the looming debt problem facing the federal government stems from the combination of the aging Baby Boom generation and the financing of Social Security and Medicare. As a result, critiques of deficit spending directed at efforts to prime the economic pump during and in the aftermath of the Great Recession are largely misdirected.

Rather than focusing on the deficit, the most important priority in the wake of the Great Recession is to firm up the foundations of the economy. In particular, because this recession was characterized by high degrees of long-term unemployment, the labor market is likely to remain fragile for quite some time. Long-term unemployment is a vexing problem that requires patience and perseverance to fix, which means that a shift away from job creation and toward deficit reduction is not only likely to leave many Americans to fend for themselves in the weak economy, but may very well suppress economic growth. Rather, policymakers should instead focus on devising targeted stimulus to help energize the pace of the recovery.

An effective, targeted stimulus would include a portfolio of policies. First, extending unemployment insurance would have ripple effects across the entire economy, triggering broad-based economic growth in addition to providing a critical lifeline to struggling jobless Americans. Second, federal investment in small businesses would help jumpstart job creation. One option includes providing federal funds to help solve small businesses' credit problems, because limited access to credit in the aftermath of the financial crisis has crimped small business hiring. A second option is to implement targeted tax cuts to help small businesses. Finally, federal funds for innovation and basic research play a key role in economic recovery.

Concerns about the Federal Deficit are Misplaced

Federal budget deficit projections over the next ten years are nearly entirely due to policies that pre-date the Obama administration and the 111th Congress. While investments in economic recovery policies have had an impact on the deficit, the lion's share of projected federal deficits were created by the Bush administration's actions. Bush-era tax cuts and the wars in Iraq and Afghanistan account for almost \$7 trillion in projected deficits between 2009 and 2019. In contrast, the recovery policies put in place by the Obama administration in response to the nation's worst economic crisis since the Great Depression account for \$1.1 trillion in projected deficits over the 2009 to 2019 period.¹²⁴ Moreover, the recession itself has caused a sharp deterioration in the budget outlook. Indeed, the impact of the recession on the nation's deficit projections would likely have been far more severe had Congress and the Administration not acted swiftly with recovery spending to stem further economic losses.

Given the gravity of the economic downturn facing the country, Congress and the Administration have enacted a series of spending measures — the most prominent of which was the Recovery Act — to stimulate and support the economy. As shown above, these policies have had a significantly positive impact on the economy.

Despite the success of fiscal stimulus, there are legitimate concerns over the impact such spending has had on the federal budget deficit. However, Congress and the Administration have placed a priority on imposing fiscal discipline in both the short- and long-term through a

variety of approaches. For example, Congress and the Administration enacted statutory Pay-As-You-Go legislation in February 2010 requiring lawmakers to fully offset the cost of a wide range of proposed spending increases and tax cuts with savings elsewhere in the budget.¹²⁵ In addition, President Obama established the bipartisan National Commission on Fiscal Responsibility and Reform to develop recommendations to “balance the budget, excluding interest payment on the debt, by 2015” as well as “meaningfully improve the long-run fiscal outlook, including changes to address the growth of entitlement spending and the gap between projected revenues and expenditures of the Federal Government.”¹²⁶ The Commission will submit its recommendations to the President by December 1, 2010.

Still, fully enacting the President’s budget proposal for fiscal year 2011 will lead to deficits of \$1.5 trillion in 2010 (10.3 percent of GDP) and \$1.3 trillion in 2011 (8.9 percent of GDP), according to CBO projections.¹²⁷ These deficits are unsustainable in the long run. However, they are unavoidable in the short run because substantial levels of fiscal stimulus are necessary to create jobs and get the economy back on track as quickly as possible. Indeed cutting back on fiscal stimulus while the economy is recuperating would likely prolong the economic downturn and increase deficits in the medium- and long-run.

By pursuing a variety of targeted, cost-effective strategies, Congress and the Administration can spur job creation and speed economic recovery, which will yield long-run benefits for unemployed workers as well as the government’s fiscal position. When unemployed workers find jobs, the deficit falls because the government reduces spending on social assistance and receives more in tax revenues. Moreover, unemployed workers are an untapped but productive resource, and as they find jobs, economic output, personal income, and business profits can increase and thereby raise government revenue. In short, the long-term budget outlook improves as the labor market continues its recovery.

The government can foster labor market recovery and job creation from a variety of directions. One way is to stimulate job creation through direct spending or tax incentives. Dr. Katz contends, “Both the continued fragility of the economy and the possibility of a sustained

jobless recovery represent calls to action for immediate policy steps to expand employment and incentivize job creation.”¹²⁸ He suggests passing a job creation package that includes aid to states, a net job creation tax credit, and “incentives for facilitating investment with high long-run payoffs in energy efficiency...and infrastructure.”¹²⁹ The recently enacted HIRE Act implemented some of these recommendations and established an employer tax credit. In addition, the House of Representatives passed the Home Star Retrofit Energy Act of 2010, which would provide rebates to households that invest in energy-efficient home upgrades. Encouraging these investments would help support employment in the struggling residential construction sector.

The extension of unemployment benefits is another form of fiscal stimulus that could improve the long-run budget outlook. And, a package to promote lending to small businesses — the backbone of the American economy — could also stimulate job creation and help lower the deficit. If small businesses can access credit more easily, they will be in a better position to expand, create jobs, and hasten economic recovery.

Policies to encourage government investment in research and development — and especially basic research — can improve the long-term budget outlook by promoting economic growth and job creation. Basic research may not yield tangible fruits in the short-run, but in the long-run basic research drives innovation, start-up creation, and the formation of new job-creating industries. This will improve the budget outlook, because as Mr. Zachary J. Shulman, Managing Partner of Cayuga Venture Fund, explains, “Startup companies mean more jobs, more payroll, more revenue, a higher tax base, and more dollars invested.”¹³⁰ In other words, investment in basic research could increase government revenues and drive down budget deficits in the long run.

The dramatic economic downturn required an equally dramatic fiscal response from the government to stem the hemorrhaging of jobs, and support and spur economic recovery. Budget deficits have increased substantially as a result, but not without good reason. As Federal Reserve Chairman Ben Bernanke observes, “To an important extent, these extremely large deficits are the result of the effects of the weak

economy on revenues and outlays, along with the necessary actions that were taken to counter the recession and restore financial stability.”¹³¹ One implication is that a slow, modest economic recovery could be the main threat to the long-term budget outlook. Short-run fiscal stimulus can help minimize the threat by speeding the pace of recovery. Pulling the plug on fiscal stimulus at a time when the economy remains vulnerable could prolong — and potentially derail — economic recovery and ultimately darken the long-term budget outlook.

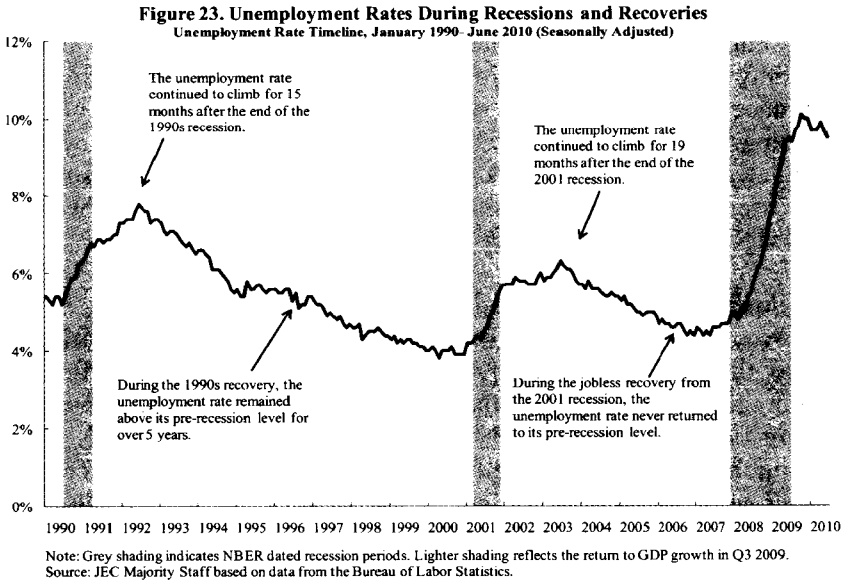
It is wiser to focus on the long-run fiscal health of the nation than to focus on reducing short-term deficits. In fact, Chairman Bernanke emphasized that what is important is for the government to establish a “credible plan for fiscal sustainability.”¹³² This is exactly the goal of the National Commission on Fiscal Responsibility and Reform: It will develop a comprehensive plan to maintain fiscal sustainability. In this way, a long-term plan to improve the government’s fiscal health will accompany the short-run fiscal stimulus that is paving the way for economic recovery.

A targeted dose of fiscal stimulus in the short-run, directed toward creating jobs and supporting the nascent economic recovery, is not incompatible with charting a strategy to rein in the federal budget deficit in the long run and restore fiscal balance. Indeed, short-run fiscal stimulus may be a necessary component of the strategy.

Extensions to Unemployment Insurance Benefits and Aid to the States

Joblessness is likely to remain a persistent problem, even as the pace of growth picks up in the coming months. Unemployment typically lags broader economic growth, for several reasons. First, hiring is expensive, and firms want to be certain they are on firm ground before they expand the workforce. Second, recessions have become increasingly structural, rather than cyclical. In other words, downturns result in fundamental, permanent changes to the distribution of workers throughout the economy (“structural change”), rather than reversible responses to changes in demand (“cyclical change”).¹³³ Following the recession of the early 1990s, the unemployment rate continued to climb for 15 months after the recession officially ended, and did not recover its pre-recession rate for over five years. (See **Figure 23**) During the

aftermath of the 2001 recession, unemployment continued to climb for 19 months following the official end of the recession. The “jobless recovery” of the Bush administration meant that unemployment remained persistently high — the unemployment rate never recovered to its pre-recession level so the economy began the 2007 recession with elevated unemployment.



Five unemployed Americans exist for every job opening today, which means that individuals are simply unlikely to find a new job with ease. The labor market’s recovery from the current recession is likely to be slow and difficult. In order to return to normal labor market conditions (the employment rate of late 2007) by January 2014, the economy would have to add a net of 14.9 million jobs to make up for the current 10.6 million jobs deficit and to absorb the 0.8 percent per year normal labor force growth projected by the Bureau of Labor Statistics. In other words, we need over 332,000 net new jobs per month sustained for 45 months (or 2.9 percent per year employment growth) to make up for two years of severe job losses during the Great Recession. That would require even stronger employment growth (2.4 percent per year) than during the robust 1993 to 2000 recovery and expansion.¹³⁴

Persistent unemployment, particularly long-term unemployment, means that further action is necessary in order to provide economic support to the millions of individuals who are struggling to reclaim their place in the labor market and may also provide fiscal stimulus that could improve the long-run budget outlook. The CBO reported that increasing aid to the unemployed is more cost-effective in terms of boosting economic growth and employment than a variety of other policies under consideration; unemployment insurance recipients are cash-strapped and will spend their benefits — and stimulate the economy — quickly.¹³⁵ In addition, extending unemployment insurance benefits can actually save the government money by reducing expenditures on disability insurance. Moreover, despite fears articulated by some Members of Congress, the best evidence suggests that extension of unemployment insurance does not inhibit workers from vigorously looking for or accepting a new job.¹³⁶

Additional aid to the states is another form of fiscal stimulus that could improve the long-run budget outlook. Both unemployment benefits and aid to the states are effective forms of fiscal stimulus, efficiently encouraging economic growth. Aid to the states is a direct source of job creation, as cash-strapped states can use the additional funds to hire new public servants. Without federal aid, many states will be forced to further trim already bare-bones public services further, resulting in more jobs lost. Both unemployment benefits and aid to the states serve as lifelines for strapped families. Unemployment benefits help jobless workers cover the bills while they seek new employment, while aid to the states helps fund critical safety net programs such as Medicaid.

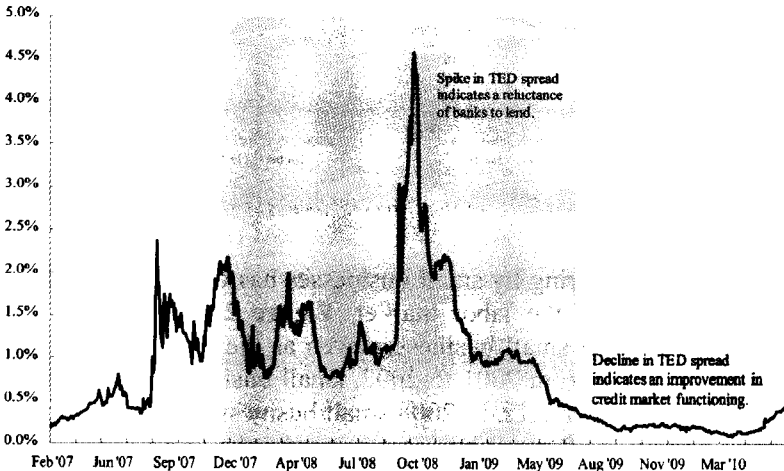
In simple terms, those who remain jobless and without unemployment benefits will need some form of social assistance in order to avoid complete destitution. In the absence of further action, they are likely to turn to alternative social programs at a significant cost to the federal government.

Small Businesses Hiring Lags As Larger Businesses Begin To Recover

Small business establishments are the backbone of the U.S. labor market. Seventy-five percent of working Americans are employed at establishments with fewer than 250 employees, and they account for nearly 80 percent of all new hires.¹³⁷ However, the tough credit

standards that banks are imposing on small businesses have hamstrung their ability to expand, create jobs and even remain in business. Dr. Alan Krueger, Assistant Secretary for Economic Policy and Chief Economist at the Treasury Department, asserts that while large companies have seen their access to credit improve as financial markets have stabilized (See Figure 24), “[s]mall businesses, which are more dependent on bank financing...are still facing severe challenges.”¹³⁸ The problem even faces some strong small businesses. Federal Reserve Chairman Bernanke observes that “it seems clear that some creditworthy businesses...have had difficulty obtaining the credit they need to expand, and in some cases, even to continue operating.”¹³⁹

Figure 24. The TED Spread
Difference Between 3-Month London Interbank Borrowing Rate (LIBOR) and 3-Month Treasury Bill Yield, February 2007- Present



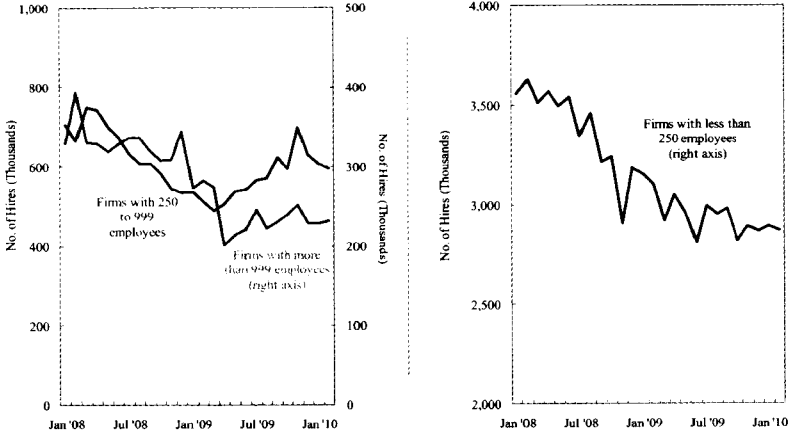
Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Sources: JEC Majority Staff calculations based on data from the U.S. Department of the Treasury and the Financial Times.

Indeed, the percentage of small business owners holding a business loan or credit line each fell almost 20 percent within the last year.¹⁴⁰ Banks may have stopped tightening their lending standards to small businesses, but they have not loosened them, which is why small businesses are still suffering.¹⁴¹ As a consequence, Dr. Krueger says that may explain why “the segment of employers that are lagging most behind now in hiring is small businesses.”¹⁴² (See Figure 25) Elaborating on the link, he says that small companies have been

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“unable to access credit to maintain employment when demand for their products collapsed in 2008.”¹⁴³

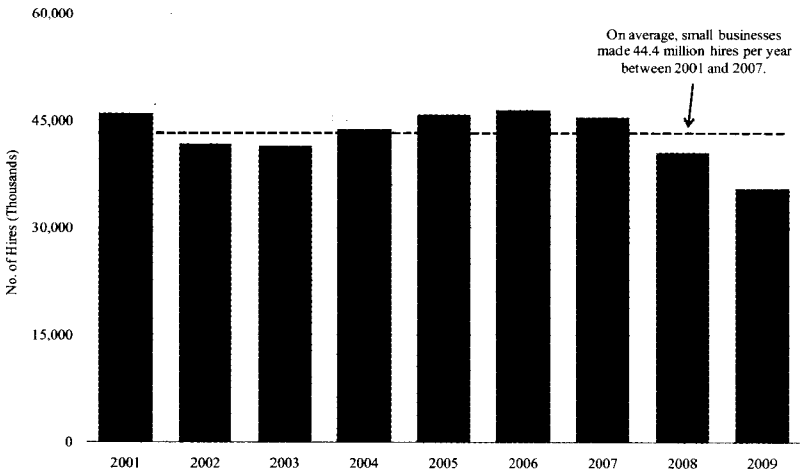
Figure 25. Monthly Hiring at Firms Since the Start of the Recession
January 2008 - February 2010



Source: JEC Majority Staff based on data from the Bureau of Labor Statistics, Job Openings and Labor Turnover Survey.

The slowdown in hiring by small businesses has dramatic implications for the recovery of the labor market. **Figure 26** depicts the steady decline in hiring by small businesses even as the economy has shown signs of recovery. From 2001 to 2007, small businesses averaged 44.4 million new hires per year. In 2008 small businesses hired 40.7 million workers and by 2009 small businesses hired only 35.5 million people, 20 percent below its 2001-2007 average.

Figure 26. Small Business Hiring
 Number of Hires at Businesses With Less than 250 Employees



Source: JEC Majority Staff based on data from the Bureau of Labor Statistics, Job Openings and Labor Turnover Survey.

In contrast, large businesses have fared better and “increase[d] employment in 5 of the 6 months since September 2009.”¹⁴⁴ According to Dr. Krueger, “Larger companies, which also faced frozen credit markets and declining product and market demand in the fall of 2008, eventually had access to corporate debt markets, which enabled them to reduce layoffs and expand employment as the financial markets improved in 2009.”¹⁴⁵ Their expansion, however, has not offset the large declines in job creation by small businesses, further highlighting the tight link between the health of small businesses and the health of the labor market. The contraction in small business hiring meant that the economy generated over 8 million fewer jobs in 2009 than in 2007 (See **Figure 26**).

Limited access to credit for new small businesses — startups — poses a threat to short-term job creation as well as long-term job creation and economic growth. Dr. Krueger notes that he is “particularly worried about startup companies....Another set of problems revolve around startups, and trying to support new businesses to form, because ultimately, will be the source of job growth in the future.”¹⁴⁶ Based on Census data that has tracked businesses from 1977 to 2005, one paper concluded that “without startups, there would be no net job growth in

the United States economy.”¹⁴⁷ Moreover, the economy relies heavily on startups to translate the most innovative ideas coming from basic research into the tangible products that enhance productivity and improve quality of life — such as the Internet, new forms of telecommunications, and medical breakthroughs. The particularly tight credit conditions facing small businesses have inhibited the emergence and growth of startups, which depresses job creation, entrepreneurship, and innovation in the economy. Many innovative ideas that have commercial promise are therefore being left on the table.

The credit conditions facing small businesses have dire implications for small businesses and their ability to create jobs, and Congress is considering a number of proposals to ease the flow of funding to small businesses to help them expand and create jobs.

In the 111th Congress, the House of Representatives passed legislation aimed at increasing the supply of available credit from banks. For example, the Small Business Lending Fund Act of 2010 (H.R. 5297), which recently passed the House of Representatives, would authorize the Secretary of the Treasury to establish a \$30 billion lending fund especially geared toward expanding small business credit access. This Fund would provide additional funds to community banks at interest rates tied to the amount of lending they provide to small businesses. Community banks would be charged a lower interest rate that will depend on the amount of lending community banks extend to small businesses. H.R. 5297 would also fund a \$2 billion State Small Business Credit Initiative Program administered by the Department of the Treasury. The State Small Business Credit Initiative Program would provide funding to state programs designed to aid small businesses. Recognizing the importance of startups as a source of job creation, H.R. 5297 would also help promising small business start-ups by channeling investment capital through public-private partnerships. These public-private partnerships should help small businesses secure financing by expanding the assets accepted from small businesses in exchange for financing.

Additionally, the House of Representatives passed the Small Business Jobs Tax Relief Act of 2010 (H.R. 5486) in order to stimulating credit demand. H.R. 5486 would increase both the capital gains tax cut for those who purchase equity in small businesses and the deduction for

startup expenditures in connection with investigating the creation of a business. Congress has also acted to encourage lending to small businesses by raising the loan guarantee limits on SBA loans. As Dr. Krueger emphasizes, “[R]aising the cap [on 7(a) loans] to \$5 million ...will open up kind of a new segment for SBA lobes with potential beneficial consequences for job growth.”¹⁴⁸ Additionally, legislation passed in 2009 by the House of Representatives, the Small Business Financing Investment Act of 2009 (H.R. 3854) would increase the SBA’s loan guarantee limits for 7(a) loans, which are designed to fund general business activities, from \$2 million to \$3 million. It would also increase the SBA’s loan guarantee limits for 504/CDC loans, which are designed to help small business finance the acquisition of fixed assets such as a building, from \$2 million to \$3 million for standard borrowers. The Senate has not yet acted on this legislation.

Federal Spending on R&D May “Prime the Pump” For Growth

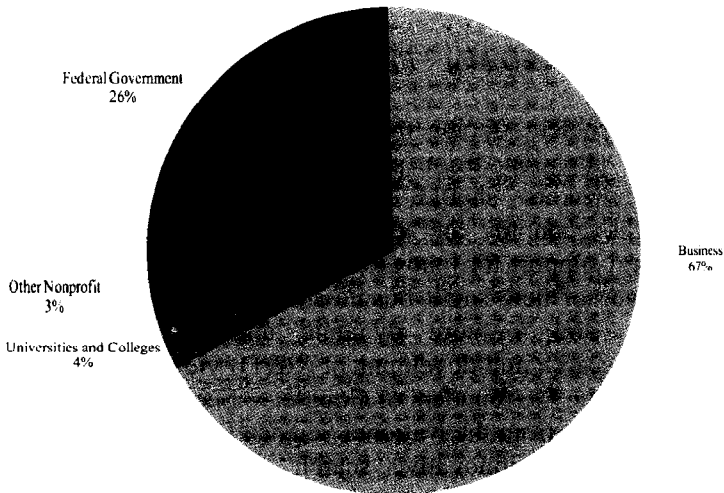
The immediate problems facing the U.S. economy and labor market requires urgent attention from policymakers. At the same time, however, policymakers should not neglect the importance of strengthening the economy and creating jobs in the long-term. In particular, federal support for innovation right now will plant the seeds for the emergence of new small businesses formed by entrepreneurs, new industries, and a more dynamic and resilient economy. Investments in research and development (R&D) yield large economic returns. For example, the founders of Google — Sergey Brin and Larry Page — used funding from the National Science Foundation to conduct their research on the innovative search engine that led to the establishment Google, which now employs close to 20,000 workers.¹⁴⁹

Federal Funding of Basic Research is Crucial

Basic research is perhaps the most important element of the R&D chain. However, society cannot rely solely on the private sector to fund basic research. Businesses underinvest in basic research because they cannot capture, and hence ignore, the full economy-wide returns from basic research, since the results — such as the discovery of the structure of DNA — cannot usually be patented and are free for everyone to use.¹⁵⁰ The federal government, however, focuses on economy-wide returns and thus has a pivotal role in helping to fill the

funding gap for basic research. The federal government's role is highlighted in **Figure 27** which shows that the federal government funded over half of all basic research in 2008.¹⁵¹ Both society and the economy have benefited tremendously from this federal investment. As Dr. Samuel L. Stanley, President of Stony Brook University, explains, “[F]ederal investment in basic research makes the innovation frontier endless. Precisely because basic research is inquiry-driven, not objectives-driven, we can’t tell in advance what the results will be. But sixty years of federal investment has proven its value, from lasers to the MRI to the Internet. It is the inexhaustible fountain of youth that will keep our economy ever green.”¹⁵²

Figure 27. Sources of Funding for R&D
2008



Source: JEC Majority Staff based on the National Science Foundation, *National Patterns of R&D Resources: 2008 Data Update*, Figure 4-2.

Federal Support for University Research Can Spark Regional Economic Growth and Job Creation

The federal government channeled approximately 60 percent of its basic research funds to universities in 2008, and universities have helped commercialize federally-funded research to transform local economies through the formation of “innovation clusters,” typically areas with a large concentration of businesses in high-tech industries.¹⁵³ Across the country, innovation hubs have spurred productivity, job creation, and growth at both the local and national level. Federal

support for university research has driven the emergence of innovation clusters because the cutting-edge ideas coming from universities are central to the startup companies that create these clusters.

However, the research findings by themselves have not spurred the proliferation of innovation clusters. A crucial ingredient has been efforts by universities to make those ideas commercially attractive; universities have emerged as both producers of ideas and active players in the innovation chain. These startups are among the most successful small businesses. They have emerged as sparkplugs for entrepreneurship that have fueled the emergence and growth of innovation clusters. Many universities have adopted novel approaches to enable faculty and students to become entrepreneurs who form local startups that develop commercially viable products arising from their research. The university-propelled startups spark the virtuous cycle of startup formation, job creation, and knowledge generation that characterizes innovation hubs. And these startups may even be more successful than startups driven by the private sector. One proponent of this view is Dr. Stanley, who suggests, “Companies spun out of research universities tend to perform better than typical startups, hav[e] better success rates and becom[e] public companies at a greater rate than the average for new businesses.”¹⁵⁴

These university-propelled innovation hubs generate numerous economic benefits for local economies. They create jobs and enhance growth in the communities that surround universities. Dr. Stanley explains, “The companies universities help to create often locate close by, creating local jobs, attracting other research-intensive businesses and stimulating growth of supporting industries. Good jobs beget other good jobs.”¹⁵⁵ Along these lines, “job multipliers” may exist: One paper estimated that an additional job created in a city’s high-tech sector created an additional 4.9 jobs in the city’s nontradable sector.¹⁵⁶ (The nontradable sector produces goods and services that can’t be traded, such as housing.) The startups that proliferate in innovation clusters generate jobs themselves but also drive job creation elsewhere.

Innovation ecosystems not only stimulate local economies, but they also provide significant economic benefits to the nation as a whole. Substantial research suggests that companies and even workers can perform better within an innovation cluster than outside of one, partly

due to spillovers of knowledge and skills: Workers and firms can learn from each other. Therefore, the nation can benefit when firms, as well as workers, in high-tech industries are located closely to each other. These benefits create incentives for other companies, startups, and highly-skilled workers to locate themselves in university-driven innovation clusters. For example, operating within an innovation hub can result in:

Higher Firm Productivity. Firms can benefit by being close to other firms in the same industry. Research has suggested that the number of firms within a particular high-tech industry is positively associated with firm productivity.¹⁵⁷ Another paper provided evidence that the arrival of a new company in a region can actually increase the productivity of companies within similar industries.¹⁵⁸

Lower Input Costs. The businesses that innovation hubs attract need not be in the industry that is most prominent there. Specifically, there is evidence that suppliers of inputs to the main firms in the hubs (such as the suppliers of equipment to biotechnology firms) may move there to lower transport costs, which makes the supply chain more efficient and further stimulates business formation and job creation in the region.¹⁵⁹ This would also lower costs for the main firms, which translates into more profits to be used, for example, on R&D and hiring.

A Well-Educated Workforce. Many of the benefits for local economies may also come from the labor market dynamics that arise from innovation clusters. Highly-skilled workers are attracted to areas with a large presence of innovative companies. This makes it easier for them to find companies that are good matches for them and increases their overall probability of finding a job. Moreover, the presence of a highly-educated worker can actually influence another worker's productivity through knowledge or skill spillovers. One paper demonstrated how highly-skilled workers, especially those working in the same industry, can increase each other's productivity (as reflected in firm-level productivity).¹⁶⁰ Building a large community of highly-skilled workers could increase the productivity of firms in the region and benefit the workers themselves through enhanced, portable knowledge or skills. These effects may even spill over to members of the community as a whole.

Better Match Between Employee and Employer. Firms may prefer to be in innovation clusters because they can more easily find workers who are better matches for the firm as well as fill vacancies quickly. Moreover, the students — particularly graduate students — coming from the universities at the center of these ecosystems are crucial to these employers, for they are in a unique position to understand the research underlying high-tech commercial products and help develop them further. Startup firms would be running blind if they lacked workers unfamiliar with the research. By providing funding to students who would otherwise be unable to pursue graduate studies, the government is helping to create a workforce that has the expertise to absorb and utilize findings from university research.

More Entrepreneurs. The presence of a highly-educated workforce not only supports local businesses and the local economy as a whole, but encourages other businesses to open up there and create jobs. Research has shown that “areas that possess more skilled labor also possess higher rates of self-employment and more skilled entrepreneurs.”¹⁶¹ Thus, one way for the federal government to promote entrepreneurship is to provide greater support for universities, which could enlarge the pool of highly-skilled workers.

More Ideas, More Startups. Innovation hubs help bring together individuals — including faculty and those working in the private-sector — and promote the formation of social networks where cutting-edge ideas are discussed or even generated. These ideas can eventually become the seed of a successful startup. Federal funding is crucial because they provide financial support for faculty and graduate students, and increases in federal funding can expand the pool of students and faculty working at the frontiers of knowledge. This enhances the vitality of the social networks, the brainstorming that could result in breakthrough ideas, and the emergence of successful companies.

The federal government plays a key role in the formation of innovation ecosystems and regional economic growth. By supporting university research, the government expands the knowledge base that universities tap into to foster startup creation and the emergence of innovation hubs.

The Federal Government Can Do More to Support Innovation and Entrepreneurship

Congress and the Administration could do more to support innovation and small-business creation in local economies and drive the creation of innovation clusters. Mr. Shulman suggests that the federal government establish a program similar to New York's Qualified Emerging Technology Companies Incentive Program, which provides tax credits for small businesses that produce goods and services in areas such as biotechnology and advanced materials.¹⁶² This could encourage the expansion of startups and promote job creation and innovation.

In addition, Congress and the Administration can enact policies that make it easier for immigrants to stay in the U.S. and use their knowledge and entrepreneurial skills to form startups and create jobs for U.S. workers. Dr. Robert Litan, Vice President for Research and Policy at the Kauffman Foundation, argues that "immigrants account for a disproportionate share of startups of successful high-tech companies, new enterprises generally, and patents. These immigrants bring both skills (often acquired at U.S. universities) and entrepreneurial drive to their efforts."¹⁶³ One policy reform he suggested would be to grant "entrepreneurs' visas."¹⁶⁴ Specifically, immigrants who "establish enterprises here should receive an immediate temporary visa, and then a time-limited visa, perhaps for five years, once they hire at least one non-family member."¹⁶⁵ This policy would expand the pool of entrepreneurs and the formation of small businesses that are the engine of job creation.

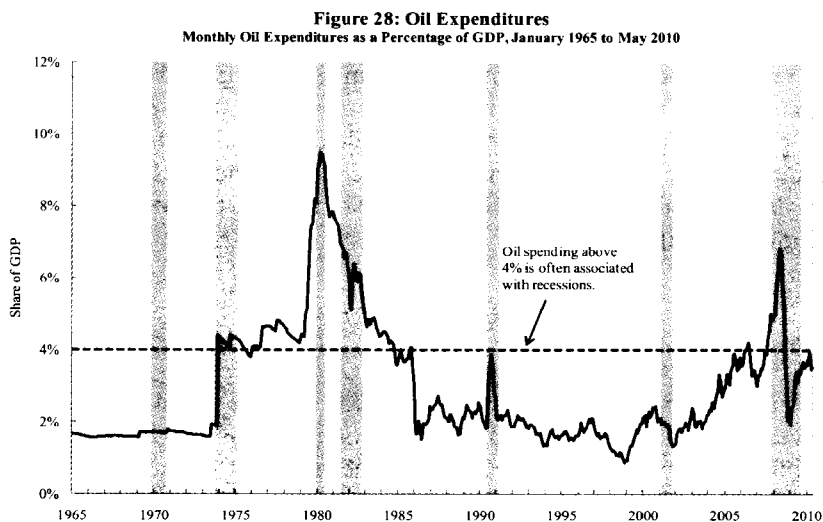
Innovation in the Clean Energy Sector

The benefits of innovation typically come in the form of higher productivity, enhanced job creation, and improvements in quality of life. However, innovation can also strengthen the economy by making it less vulnerable to recessions. The clean energy sector is one area where federal support for innovation can help the U.S. avoid economic downturns.

The lack of a clean energy policy in the U.S. sustained the nation's dependence on oil and contributed to the Great Recession by making

consumers more vulnerable to the spikes in oil and gasoline prices that occurred in 2007-2008. Rising oil and gasoline prices forced consumers to cut back spending on other goods and services, which hurt businesses and their employees.¹⁶⁶ Moreover, many businesses — such as retail establishments — had to pay more to transport their products to stores, which lowered their profits and ability to expand and create jobs.¹⁶⁷

The nation's dependence on petroleum consumption may make the country more susceptible to recessions in the future. Looking at the relationship between oil prices and past recessions, it appears that when oil expenditures reach 4 percent of U.S. GDP, the U.S. is at risk of falling into a recession.¹⁶⁸ (See **Figure 28**) Reducing the nation's dependence on petroleum consumption will lower overall oil expenditures, help prevent oil expenditures from reaching 4 percent of U.S. GDP, and make the economy less vulnerable to a recession.



Note: Grey shading indicates NBER dated recession periods. Lighter shading reflects the return to GDP growth in Q3 2009.
Source: James Hamilton, *More on Oil Prices and the Economic Recovery*, April 15, 2010. www.econbrowser.com.

To lower the risk of falling into another recession, policymakers should adopt a two-pronged strategy that both increases funding for research on clean energy and promotes investment in new transportation choices. These are complementary, mutually reinforcing approaches to

reducing the nation's reliance on petroleum. Increasing R&D funding for the development of affordable and accessible sources of clean energy is a necessary step to develop sources of energy that makes the country less dependent on petroleum. To complement R&D funding for clean energy, policymakers should also devote significant levels of funding toward developing new transportation choices that will further reduce the country's reliance on petroleum. For example, expanding mass transit and making cities more accessible to pedestrians and cyclists lowers the nation's overall consumption of gas and less susceptible to fluctuations in oil prices.

If petroleum maintains its prominence as an energy source, oil price increases will continue to hurt the economy in many ways. They will reduce consumer confidence and spending on other goods and services; lower the prices of homes located in exurbs; shrink the demand for automobiles; and raise the cost of transporting goods. These potential developments will lower overall spending in the economy, decrease household wealth, and increase income insecurity. Ominously, these were the same developments that contributed to the Great Recession, and policymakers can prevent them from occurring, and build a more robust economy, by supporting the development of alternative fuels and promoting new transportation choices. Policies that lower the nation's reliance on petroleum will reduce the economy's vulnerability to volatile oil prices and yield long-run returns in the form of greater economic stability.¹⁶⁹

CONCLUSION

At the start of 2009, the economy was on the brink of disaster. However, by the start of 2010, the economy was growing, and the private sector created 600,000 jobs in the first half of the year. In just one year, then, the real possibility of economic calamity gave way to confidence that the fragile economy was slowly recovering. Swift and sensible policies enacted by both Congress and the Administration, including the Recovery Act and continued extensions of unemployment insurance benefits, bolstered the economy and supported struggling American workers. Indeed, estimates by both the CBO and CEA suggest that the Recovery Act has made a large,

positive impact on the economy. By many measures, fiscal stimulus has succeeded at getting the economy back on track.

However, the severity of the Great Recession left long-lasting scars on the economy that will take time to heal. Moreover, the labor market, already weak due to the anemic job growth during the Bush administration, was in no position to handle these blows. The Great Recession left policymakers with the challenge of dealing with a record level of long-term unemployment, a paucity of job openings per unemployed worker, and an historically low rate at which workers exited unemployment. Although the labor market is on the right trajectory, it suffered from such severe trauma during the Great Recession that it will take time before it returns back to good health.

Some groups will face a more difficult uphill climb than others, however. In particular, African American and Hispanic workers, as well as young workers, suffered disproportionately during this recession. Moreover, workers residing in states particularly rattled by the collapse of the housing market — such as

California, Florida, and Nevada — are going to find it difficult to get back to work while the economic climate in their states remains grim.

However, bright spots emerged in the first half of 2010. In the first half of 2010, manufacturers — which had reduced their payrolls substantially during the Great Recession — registered the largest six-month gain in employment since 1998. The leisure and hospitality sector has also started to rebound, with employment rising by 123,000 jobs in the first half of 2010.

This report has identified ways to sustain and speed economic recovery: extending unemployment insurance benefits, alleviating the tight credit conditions facing small businesses, improving job training programs, and investing in basic research. These are all federal investments that will yield dividends in both the short run and the long run.

However, there has been growing concern that short-term deficits will imperil the future of the country. True, policymakers should avoid enacting policies that will substantially raise the budget deficit whenever it is prudent. However, cutting back on emergency measures

targeted toward sustaining the economic recovery — such as increased aid to states or extended unemployment insurance benefits — is not only imprudent, but fiscally irresponsible. The recession is responsible for much of the increase in short-run deficits. As economic recovery moves forward, fiscal stimulus will become less necessary.

The gravest threat to America's fiscal balance sheet is a premature end to the recovery. Fiscal stimulus has been effective at boosting economic growth and employment, but calls to end further fiscal stimulus while the economic climate remains in trouble, if followed, could short-circuit the nascent economic recovery, plunge the economy back into recession, and darken the long-term budget outlook.

It is the long-term budget outlook, not the short-term outlook, that policymakers should focus on. A long-term plan to rein in budget deficits and put the nation on a fiscally sustainable path is what is required today. Congress and the Administration have focused on this problem by passing Pay-As-You-Go legislation to manage short-term deficits, and the Administration established the National Commission on Fiscal Responsibility and Reform to devise a plan to make the country's long-term fiscal trajectory sustainable.

The economy has a long road to tread before it fully heals. However, continuing to enact targeted, cost-effective policies will push the economy along and reduce the likelihood that it falls into an abyss.

¹ Bureau of Labor Statistics (BLS). Current Establishment Survey, Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail; see BLS, "The Employment Situation – June 2010," Press Release for current data; and BLS, "Census 2010 temporary and intermittent workers and Federal government employment" for details on Census hiring, available at <http://www.bls.gov/ces/cescensusworkers.pdf>.

² BLS. Current Establishment Survey, Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail.

³ *Ibid.*

⁴ *Ibid.*

⁵ *Ibid.*

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ Jeffrey Joerres. Testimony before the Joint Economic Committee hearing on “Prospects for Jobs and Growth.” February 26, 2010. All testimony before the JEC referenced in this report can be found at <http://jec.senate.gov/public/index.cfm?p=HearingsCalendar>.

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ BLS. Current Establishment Survey, Table B-1.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ Joint Economic Committee. “Understanding the Economy: State-By-State Snapshots, June 2010”. The report is available at http://jec.senate.gov/public/index.cfm?p=Reports1&ContentRecord_id=e515b1cf-ba35-4611-8014-a74d9b8ac209

²¹ The unemployment rate today is even higher than the 10.8 percent postwar peak during the 1982-83 recession after controlling for population demographic changes. See Elsby, Michael W., Bart Hobijn, and Aysegul Sahin. “The Labor Market in the Great Recession,” *Papers on Economic Activity*, forthcoming. The paper is currently available as NBER Working Paper 15979. May 2010, cited in Testimony of Dr. Lawrence Katz for the Joint Economic Committee hearing on “Long-Term Unemployment: Causes, Consequences, and Solutions.” April 29, 2010.

²² Congressional Budget Office. “The Budget and Economic Outlook: Fiscal Years 2010 to 2020.” January 2010. Also, Board of Governors of the Federal Reserve System. “Monetary Policy Report to Congress.” February 2010.

²³ Christina D. Romer, Chair, Council of Economic Advisers. “From Recession to Recovery: The Economic Crisis, the Policy Response, and the Challenges We Face Going Forward.” Testimony before the Joint Economic Committee hearing on “The Economic Outlook.” October 22, 2009.

²⁴ For more detail, see the 2009 Joint Economic Committee Annual Report. In particular, see Figures 1-3.

²⁵ For more information, see the transcript from the Joint Economic Committee hearing on “The Challenge of Creating Jobs in the Aftermath of the ‘Great Recession.’” December 10, 2009.

²⁶ BLS. Job Opening and Labor Turnover Survey (JOLTS) at http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=JTS00000000JOL.

²⁷ Although workers can exit unemployment by finding a new job, they can also exit unemployment by leaving the labor force entirely. In other words, an exit from unemployment need not imply that someone has been reemployed.

Moreover, unemployment inflows take into account both workers who have lost their jobs and labor force reentrants who have not found a job.

²⁸ Elsby *et al.*, p. 14.

²⁹ Elsby *et al.*, p. 30.

³⁰ Dr. Till von Wachter (2010a). Testimony before the Joint Economic Committee hearing on “Long-Term Unemployment: Causes, Consequences, and Solutions.” April 29, 2010.

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

³⁴ *Ibid.*

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ Shimer, Robert. “The Probability of Finding a Job,” *American Economic Review: Papers & Proceedings*. May 2008.

³⁹ Center for Budget and Policy Priorities. (2010a). “Recession Continues to Batter State Budgets; State Responses Could Slow Recovery.” June 10, 2010.

⁴⁰ Center of Budget and Policy Priorities. (2010b). “An Update on State Budget Cuts.” May 25, 2010.

⁴¹ *Ibid.*, p. 10.

⁴² *Ibid.*, p. 9.

⁴³ *Ibid.*, p. 9.

⁴⁴ *Ibid.*, p. 10.

⁴⁵ *Ibid.*, p. 10-11.

⁴⁶ *Ibid.*, p. 11.

⁴⁷ *Ibid.*, p. 11.

⁴⁸ Katz (2010).

⁴⁹ *Ibid.*

⁵⁰ Dr. Harry J. Holzer. Testimony before the Joint Economic Committee hearing on “Avoiding a Lost Generation: How to Minimize the Impact of the Great Recession on Young Workers.” May 26, 2010.

⁵¹ BLS. Current Population Survey. For more information on the topic, see Joint Economic Committee Majority Staff report. “Understanding the Economy: Long-Term Unemployment in the African American Community.” February 2010. The report is available at

http://jec.senate.gov/public/index.cfm?a=Files.Serve&File_id=f7a324ea-4998-4a96-aeaa-0265a3a68aae.

⁵² *Ibid.*

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ BLS. Current Population Survey, Table 12.

⁵⁷For information on the employment situation of women during the recession, see Joint Economic Committee Majority Staff report. “Women in the Recession: Working Mothers Face High Rates of Unemployment.” May 2009.

⁵⁸For more details on this topic, see Joint Economic Committee Majority Staff report. “The Earnings Penalty for Part-Time Work: An Obstacle to Equal Pay.” April 20, 2010. The report is available at http://jec.senate.gov/public/?a=Files.Serve&File_id=c8242af9-a97b-4a97-9a9d-f7f7999911ab.

⁵⁹*Ibid.*

⁶⁰*Ibid.*

⁶¹*Ibid.*

⁶²BLS. Current Establishment Survey.

⁶³For more details on this topic, see Joint Economic Committee Majority Staff report. “Understanding the Economy: Unemployment Among Young Workers.” May 2010. The report is available at http://jec.senate.gov/public/index.cfm?a=Files.Serve&File_id=adaef80b-d1f3-479c-97e7-727f4c0d9ce6.

⁶⁴BLS. Current Population Survey.

⁶⁵*Ibid.*

⁶⁶*Ibid.*

⁶⁷*Ibid.*

⁶⁸*Ibid.*

⁶⁹*Ibid.*

⁷⁰Dr. Till von Wachter (2010b). Testimony before the Joint Economic Committee hearing on “Avoiding a Lost Generation: How to Minimize the Impact of the Great Recession on Young Workers.” May 26, 2010.

⁷¹*Ibid.*

⁷²*Ibid.*

⁷³*Ibid.*

⁷⁴*Ibid.*

⁷⁵Holzer (2010).

⁷⁶David R. Jones. Testimony before the Joint Economic Committee hearing on “Avoiding a Lost Generation: How to Minimize the Impact of the Great Recession on Young Workers.” May 26, 2010.

⁷⁷Joint Economic Committee Majority Staff report. “The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values, and Tax Revenues, and How We Got There.” October 2007. This report is available at http://jec.senate.gov/public/index.cfm?p=Reports1&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&ContentType_id=efc78dac-24b1-4196-a730-d48568b9a5d7&Group_id=c120e658-3d60-470b-a8a1-6d2d8fc30132&MonthDisplay=10&YearDisplay=2007

⁷⁸ Katz (2010). According to Dr. Katz, economic distress in these states is slowing “the labor mobility from declining to expanding regions that ordinarily helps drive U.S. job recoveries.”

⁷⁹ H.R. 4213 was amended on the floor of the Senate and passed on March 10, 2010. The House added additional amendments during their reconsideration of the bill and passed the amended version of H.R. 4213 on May 28, 2010. The Senate is currently considering the bill on the floor after adding an amendment to extend unemployment insurance.

⁸⁰ The Senate-passed bill amended the House bill to include funding for the wars in Afghanistan and Iraq, and humanitarian aid to Haiti. In July, the House passed an amended version of this legislation, which includes additional domestic spending.

⁸¹ Congressional Budget Office. “Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from January 2010 Through March 2010.” May 2010, p. 2.

⁸² *Ibid.*

⁸³ Council of Economic Advisers (CEA 2010a). “The Economic Impact of the American Recovery and Reinvestment Act of 2009: Fourth Quarterly Report,” first page of Executive Summary.

⁸⁴ *Ibid.*, p. 12.

⁸⁵ *Ibid.*, first page of Executive Summary.

⁸⁶ From www.recovery.gov.

⁸⁷ Council of Economic Advisers. (2010b). “The Economic Impact of the American Recovery and Reinvestment Act of 2009: Third Quarterly Report,” second page of Executive Summary.

⁸⁸ Council of Economic Advisers. (2010a). p. 29.

⁸⁹ *Ibid.*, second page of Executive Summary.

⁹⁰ *Ibid.*, p.36.

⁹¹ Douglas W. Elmendorf, Director of the Congressional Budget Office. Testimony before the Joint Economic Committee hearing on “The Road to Economic Recovery: Policies to Foster Job Creation and Continued Growth.” February 23, 2010.

⁹² von Wachter (2010a)..

⁹³ Joint Economic Committee Majority Staff report. “Extending Unemployment Insurance Benefits: The Cost of Inaction for Disabled Workers.” May 2010. The report is available at (http://jec.senate.gov/public/?a=Files.Serve&File_id=d5003466-eb78-4a91-b5b1-eb99c2982166).

⁹⁴ Valletta, Rob and Katherine Kuang. April 19, 2010. “Extended Unemployment and UI Benefits.” Federal Reserve Bank of San Francisco. (<http://www.frbsf.org/publications/economics/letter/2010/el2010-12.html>).

⁹⁵ Kaiser Family Foundation (<http://www.kff.org/uninsured/upload/7875-A.pdf>) and FamiliesUSA (<http://www.familiesusa.org/assets/pdfs/cobra-2009.pdf>).

⁹⁶ Statement of Douglas W. Elmendorf, Director of the Congressional Budget Office, to the Joint Economic Committee. February, 2010.

⁹⁷ Bureau of Labor Statistics. "The Employment Situation: June 2010." Released June 4, 2010.

⁹⁸ Blinder, Alan S. "Getting the Biggest Bang for Job-Creation Bucks." *The Washington Post*, February 19, 2010.

⁹⁹ Elmendorf (2010).

¹⁰⁰ Joint Economic Committee Majority Staff 2010 Jobs Questionnaire.

¹⁰¹ In a recent report entitled "Estimates of Newly Hired Employees Eligible for the HIRE Act Tax Exemption," the Treasury Department estimated that, from February to March 2010, "4.5 million workers who had been unemployed for eight weeks or longer were hired by employers who are eligible for the HIRE Act payroll tax exemption." The report can be found at <http://www.treas.gov/press/releases/docs/HIREAct-Analysis-7-11-2010-FINAL.pdf>.

¹⁰² The employee must have begun employment with a qualified employer after February 3, 2010 and before January 1, 2011. Moreover, they must have been unemployed or employed for up to 40 hours during the 60-day period prior to when they were hired; could not replace an employee at the qualified employer unless that employee quit or was fired for cause; and who were not family members of the qualified employer or related to the qualified in other ways specified by the legislation. Details can be found at <http://www.irs.gov/businesses/small/article/0,,id=220745,00.html>.

¹⁰³ Dr. Richard Berner, Managing Director, Co-Head of Global Economics and Chief U.S. Economist at Morgan Stanley. Testimony before the Joint Economic Committee hearing on "The Road to Economic Recovery: Prospects for Job Growth." February 26, 2010. According to Dr. Richard Berner, "For years, employers have complained that they don't find the skills they need in today's workforce. Worker skills have greatly lagged technical change and tectonic shifts in the structure of our economy....massive dislocations in several industries in recession have magnified that mismatch as workers who have been trained for one occupation lose their jobs."

¹⁰⁴ Bureau of Labor Statistics, Current Population Survey, June 2010.

¹⁰⁵ Bureau of Labor Statistics, "College Enrollment and Work Activity of 2009 High School Graduates," April 27, 2010. <http://www.bls.gov/news.release/hsgcec.nr0.htm>

¹⁰⁶ Community-college students are much less likely to apply for financial aid than students at four-year colleges and universities. In the 2005-2006 academic year, for example, 34.1 percent of students at public two-year

colleges applied for aid compared to 59.2 percent of students at public four-year colleges and universities.

¹⁰⁷ Beyond investing in financial aid for students, Congress passed the College Cost Reduction and Access Act (H.R. 2669) in 2007 which allowed for income-based repayment of student loans for borrowers experiencing “partial financial hardship.” Beginning July 1, 2009, loan repayment for eligible borrowers is capped at 15 percent of their discretionary income, which is reassessed each year. Any outstanding balance would be forgiven after 25 years. As part of the newly-signed health care legislation, Congress and the Obama administration lowered the threshold and maximum payments to 10 percent of a borrower’s discretionary income, and shortened the period of repayment before any outstanding balance is forgiven to 20 years. Those changes will apply to new borrowers after July 1, 2014. Additionally, borrowers facing unemployment or other extreme economic hardship can also qualify for a deferment for up to three consecutive years.

¹⁰⁸ Community college enrollment increased from 3.1 million young adults in Fall of 2007 to 3.4 million in Fall, 2008, an 11.8 percent increase, according to data from the Census Bureau analyzed by the Pew Research Center. “College Enrollment Hits All-Time High, Fueled by Community College Surge,” Richard Fry, Pew Research Center, October 29, 2009.

¹⁰⁹ Katz (2010).

¹¹⁰ Joint Economic Committee Hearing on Youth Unemployment, May 29, 2010. Similarly, Dr. Berner testified that “Long-term solutions include policies that keep students in schools and improve access to education, reorientation of our higher educational system towards specialized and vocational training and community colleges, and immigration reform.” Berner (2010).

¹¹¹ von Wachter (2010a).

¹¹² For more information on the Job Training Corps., please see Berner (2010).

¹¹³ *Ibid.*

¹¹⁴ These workers who need to migrate from one sector to a new sector have been characterized as “industry migrants” by Manpower, Inc., a leading temporary help services company. See Joerres (2010).

¹¹⁵ Katz (2010). In his testimony, Dr. Katz explained the challenge this way: “Many job losers from sectors such as construction and manufacturing may face difficulties in making the psychological and financial adjustments as well as gaining the training and education required for the new jobs available in the growing (primarily service) sectors.”

¹¹⁶ Elmendorf (2010).

¹¹⁷ For more information, see “Job Training That Works: Findings from the Sectoral Employment Impact Study,” Public/Private Ventures, By Sheila Maguire, Joshua Freely, Carol Clymer and Maureen Conway, May 2009.

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- ¹¹⁸ Testimony of Dr. Lawrence Katz before the Joint Economic Committee, April 29, 2010.
- ¹¹⁹ von Wachter (2010b).
- ¹²⁰ Joerres (2010).
- ¹²¹ American Jobs and Closing Tax Loopholes Act (H.R. 4213), passed by the House of Representatives on May 28, 2010, included funding for 350,000 summer jobs for youth in 2010.
- ¹²² Jones (2010). "... I think just the notion of 'here's your check, come here,' but at the end there is no connection to another employer, whether private or public, there is no real definition of whether you did a good job or a bad job, I think is a wasted opportunity with scarce money."
- ¹²³ von Wachter (2010a), and Dr. Kevin Hassett. Testimony before the Joint Economic Committee hearing on "The Road to Economic Recovery: Prospects for Job Growth." February 26, 2010.
- ¹²⁴ Ruffing, Kathy and James R. Horney. June 28, 2010. "Critics Still Wrong on What's Driving Deficits in Coming Years." Center on Budget and Policy Priorities. (<http://www.cbpp.org/cms/index.cfm?fa=view&id=3036>).
- ¹²⁵ Exceptions are made for discretionary spending and emergency spending. <http://www.fiscalcommission.gov/chapter/>
- ¹²⁷ Congressional Budget Office. "An Analysis of the President's Budgetary Proposals for Fiscal Year 2011," March 2010. Note that the analysis reflects legislation enacted through March 12, 2010. In particular, it does not account for the effects of the Patient Protection and Affordable Care Act.
- ¹²⁸ Katz (2010).
- ¹²⁹ *Ibid.*
- ¹³⁰ Zachary J. Shulman, Managing Partner of Cayuga Venture Fund. Testimony before the Joint Economic Committee hearing on "Fueling Local Economies: Research, Innovation, and Jobs." June 29, 2010.
- ¹³¹ Honorable Dr. Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System. Testimony before the Joint Economic Committee hearing on "The Economic Outlook." April 14, 2010.
- ¹³² *Ibid.*
- ¹³³ Groshen, Erica and Simon Potter. August 2003. "Has Structural Change Contributed to a Jobless Recovery?" Federal Reserve Bank of New York. Current Issues in Economics and Finance. August 2003 (9): 8. http://www.newyorkfed.org/research/current_issues/ci9-8/ci9-8.html.
- ¹³⁴ Katz (2010).
- ¹³⁵ Congressional Budget Office, "Policies for Increasing Economic Growth and Employment in 2010 and 2011," January 2010.
- ¹³⁶ Joint Economic Committee Majority Staff report. "Does Unemployment Insurance Inhibit Job Search?" July 2010.
- ¹³⁷ *Ibid.* See also unpublished data from BLS, Job Openings and Labor Turnover Survey submitted in Dr. Alan Krueger, Assistant Secretary for

Economic Policy and Chief Economist at the Treasury Department. (Krueger 2010). Testimony before the Joint Economic Committee hearing on “Avoiding Another Lost Decade: How to Promote Job Creation.” May 5, 2010.

¹³⁸ Krueger (2010).

¹³⁹ Bernanke. “Restoring the Flow of Credit to Small Business.” July 12, 2010.

¹⁴⁰ Dennis Jr., William J. “Small Business Credit in a Deep Recession”. NFIB Research Foundation, February 2010.

¹⁴¹ Joint Economic Committee Majority Staff report. “Small Business Employment: Tight Credit Standards Slow Hiring.” May 2010.

¹⁴² Krueger (2010).

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

¹⁴⁷ Kane, Tim. “The Importance of Startups in Job Creation and Job Destruction.” Kaufmann Foundation, July 2010, p. 1.

¹⁴⁸ Krueger (2010).

¹⁴⁹ The Science Coalition. “Sparking Economic Growth.” April 2010, p. 109.

¹⁵⁰ Joint Economic Committee Majority Staff report. “The Pivotal Role of Government Investment in Basic Research.” May 2010. This report is available at http://jec.senate.gov/public/?a=Files.Serve&File_id=29aac456-fce3-4d69-956f-4add06f111c1..

¹⁵¹ *Ibid.*

¹⁵² Dr. Samuel L. Stanley Jr., President of Stony Brook University. Testimony before the Joint Economic Committee hearing on “Fueling Local Economies: Research, Innovation, and Jobs.” June 29, 2010.

¹⁵³ National Science Foundation, National Patterns of R&D Resources: 2008 Data Update, Table 6.

¹⁵⁴ Stanley (2010).

¹⁵⁵ *Ibid.*

¹⁵⁶ Moretti, Enrico. “Local Multipliers.” *American Economic Review Papers and Proceedings* (May 2010).

¹⁵⁷ Henderson, J. Vernon. “Marshall’s Scale Economics.” *Journal of Urban Economics* (January 2003).

¹⁵⁸ Greenstone, Michael, Richard Hornbeck, and Enrico Moretti. “Identifying Agglomeration Spillovers: Evidence from Winners and Losers of Large Plant Openings.” *Journal of Political Economy* (June 2010), pp. 536-598. This paper also found that wages tended to increase as well, which cut into the profits of firms.

¹⁵⁹ Ellison, Glenn, Edward L. Glaeser, and William R. Kerr. “What Causes Industry Agglomeration? Evidence from Coagglomeration Patterns.” *American Economic Review* (June 2010).

¹⁶⁰ Moretti, Enrico. “Workers’ Education, Spillovers and Productivity: Evidence from Plant-Level Production Functions.” *American Economic Review* (June 2004). This paper also found that the productivity gains from the knowledge spillovers are largely offset by real wage increases.

¹⁶¹ Doms, Mark, Ethan Lewis, and Alicia Robb. “Local Labor Market Endowments: New Business Characteristics and Performance.” Working paper. October 2008.

¹⁶² Shulman (2010).

¹⁶³ Dr. Robert Litan. Testimony before the Joint Economic Committee hearing on “Fueling Local Economies: Research, Innovation, and Jobs.” June 29, 2010. Dr. Litan was unable to attend and Kauffman Foundation researcher Dane Stangler delivered testimony on his behalf.

¹⁶⁴ *Ibid.*

¹⁶⁵ *Ibid.* Note that legislation has been introduced to make it easier for immigrant entrepreneurs to stay in the U.S. Congresswoman Carolyn B. Maloney, Chair of the Joint Economic Committee, introduced the StarUp Visa Act of 2010 (H.R. 5193), which would provide visas for immigrant entrepreneurs who have \$250,000 in financial backing to launch a firm and create jobs.

¹⁶⁶ Joint Economic Committee Majority Staff report. “Rising Oil Prices: A Potential Threat to Economic Recovery and Energy-Efficiency Policies.” April 2010.

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*

¹⁶⁹ For more on this topic, see Peter Ogden, John Podesta, and John Deutch, “Ending the Inertia on Energy Policy: A New Strategy to Spur Energy Innovation”, *Issues in Science and Technology*, Winter 2008.

**MINORITY
AND
ADDITIONAL VIEWS**

MINORITY AND ADDITIONAL VIEWS OF SENATOR SAM BROWNBACK AND REPRESENTATIVE KEVIN BRADY

INTRODUCTORY COMMENTS AND OBSERVATIONS

We submit these views without the benefit of reviewing the majority's contribution. It is likely, however, that the bulk of the majority's contribution will be a predictable assignment of blame for all the nation's economic ills to past Administrations and Congresses as well as an ideological "fairy tale" based on defense of stimulus, financial services, and health care legislation. We will endeavor to present a fact based review of both current economic data and the risks presented by the continued pursuit of discredited tax and spend policies advocated by the majority.

REVIEW OF SELECTED ECONOMIC DATA AND CONDITIONS

The economy entered into a recession in December of 2007, according to the Business Cycle Dating Committee of the private, nonpartisan National Bureau of Economic Research.

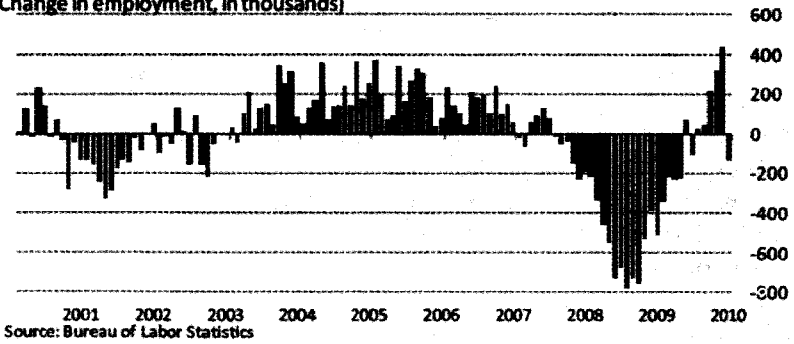
Total non-farm payroll employment in June 2010 stood at a level of 130.47 million, 7.48 million below the December 2007 peak in total non-farm payrolls. Total non-farm payroll employment reached its nadir in December 2009 at a level of 129.59 million, 8.36 million below the December 2007 peak.

Private sector payrolls peaked at 115.57 million in December 2007, declined to a low of 107.11 million in December 2009, and presently stand at a level of 107.70 million – or 7.87 million below the December 2007 peak.

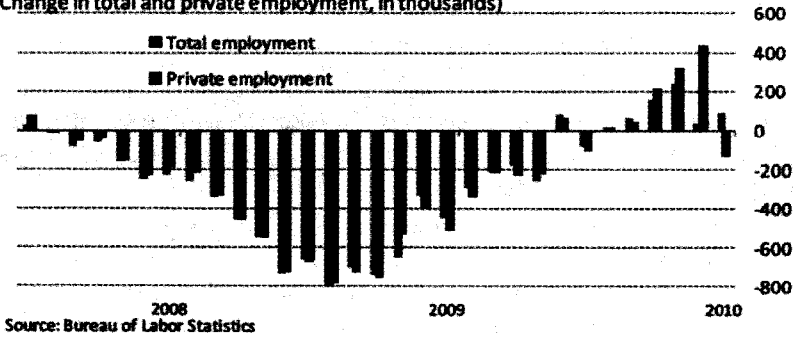
On the other hand, government payrolls have actually increased during the present economic downturn by 393,000. Since December 1999, government payrolls have increased by 2.23 million, while private sector payrolls have declined by 2.29 million jobs.

The number of individuals classified as unemployed in June 2010 was 14.6 million, 6.9 million more than at the beginning of the recession, but 989,000 less than the October 2009 peak of 15.6 million.

Payroll Employment Since 2000
 (Change in employment, in thousands)

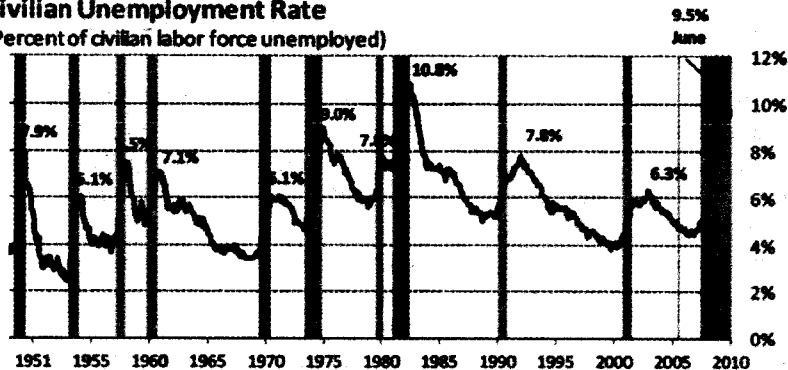


Total and Private Employment Since Recession
 (Change in total and private employment, in thousands)



In December 2007, the unemployment rate stood at 5.0%. In October 2009, the unemployment rate peaked at 10.1% before declining to the June 2010 rate of 9.5%. The peak of 10.1% represented the highest level for the unemployment rate since April 1983.

Civilian Unemployment Rate (Percent of civilian labor force unemployed)



Source: Bureau of Labor Statistics; graybars denote recessions

However, the recent apparent improvement in the “official” unemployment rate is, in some respects, misleading.

For twelve consecutive months, year-over-year growth in the nation’s labor force has been negative. Prior to the current streak, the last time any month registered a year-over-year decline in the nation’s labor force was July 1962. The nation’s labor force peaked at 154.96 million in May 2009, 1.22 million higher than the level of 153.74 million in June 2010. Prior to year-over-year labor force growth turning negative in July 2009, the average monthly year-over-year growth in the labor force since January 1980 was 1.32%. If historical labor force growth had continued at that rate, the June 2010 labor force would have been 156.81 million or 3.06 million higher than the level reported by the Bureau of Labor Statistics (BLS).

Under this scenario, if employment remained as reported, but the labor force had grown at historical levels, the reported unemployment rate would stand at a dizzying 11.3%. Even if the labor force had simply maintained its June 2009 level, the unemployment rate would stand at 10.1%. Clearly, the apparent decline in the official unemployment rate has as much or more to do with individuals dropping out of the labor force as it does with more people becoming employed.

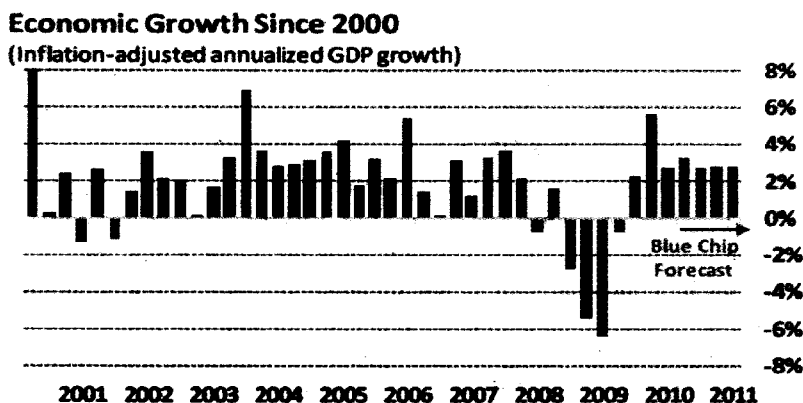
Other labor force measures continue to point to a bleak labor market. For instance, the average duration of unemployment stands at 35.2 weeks, an all-time higher for the data series that began in January 1948. Prior to the current recession, the prior high was 21.2 weeks in July 1983. The BLS began reporting median durations of

unemployment in 1967. The June 2010 median duration of 25.5 weeks of unemployment represents a series high. The pre-recession high was 12.3 weeks in May 1983.

The percentage of long-term unemployed is of particular concern because research shows that the longer an individual is unemployed the more difficult it is for him or her to re-enter successfully the work force. In June 2010, among the unemployed the percentage of those unemployed for 27 weeks or longer was 45.5%, slightly below the series record (dating back to January 1948) of 46% reached in May 2010. Also, in June 2010, the percentage of those unemployed for 15 weeks or more stood at 60.3%, near the series peak of 61.3% in April 2010. Prior to the current recession, the series high for unemployment of 27 weeks or more was 26.0% in June 1983 and for unemployment of 15 weeks or more was 41.1% in May 1983.

The Current Population Survey (CPS) labor force flows also reveal a continuing narrative of galvanizing unemployment. For instance, in June 2010 flows into “not in labor force” from unemployed reached an all-time series high of 3.1 million. The pre-recession high for the series that dates to 1990 was 2.0 million.

While the labor market remains depressed, growth as measured by real Gross Domestic Product (GDP) has been positive in each of the last three quarters after declining in five of the prior six quarters.

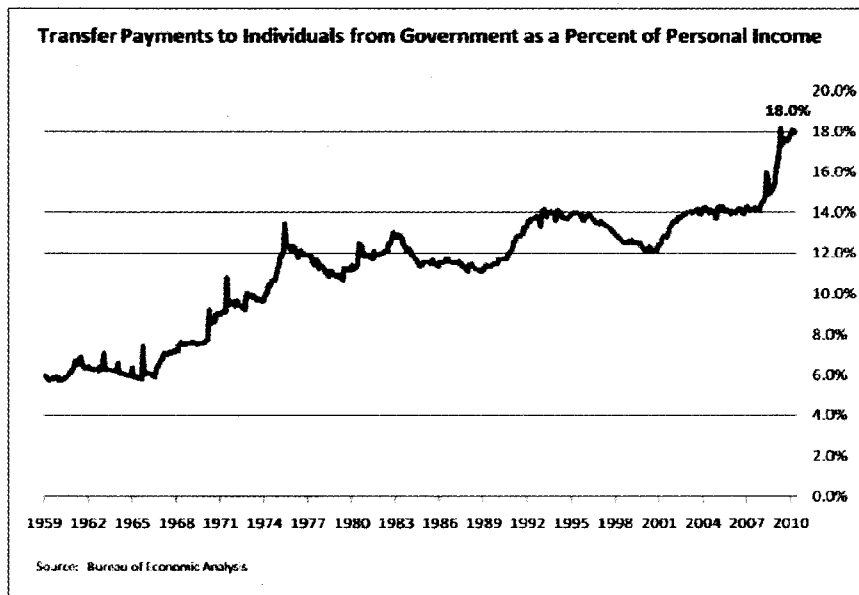


Personal Consumption Expenditures (PCE) is a key component of GDP comprising roughly 70% of Real GDP. During the 1st quarter of 2010, they comprised 70.7% of GDP near the all-time high of 71.3%

reached in the 3rd quarter 2009. Over time, PCE has become an increasingly greater share of GDP. For instance, over the course of the 1990s, PCE accounted on average for 66.6% of GDP, while it accounted for 65.9% during the 1980s.

Other important components of GDP growth are investment, particularly private non-residential fixed investment, and exports.

The makeup of the nation's personal income points to a disturbing trend. In January 2000, transfer payments to individuals from government represented 12.1% of the nation's personal income. In January 2009, transfer payments represented 16.0% of personal income. In the most recent month that data is available for (May 2010), transfer receipts represented 18.0% of personal income.



Since January 2009, personal income has increased by \$299.2 billion to an annual rate of \$12.338 trillion in May 2010 from \$12.038 trillion in January 2009. Of that \$299.2 billion increase, \$281.4 billion is the result of increased government transfer payments. In other words, 94% of all income gains are the result of government transfer payments.

Unfortunately, the current administration and the majority in Congress have chosen to address the current economic crisis by placing faith in a

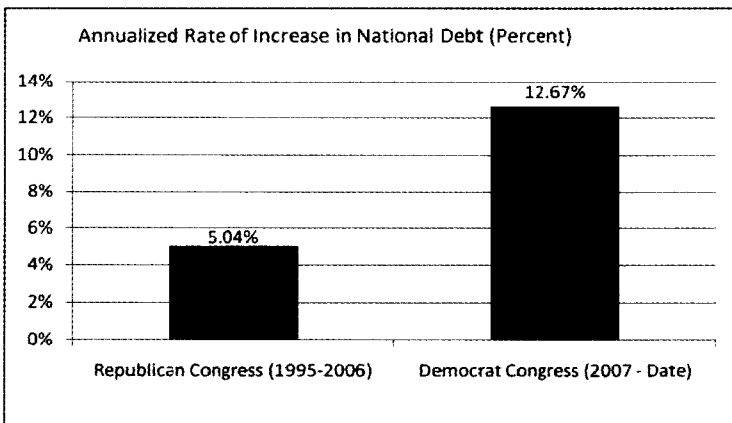
government of ever increasing size and greater intrusion into the private sector and the lives of the nation's citizens.

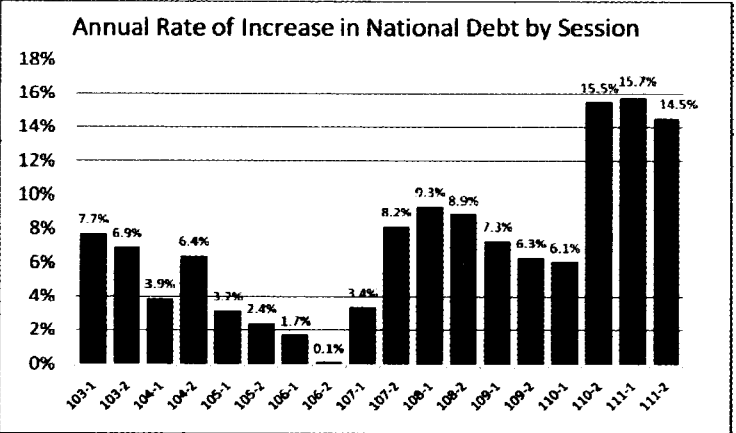
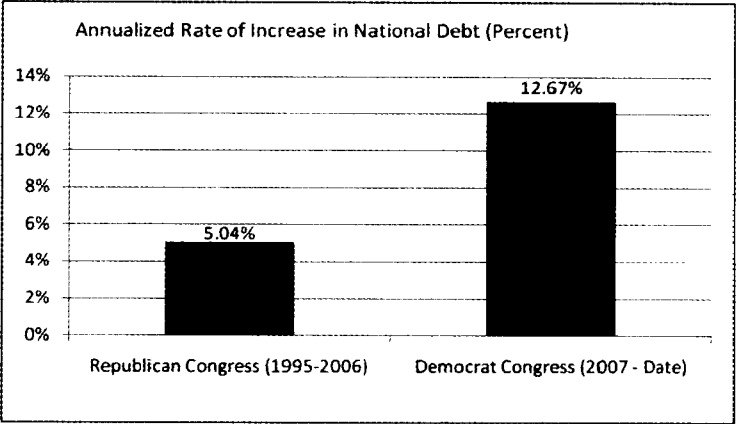
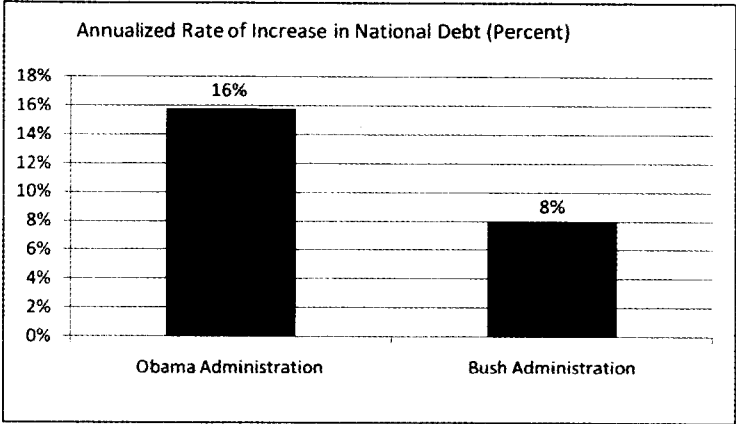
It is our belief that this represents a misguided approach that threatens to harm irreparably the nation's economic future.

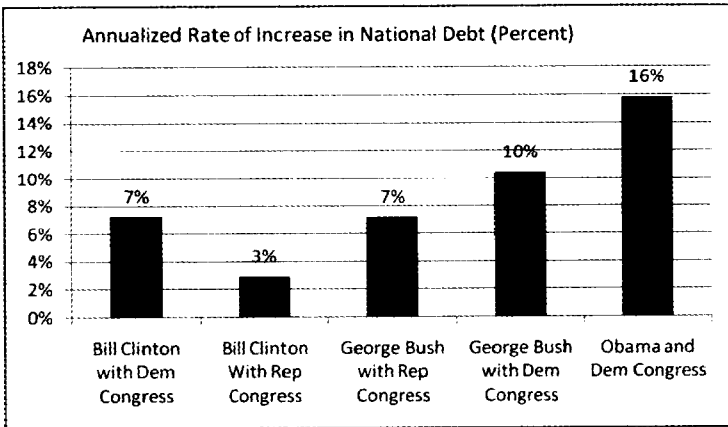
THE SKYROCKETING NATIONAL DEBT AND GOVERNMENT SPENDING

In the short time, that the current administration has been in office (through July 12, 2010), the total national debt has increased by \$2,567,645,965,465.20 (more than \$2.5 trillion). That translates into nearly \$4.8 billion per day, \$199 million per hour, \$3.3 million per minute and more than \$55,000 per second.

Under the current administration, the national debt is increasing at an annual rate of 15.8%. This compares with an annual rate of increase under George W. Bush of 8.0%. It is important to look not only at administrations, but congressional control as well. The following charts illustrate the path of the national debt by administration and partisan control.







The current administration and the majority are quick to point the finger of blame for the current fiscal situation. They resort to assertions that when President Bush took office there were surpluses as far as the eye could see and that tax cuts “for the rich” plunged us into massive deficits as far as the eye can see.

Those types of statements make for nice rhetoric, but lack any foundation in reality.

The harsh reality of our current fiscal crisis is that the government simply spends too much. And the budget submitted by the President in February only exacerbates the situation by taking us further down an unsustainable path. Perhaps in recognition of this folly, the majority party has chosen not to bring a budget resolution to the floor of either chamber. Having already voted to increase permanently the statutory debt limit to over \$14 trillion, it is understandable that they would not want to be on record supporting a budget that does nothing to restrain the growth of government spending and would reflect a deficit of more than \$1 trillion for the second year in a row.

As to the charge that tax cuts are the reason for our current fiscal dilemma, a look at the hard data suggests that such a charge is, at best, disingenuous. The Congressional Budget Office (CBO) recently noted in a letter to Representative Maurice Hinchey that it was not possible to estimate the actual revenue impact of the “Bush Tax Cuts.”¹

¹ Available at <http://www.cbo.gov/ftpdocs/114xx/doc11492/HincheyLtr.pdf>.

First, as to the assertion that President Clinton left the Bush Administration “surpluses as far as the eye can see” one need look no further than CBO’s baseline estimates from January 2001 to recognize that spending is the culprit.² In January 2001, CBO’s baseline for total outlays from Fiscal Year 2001 through Fiscal Year 2009 totaled \$19.1 trillion. For the same time period, the government spent \$22.7 trillion - - \$3.6 trillion more than the January 2001 baseline.

CBO’s total projected surplus in the January 2001 baseline for that time period was \$4.2 trillion. However, their projected on-budget surplus was \$2.2 trillion, while the off-budget surplus was estimated at \$2.0 trillion.

Roughly 48% of the projected surpluses were off-budget surpluses, for example, money flowing into the Social Security and Medicare Trust Funds.

To further illustrate the point, federal spending as a percentage of GDP declined to 18.2% in Fiscal Years 2000 and 2001. In January 2001, CBO’s baseline projection was for spending as a percent of GDP to decline to 15.6% in Fiscal Year 2009. Instead, spending amounted to 24.7% of GDP – a level last seen in Fiscal Year 1946 as World War II was drawing to a close.

Even in the unified budget surplus years, revenues only exceeded 20% of GDP only once. In Fiscal Year 2000, total receipts amounted to 20.6%. On only two other occasions have receipts exceeded 20% of GDP. In 1944, receipts were 20.9% of GDP; in 1945, they were 20.4% of GDP.

The historical data alone should make it clear that our economy has never been able to sustain growth and government revenue takes in excess of 20% of GDP. The notion that spending in excess of 23.5% and higher of GDP is sustainable ignores economic reality, yet that is exactly what the Administration has proposed.

We are at a crossroad. We simply cannot continue to spend our nation deeper and deeper into debt. “The sharp run-up in public sector debt will likely prove one of the most enduring legacies of the 2007-2009 financial crisis in the United States and elsewhere,” concludes a recent paper presented at the American Economic Association.

This important study reveals some compelling data and findings on the relationship between significant buildups in government debt and

² Available at <http://www.cbo.gov/ftpdocs/27xx/doc2727/entire-report.pdf>.

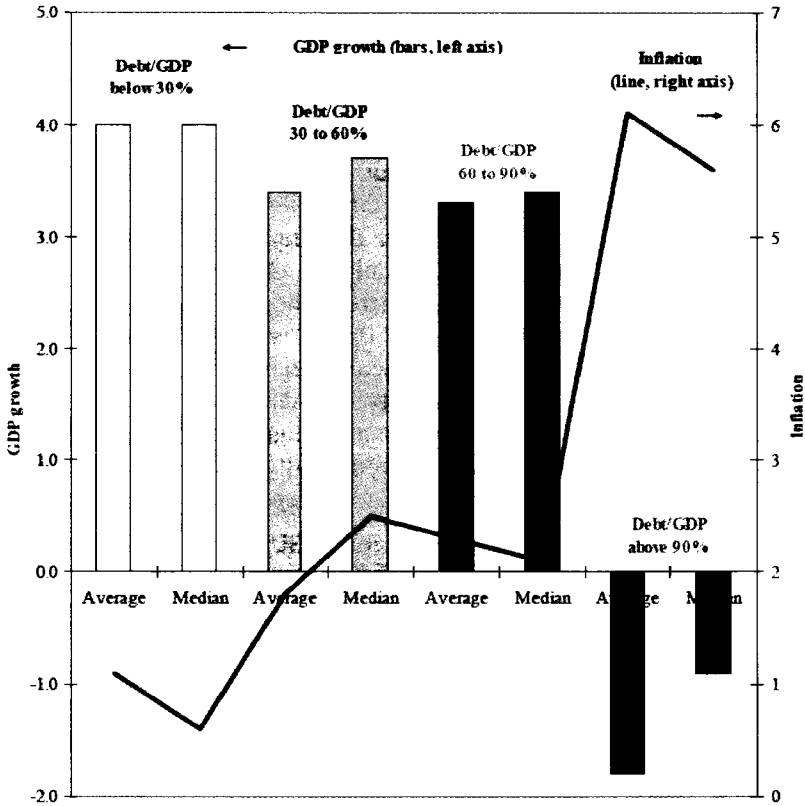
declines in economic growth. In their paper, titled “Growth in a Time of Debt,” economists Carmen Reinhart (University of Maryland) and Kenneth Rogoff (Harvard University) utilize a comprehensive new dataset to analyze the impact of government debt on GDP growth and inflation. The study is particularly timely in light of the recent financial crisis and ensuing buildup of government debt across the globe.³

Although the authors do not distinguish between the causes of debt buildups, they do note that peace-time debt buildups are more problematic than those in war-time. Peace-time debts have no natural end and can indicate unstable underlying political economy dynamics which may endure for a long time. Because of the more harmful nature of peace-time debt accumulation, the negative impact of the recent debt buildup in the U.S. and across the globe may be more severe than what these longer-term results, incorporating both peace- and war-time debt buildups, would imply.

When comparing 20 advanced economies in the post- World War II time period (1946-2009), Reinhart and Rogoff found a distinct debt threshold—equal to 90 percent or more of gross domestic product (GDP)—at which point debt level had a significantly negative impact on GDP growth (see figure to below from the study).⁴ For countries with debt levels greater than or equal to 90 percent of GDP (classified as very high debt), median GDP growth was 1 percentage point below that of countries with lower debt levels. Average growth levels revealed an even greater impact: average GDP growth in countries with very high debt was a full 4 percentage points below that of countries with lower debt.

³ Reinhart, Carmen M. and Kenneth S. Rogoff, “Growth in a Time of Debt,” December 31, 2009 draft, prepared for the American Economic Review Papers and Proceedings.

⁴ The authors classified debt levels, by country and year, according to the following four classifications: low (below 30 percent of GDP); medium (30 to 60 percent); high (60 to 90 percent); and very high (above 90 percent).



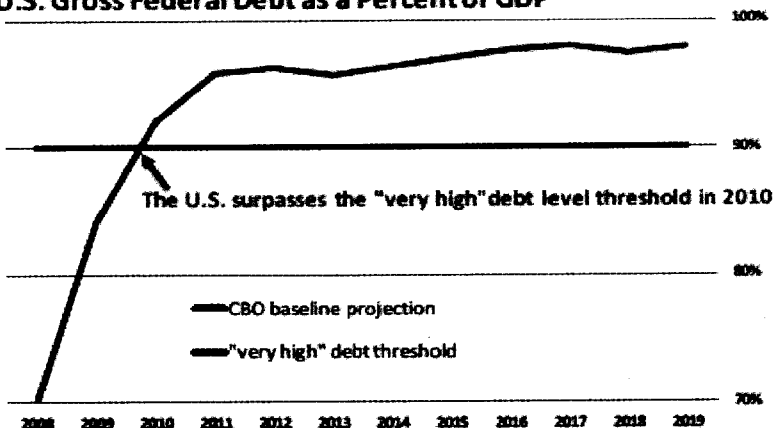
After growing substantially as a percent of GDP over the past decade, gross federal debt in the U.S. exploded during the recent financial crisis and is predicted to continue growing for the foreseeable future due to rising spending levels and growing entitlement burdens. Between 2008 and 2009, gross federal debt in the U.S. rose from 70% of GDP to 84%, and is projected to reach 92% in 2010. The Congressional Budget Office predicts the U.S. debt level will approach 100% of GDP by the end of the decade and will continue to rise beyond that point due to growing entitlement burdens.⁵ The findings of this study reveal that the recent buildup in debt in the U.S., combined with proposed government spending increases over the

⁵ These are CBO's "baseline" budget projections, which assume that, among other things, all expiring tax provisions, including EGTRRA and JGTRRA, are not extended, and that the AMT is not patched or indexed for inflation.

following decade and impending budgetary pressure from entitlements, could cause a significant and prolonged decline in American economic growth.

For those who expect or hope that the U.S. can “grow” itself out of its fiscal difficulties, Reinhart and Rogoff caution that, “seldom do countries simply ‘grow’ their way out of deep debt burdens.” Rather, countries that have accumulated large federal debts must take comprehensive action to reduce their debt levels. Before debt can be reduced, however, it must stop accumulating. To allow our economy to meet its long-run growth potential, current and future spending must be brought into balance with revenues. If this is not done, the U.S. and other countries that face similar fiscal situations risk rising interest rates on debt burdens and the inability to finance current spending. As Reinhart and Rogoff note, “Even countries that are committed to fully repaying their debts are forced to dramatically tighten fiscal policy in order to appear credible to investors and thereby reduce risk premia.”

U.S. Gross Federal Debt as a Percent of GDP



Source: Congressional Budget Office and Reinhart and Rogoff "Growth in a Time of Debt"

In addition to examining public debt levels, Reinhart and Rogoff observed the effect of financial crisis on private debt. In contrast to public debt, private debt tends to contract sharply for some time following a financial crisis. The deleveraging of private debt tends to exacerbate the post-crisis downturn by causing lower growth and higher unemployment. In the U.S., in particular, the authors note that private deleveraging is typically accompanied by very slow growth and deflation. In relation to previous financial crises, the authors observe

that “the magnitude of the current deleveraging episode in the United States has no counterpart in the post-war period.”

This study serves as a warning to the United States and other countries that have accumulated significant levels of government debt in response to the financial crisis. While “outsized deficits and epic bank bailouts” may be useful in combating a recession, higher government debt levels—particularly at a time of aging populations and rising social insurance costs—pose a serious threat to long run economic growth and well-being.

INCREASED UNCERTAINTY HAMPERS ECONOMIC RECOVERY

As the Chamber of Commerce of the United States noted in its open letter to the President, Congress and the American People, *“Uncertainty is the enemy of growth, investment, and job creation. Through their legislative and regulatory proposals—some passed, some pending, and others simply talked about—the congressional majority and the administration have injected tremendous uncertainty into economic decision making and business planning. This is why banks are reluctant to lend and why American corporations are sitting on well over a trillion dollars. It is why America’s small businesses and entrepreneurs, the engines of innovation and job creation, are starving for capital and are either struggling to survive or unable to expand.”*

We have consistently warned that the current administration and the majority in Congress were pursuing policies that threatened the future economic health and well-being of our nation. The letter goes on to provide several examples of wrong-headed policies or desirable actions.

The letter notes that *“There must be a recognition by the administration and Congress that the regulatory burden they have imposed on the U.S. economy has reached a tipping point. Unless the cumulative impact of existing regulations, newly mandated regulations, and proposed regulations is seriously addressed, the economy will not create the jobs Americans need. We will lose even more jobs. They will simply disappear or be sent offshore.”*

In recent months, the House passed a climate change bill that would create nearly 1,500 new regulations and mandates and carry a price

tag of well over a trillion dollars. The Senate is considering similar legislation. The Environmental Protection Agency is moving forward with 29 major economic rules and 173 major policy rules, an unprecedented level of regulatory action. The Labor Department is considering dozens of new, restrictive workplace policies while the newly appointed National Labor Relations Board is expected to make sweeping changes governing every facet of union-management relations.

The soon-to-be-finalized financial regulatory reform legislation creates over 350 regulatory rulemakings, 47 studies, and 74 reports—dwarfing anything in Sarbanes-Oxley. The massive health care bill, with its unprecedented and confusing employer mandate and hundreds of billions of dollars in business taxes, will require thousands of pages of new regulations to be followed by individuals, businesses, health care industry providers, and the states.”

It is time for the majority and the current administration to recognize that far from stimulating the economy, their policies have put the U.S. economy in a vapor lock of uncertainty. Higher taxes, job and innovation killing regulatory policies, and reckless federal spending have brought us to the brink. The time to reverse course is now.

HEALTH CARE REFORM

In March, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA) which supporters assert will extend health insurance coverage to an additional 32 million U.S. residents by the end of the decade. Supporters, including the President, have asserted that the health care reform legislation represents a major deficit reduction package and will bend the health care cost curve. Despite concerns raised over the impact the reform package will have on existing health insurance coverage, President Obama has continued to assert that “If you like your doctor, you can keep your doctor. If you like your health care plan, you can keep your health care plan.”

Again, many of the majority and administration’s assertions are either factually untrue, speculative, or at worst based on sleight of hand.

For instance, on July 22, 2009, President Obama asserted that “If we don't act, 14,000 Americans will continue to lose their health insurance every single day.” That number was used frequently in the debate over

health care reform. It's a striking number, but a number that is subject to significant debate and interpretation. The statement implied that there would have been 14,000 fewer Americans with health insurance each and every day. Nice sound bite, but misleading.

If accurate, the statement implied that more than 5 million Americans would lose coverage every year. By that reasoning, the projection of the Congressional Budget Office (CBO) that the number of uninsured would increase by 4 million over the 2010 – 2019 period under prior law would be off by a factor of nine. Instead of 54 million uninsured, CBO would have projected 95 million residents without health insurance. The CBO estimates that the number of uninsured will rise under prior law from 50 million in 2010 to 54 million in 2019. Putting aside the question of whether the president's statement is correct, even CBO's projected increase did not, on its face, yield a complete picture. Who are the uninsured?, who will be eligible for subsidies?, and how much will those subsidies cost were critical questions in the health care debate?

Contrary to general conception, CBO's estimate for the number of uninsured is not based directly on data from any current survey. Rather it is the output of a micro-simulation model.

"CBO's estimate of the number of uninsured people originates with a point-in-time, SIPP-based estimate in 2002. Some demographic groups, among them Hispanics, have lower rates of health insurance participation than the general population does. The number of people in those groups is expected to increase faster than the general population. Thus, the adjustments to the SIPP weights to match the changing demographics of the U.S. population result in an increase in the number of uninsured individuals (as a percentage of the U.S. population) over the period between 2008 and 2017."⁶

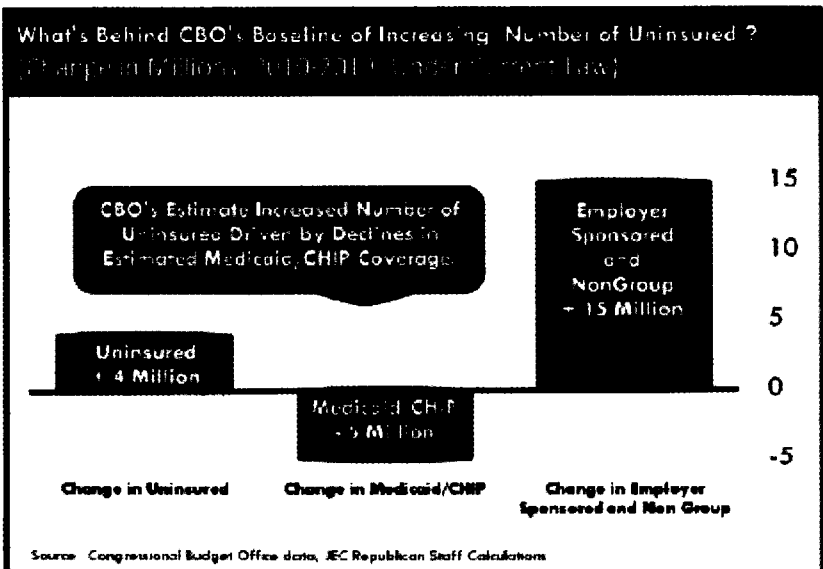
CBO makes other adjustments to correct for "survey inaccuracies,"⁷ including such items as the "Medicaid undercount" that exists in many surveys. CBO's estimate of the baseline number of the uninsured is based on a "point-in-time" estimate that is adjusted to reflect changes over time in the demographic makeup of the population. In other words, a basic profile is developed for a point in time then the overall

⁶ CBO's Health Insurance Simulation Model: A Technical Description, Congressional Budget Office, October 2007, page 13. Available online at: <http://www.cbo.gov/ftpdocs/87xx/doc8712/10-31-HealthInsurModel.pdf>.

⁷ Ibid.

estimate for future years is reached by adjusting for changes in the makeup of the population.

On top of this, CBO makes adjustments for changes in various programs already scheduled under current law. Ironically, as the chart to the right depicts, at a top level, the increase in the number of uninsured from 50 to 54 million – 4 million – was more than accounted for by the projected decrease in Medicaid/CHIP enrollment from 40 million to 35 million.



Much of this increase was related to the scheduled expiration of the CHIP program's current authorization in 2013. As the table shows, if the percentage of the non-elderly population covered by Medicaid/CHIP remained at the 2010 projected level of roughly 15%⁸ (not an unreasonable assumption), the number of individuals with Medicaid/CHIP coverage would rise to 42 million, and the overall number of uninsured would shrink by 2-3 million over the period despite the fact that the non-elderly population grows by 15 million

⁸ Ibid, p. 15. CBO's 2008 baseline estimate of Medicaid/SCHIP coverage was 16.1% or 42.1 million. CBO's estimate of 40 million (15% of the non-elderly population) as a baseline in 2010 represents a decline of more than 2 million from the 2008 baseline.

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during the same time period. In short, we would see a swing of 7 million in the number of uninsured. What does this mean?

In terms of those with health insurance coverage, CBO estimated that the number of non-elderly individuals with non-Medicaid/CHIP health insurance would have increased from 177 million in 2010 to 191 million in 2015 and 192 million in 2019. If the percentage of the population covered by Medicaid/CHIP remained at the level of 15% of the population estimated for 2010, the percentage of the non-elderly population without health insurance coverage would decline from 19% to 17% rather than remain at 19%.

Percentage and Number of Uninsured Would Decline If Medicaid/CHIP Coverage Remained at 15% of Non-Elderly Population

	CBO Baseline		Medicaid/CHIP Covers 15%
	2010	2019	2019
Percentage Uninsured	19%	19%	17%
Number Uninsured (Millions)	50	54	47
Number Insured (Millions)	217	228	235

It is clear that the primary factor behind the baseline increase in the number of uninsured non-elderly residents is the decreasing number and percentage of individuals enrolled in government sponsored health insurance, not the loss of private coverage. To the contrary, CBO's scoring of the various versions of health care reform legislation indicated that without government action private coverage would increase over the next decade, not decrease. Under CBO's baseline, from 2010 to 2014, CBO data suggests private coverage will be increasing at a rate of more than 8,000 people per day.

There are a significant number of provisions of the health care reform law that create perverse incentives and increase the likelihood that employers will choose to drop health care coverage for employees.

For decades, the small business community has been petitioning Congress for relief from the high and rising costs of the health benefits they provide to their workers. In 2008, presidential candidate Barack

Obama promised that his health care reform plan would lower a typical family's health care premiums by \$2,500 a year.⁹

But in November 2009, the Congressional Budget Office estimated that, if the Democrats' Patient Protection and Affordable Care Act (PPACA) were enacted, premiums in the group insurance market would keep rising by \$1,000 a year, as if the bill had not passed.¹⁰ CBO's analysis, however, did not highlight the disproportionate upward pressure on premiums paid by workers in small businesses, thanks to a new and inequitable excise tax.

PPACA imposes a new tax on health insurers of \$8.1 billion annually beginning in 2014 and rising to \$14.3 billion by 2018 (and indexed for medical inflation thereafter).¹¹ The Congressional Budget Office affirms the general consensus of economists that the new tax "would be largely passed through to consumers in the form of higher premiums for private coverage."¹² An October 2009 analysis, by the respected tax policy expert, Kenneth J. Kies, suggests the insurance tax could cost the typical family of four with employment-based coverage as much as \$1,000 a year in higher health premiums.¹³

But the impact of the tax would not be equally shared across the board by those who ultimately pay it; rather, small businesses and their employees would bear a disproportionate burden. This is because the

⁹ Sen. Barack Obama, "A Politics of Conscience," speech, Hartford, CT., 10/23/07.

¹⁰ CBO found that premiums might drop slightly in the large group insurance market (50+ lives) by up to 3% and in the small group market (2-50 lives) by up to 2% in 2016, compared with where they might have been without PPACA. For the nongroup market, CBO found a 10-13% increase. CBO, letter to Sen. Evan Bayh, 11/30/09; attachment, p. 5, table 1.

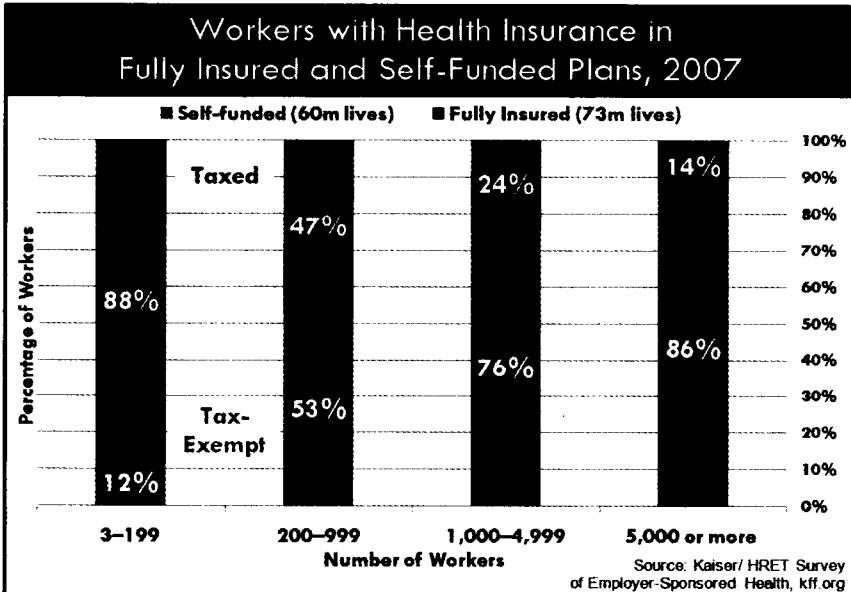
¹¹ § 9010 of PPACA. Tax is based on net premiums written. Each year, each health insurance company is to pay a share of a total amount specified in the law, equal to the company's share of the market. Tax is not deductible as a business expense. Joint Committee on Taxation, JCX-18-10, 3/21/10. The yearly amounts total \$73b over 2014-19, but JCT estimates only \$60.1b will actually be collected. JCT, JCX-17-10, 3/20/10.

¹² CBO, *op. cit.*, pp. 15-16.

¹³ Kenneth J. Kies, Federal Policy Group, "Study on \$6.7 billion Annual Insurer Fee," 10/15/09, www.fpgdc.com. See also New York Post, "Insure fee-hike alert: Tax will wallop families," by Carl Campanile, 10/16/09. Kies's actual figure was \$500 a year, but was based on an early version of the tax that raised only half the amount of the one enacted: \$6.1b a year (JCT, JCX-36-09, 9/22/09) versus \$12.1b (JCX-17-10, 3/20/10).

tax applies only to fully insured health benefits coverage. Self-funded plans, which are the most common type of plan for employers with 200 or more employees, are exempt from the tax. Self-funded plans require the employer to retain the risk of insured employees, which is typically something small employers and the self-employed cannot afford to do because their risk pool is too small.¹⁴

As the chart below shows, 88% of workers in businesses with 3-199 employees are in fully insured plans and would be subject to the tax, while only 14% of workers in companies with 5,000 or more employees would be subject to it.¹⁵ Thus, the insurance tax is not only costly but also unfair to those workers who are employed disproportionately in small businesses.



Some proponents of Obamacare may challenge the foregoing analysis on grounds that it does not take into account the new small employer

¹⁴ National Federation of Independent Business, "The 'Health Insurance Fee': A Tax on Small Business and the Self-Employed," www.nfib.com (accessed 4/9/10).

¹⁵ Employee Benefits Research Inst., EBRI Fast Facts 114, 2/11/09. Of the 132.8m persons covered in 2006 by employer health benefits under ERISA, 55% (73m) were in fully insured plans, 45% (60m) were in self-funded plans. EBRI Issue Brief 10/07.

health care tax credit that became available when the bill was enacted. This credit subsidizes a portion of the employer's premium contribution but is only available for a few years and only to very small firms with relatively low average wages.¹⁶ While the credit could potentially offset some of the ultimate premium burden placed on small businesses, its existence does not alter the economic effects of the insurance tax. That tax will tend to drive up overall premium costs, regardless of any government transfer payments attempting to make the burden less onerous.

In addition to the new tax on insurers, PPACA also levies approximately \$5 billion a year in combined taxes and fees on manufacturers and importers of medical devices and brand-name prescription drugs. Since most such therapies are paid for through insurance, public as well as private, these new taxes too will ultimately be passed on to consumers in the form of higher medical costs and insurance premiums. They may also negatively affect medical research and innovation.

Far from reducing family health care premiums by \$2,500 a year, as promised by candidate Obama, the bill signed by President Obama contains a new tax that will paradoxically drive premiums upward—by as much as \$1,000 a year for a typical family of four with job-based coverage, separate and apart from the bill's other premium-increasing provisions. Unfairly, the costs of this new tax will be passed through to employees of small firms, the very firms that find it hardest to afford and offer coverage today.

During the health care reform debate, the majority and the administration hailed the legislation as reducing the deficit. Republicans generally responded with charges that the legislation had ten years of taxes and six years of benefits and pointed to other questionable aspects of the majority's claim.

¹⁶ § 1421 of PPACA establishes a small business tax credit. The full credit is available to firms with fewer than 10 employees and whose workers' average annual wages do not exceed \$25,000; partial credits are available on a sliding scale for firms up to 25 workers and wages up to \$50,000. The credit is not available to sole proprietorships. In 2010-13, the credit equals 35% of the employer's contribution toward the employee's health insurance premium, if the employer contributes at least 50% of the total premium cost or 50% of a benchmark premium. After 2013, the credit amount rises to 50%, but becomes available only for coverage purchased through a health benefits exchange and for no more than two consecutive years. JCT, JCX-18-10, 3/21/10.

The legislation signed into law was replete with budget gimmicks that needed to be utilized in order to achieve a non-deficit increasing score from CBO and JCT. We will highlight a couple of those “gimmicks” and the implications for future policy.

The legislation as signed into law contemplates hundreds of billions of dollars in Medicare cost savings. Those cost savings were scored as offsetting new health care spending instead of being used to improve the Medicare system’s actuarial imbalance that, in present value terms, amounts to tens of trillions of dollars.

Perhaps the most clever scheme in the new law is the so-called “CLASS Act” buried deep within the Patient Protection and Affordable Care Act. This new program will provide a cash benefit for certain disabled persons to help them with their long-term care needs—and will directly compete with existing private-market insurance offerings. Unlike other federal entitlements, CLASS is supposed to be voluntary and self-financing, with no federal subsidies. However, the program as currently designed is unsound and appears doomed to add to the federal deficit within the next 15 to 20 years. Taxpayer intervention will likely be needed.

This so alarmed Senator Kent Conrad (D-ND), chairman of the Senate Budget Committee, that he has publicly denounced CLASS as “a Ponzi scheme of the first order, the kind of thing that Bernie Madoff would have been proud of.”¹⁷

While Mr. Madoff’s views on the CLASS Act are unknown (he is currently serving a 150-year sentence in federal prison for investment fraud), Sen. Conrad’s concerns are justified.

CLASS, which stands for Community Living Assistance Services and Supports, will provide a cash benefit to disabled or memory-impaired adults who need help with such activities of daily living as eating, dressing, and bathing. Among other things, this money can be used for nursing care in the home or in a skilled nursing facility. Certain key program details have been left to the Secretary of Health and Human Services to decide, including its start date (presumably around 2013) and, more importantly, the exact premium and benefit amounts. Other details are known. Most workers will be auto-enrolled, with a right to opt out, and premiums will be collected primarily via payroll

¹⁷ Washington Post, “Proposed long-term insurance program raises questions,” 10/27/09.

withholding. Eligibility for benefits is limited to enrollees who have paid premiums for at least five years and have worked at least part-time for three of those five years. Premiums, which may vary only by age at enrollment, must remain level over time and will be capped at a nominal \$5 for the poor and full-time college students. There is a benefit floor of \$50 a day. The Congressional Budget Office assumes average benefits will be about \$75 a day.¹⁸

By comparison, most private offerings pay benefits of \$120 to \$400 a day, with the average being \$165.¹⁹

Although CLASS involves no federal subsidies, it is a federal program, administered by the Secretaries of HHS and Treasury. All of its financial operations will be included in the federal budget. Since no benefits will be paid during its first five years, CLASS will initially improve the federal balance sheet by an estimated \$70.2 billion over its first decade.²⁰ That, of course, is why congressional Democrats included it in their bill—to help make Obamacare seem less costly than it is. However, these “savings” will later have to be paid out again as cash benefits. As the chart shows, CLASS’s positive effect on the budget will decline after 2015, when benefits start. By 2030, projected costs will exceed premium revenues, causing the CLASS trust fund to add to federal deficits. Although the law requires the HHS Secretary to raise premiums each year as necessary to keep the trust fund solvent over the subsequent 75 years, Medicare’s Chief Actuary, Richard S. Foster, believes “there is a very serious risk that the problem of adverse selection will make the CLASS program unsustainable”—a view shared by the nation’s leading actuarial societies.²¹

CLASS practically invites adverse selection, the bane of poorly designed insurance schemes, because it is voluntary, open to all, and yet permits premiums to vary only by age. This differs from how things work in the private market, where although anyone may buy long-term care insurance, applicants who are more apt to need care due to age, health history, or current medical conditions are charged a higher premium to reflect their relatively higher risk level. When

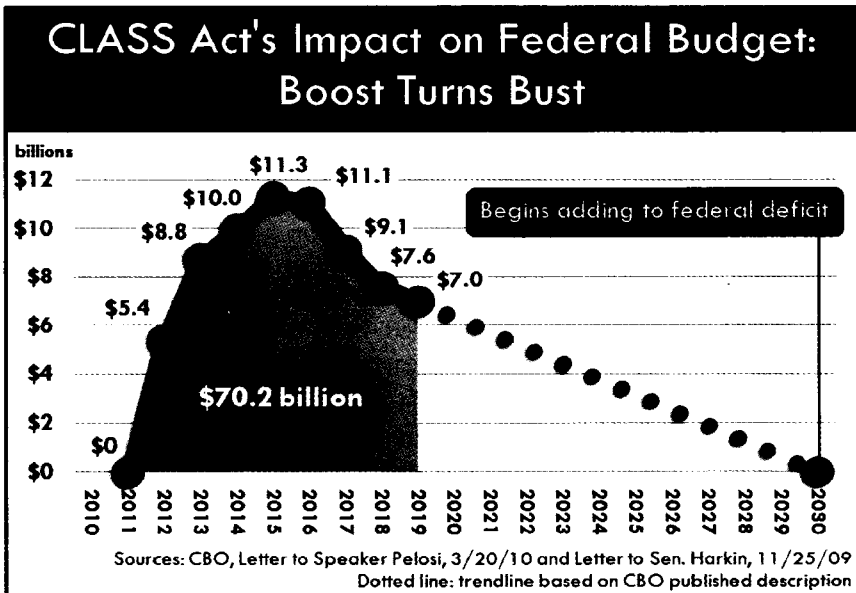
¹⁸ CBO, Letter to Speaker Pelosi, 3/20/10.

¹⁹ American Academy of Actuaries and Society of Actuaries, Joint letter on CLASS Act, 7/22/09, http://www.actuary.org/pdf/health/class_july09.pdf.

²⁰ CBO, *op. cit.* The Medicare Agency, CMS, projects a much lower \$38b in savings. CMS, “Estimated Financial Effects of [PPACA],” 4/22/10.

²¹ AAA and SOA, *op. cit.*

premiums can vary only by age, relatively healthy, low-risk people will not buy the insurance, and the cost of insuring the remaining, higher-risk population will rise. If CLASS is truly self-financing, the Secretary will have to keep raising the premiums, because only high-risk individuals will choose to be insured. This will be sustainable only so long as the premiums remain lower than those of private-market alternatives for persons with the same risk level. Congress has made the Secretary's job difficult here, however, by capping premiums for poor people and undergraduates and exempting certain retirees from premium hikes; which means the Secretary must set higher premiums for all other enrollees. Even high-risk participants who might prefer to remain in CLASS will opt out once they realize they can obtain similar coverage for a lower cost in the private market. CBO estimates only 3.5% of the adult population, or roughly 10 million people, will enroll by 2019. The current participation rate for private long-term care insurance offered through employers, with no auto-enrollment, is 4%.²²



If the Secretary fails to raise premiums sufficiently, Congress will be forced to step in. It could raise premiums further, reduce benefits, or restrict eligibility—or even make participation mandatory. The latter

²² CBO, Letter to Sen. Harkin, 11/25/09. CMS's Foster projects enrollment of only 2% of the eligible population by 2013. CMS, op. cit.

option is not altogether improbable, given how adamant congressional Democrats have been that Obamacare must be mandatory—to avert adverse selection. Should Congress fail to reform the program, its only way to avert insolvency will be a taxpayer bailout. CLASS cannot be voluntary, self-sustaining, and a good deal for workers and taxpayers, all at once. Something, or rather someone, will have to give.

As currently designed, CLASS will not be able to sustain itself without subsidies from taxpayers or from all workers in the form of mandatory enrollment. In addition to being unsound, the program is unnecessary. Americans already have an array of private long-term care insurance options to choose from: many are more economical than CLASS, most offer richer benefits. The best remedy for the unsustainable, unaffordable CLASS program is to repeal it.

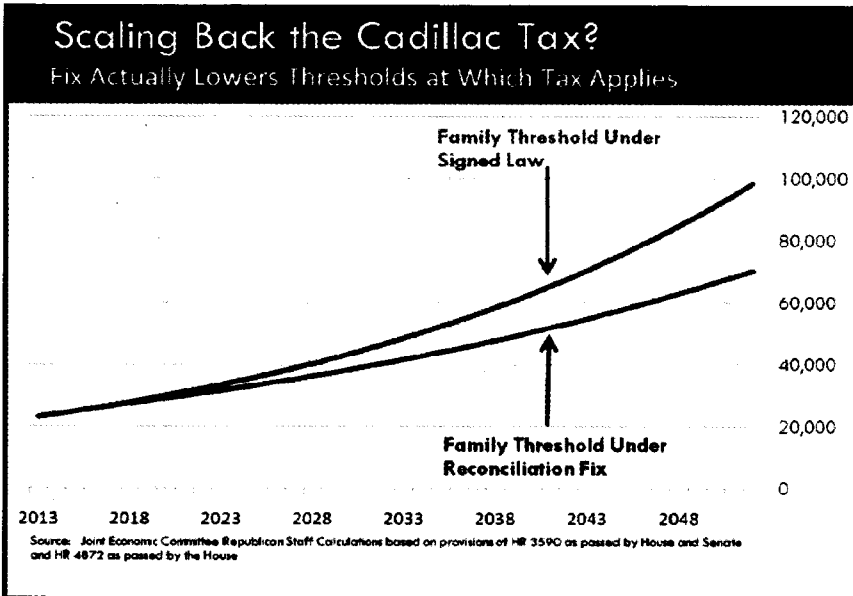
And then there is, perhaps, the most intellectually dishonest aspect of the new health care law – the use of inflation to expand the application of various taxes imposed under the law.

For instance, the high cost plans excise (“Cadillac plans”) will increasingly hit more and more health insurance plans. In passing final legislation, the majority revealed in a deal that delayed the implementation of the Cadillac plans tax. In reality, the majority engaged in a “Cadillac Shuffle” by delaying implementation but doing so in a way that insures the tax will apply to more plans at an earlier date than in the Senate passed legislation. The changes were represented as a “scaling back of the tax.” True, the effective date that the tax begins was delayed for five years, but beyond the ten-year budget window, the allegedly scaled back version of the tax will actually hit even more plans and generate more tax revenue than the original tax.

Instead of adjusting by the Consumer Price Index for All Urban Consumers (CPI-U) plus 1%, the so-called “fix” would adjust those thresholds in the out years by just the CPI-U. In addition, a special provision to adjust the initial thresholds if premiums grow faster than the Congressional Budget Office (CBO) projects will ensure that the tax will not hit federal employees, including Members of Congress, favorite plan when the tax is initially applied.²³

²³ HR 4872 contains a provision to change the initial thresholds in 2018 based on increases in the Blue Cross Standard Option offered under the Federal Employee Health Benefits Program. If the increase in premiums under that plan, the favorite of federal employees and Members of Congress, is greater

The new thresholds provided in the fix (\$10,200 for individual plans and \$27,500 for family plans) are essentially the same as the thresholds provided by the enacted legislation after indexing at CPI-U plus 1% for five years. The only plans that benefit in the short term under the reconciliation fix are plans that would have been subject to the tax under the enacted legislation between 2013 and 2017. In fact, for more modest plans, the tax bite will hit sooner and harder.



The irony is that the reconciliation legislation replaces the high cost plans excise tax revenue with revenue from a new Medicare tax on job and growth producing investment income. In reality, while the short term revenues under the high cost plans tax are reduced during the budget window, over the long-term the high cost plans tax revenues will be greater than under the enacted legislation. That is, unless the indexing level is adjusted in the future to prevent average and modest

than 55% between 2010 and 2018, the thresholds would be adjusted upwards to compensate for the excess cost growth. The 55% factor implies that premiums for that plan will only grow by 5.6% a year. If they grow faster, the thresholds will be higher. Over the last ten years the annualized growth rate for the Blue Cross Standard Option Plan has been 8.6% for self only plans and 8.7% for family plans, significantly higher than the 5.6% annual cost growth factor contained in the reconciliation bill.

plans from becoming subject to the tax, in which case many of the revenues that are supposed to pay for new health care subsidies will no longer exist.

As noted, the thresholds at which the new “Medicare” taxes contained in the legislation are not indexed for inflation meaning that taxes will hit taxpayers at progressively lower income levels.

Beginning in 2013, so-called “unearned” income (that is, investment income) such as capital gains, dividends, and interest will be subject to this tax for individuals making over \$200,000 in 2010 dollars and families making over \$250,000. But because the tax threshold is not indexed for inflation, it will increasingly hit individuals and families with lower incomes as time passes.

The new 3.8% investment tax will be particularly devastating because taxes on investment income discourage a key source of technological advancement and rising productivity—essential foundations of economic growth.

When combined with President Obama’s plans to allow existing-law tax rates for upper earners to jump up in 2011, the top marginal tax rate on capital gains will increase from 15% to 23.8% (a 59% increase) and the top rate on dividends will increase from 15% to 43.4% (a staggering 189% increase). Such massive increases in taxes on savings and investments will tend to discourage individuals and families from bettering both themselves and the economy through saving and investing. When prices rise, people respond by reducing their consumption. Just imagine if the cost of a gallon of milk were to jump from \$3.50 to \$5.57 or to \$10.12 beginning in 2013; if that were to happen, economists would expect a significant decline in the amount of milk consumed from that point forward. We can expect a similarly significant decline in investment—in favor of current consumption—for individuals and families hit with a significant tax increase on their investments.

The downsides of this tax are hard to overstate. Investment is the foundation for increased productivity, technological advancements, income growth, and overall economic prosperity. Reduced investment will lead to lower incomes and lower GDP, which will further exacerbate the impending fiscal disaster facing the United States as a result of the massive deficits and debt that President Obama and Washington Democrats have been piling up at a breathtaking rate. The result will be lower economic output and growth, lower wages,

and a nation less economically prepared for the future. It is hard to imagine a worse time to discourage the most productive and growth-generating sectors of our economy.

Opposition to the new 3.8% investment tax was undoubtedly muted by the fact that it was billed as a tax on the “unearned” income of wealthy individuals and families. People of modest incomes and those not currently receiving any “unearned” income might reasonably believe they are immune from the tax. However, failure to index this tax to inflation means that it will eventually hit middle-class individuals and families. In fact, in the very first year that it takes effect—2013—the tax will hit individuals making less than \$200,000 in today’s dollars and families making less than \$250,000; an undeniable violation of the President’s pledge.

Although Democrats recognized their failure to index the investment tax as a serious problem similar to that of the existing Alternative Minimum Tax, they nevertheless did not index it because doing so would have deprived them of the necessary revenues to help pay for their massive new health care entitlement. Finance Committee Chairman Max Baucus (D-MT) said during the debate over the health care bill: “We don’t want to get into an AMT situation. . . . It is very possible that if this level [the \$200,000/\$250,000 threshold] is not indexed, we may be paying the price later on, in several years’ time, but this is not the time or place.”²⁴ The Democrats’ imprudent approach of pushing through with legislation that they recognize as fiscally unsound is only one example of their recent haste to accomplish their partisan agenda without regard to cost or economic effect. This recklessness has contributed significantly to our nation’s deteriorating fiscal outlook and will have a damaging effect on our economy in both the near-term and long-run.

An often overlooked issue is the various incentives the legislation creates for employers to drop employee health coverage in favor of paying a fine and sending their employees to the public exchanges. Should this occur on any kind of scale, the cost of subsidies under the legislation will soar and even the gimmicks used to “pay for” the legislation will not sustain the illusion that the legislation is deficit neutral.

²⁴ Sen. Baucus (MT). “Health Care and Education Reconciliation Act of 2010,” Congressional Record Vol. 156, No. 48 (25 March 2010) p. S2074.

Significant concerns also exist about the Internal Revenue Service's ability to implement the new law even with a massive increase in personnel and budgets. Policy makers should be concerned that the complexity of the "scheme" itself creates significant risks – even a potentially catastrophic system failure.

TAX POLICY CONCERNS

Significant concerns also exist over the majority and President's desire to allow automatic tax increases to go into effect at the end of this calendar year. We will not discuss this at great length, but will note that the uncertainty over tax policy are creating significant disincentives for investment that is badly needed if we are to jump start the economy – particularly labor markets. Historical evidence suggests that private investment is an important factor in generating payroll job growth.

The increase in capital gains rates and taxes on dividends will deter investment and hamper growth in the future. The expiration of those tax rate reductions may also create a false picture of economic activity in late 2010 as taxpayers shift income into the current year to avoid higher taxes in 2011.

There is serious risk that should not be overlooked regarding the adverse economic impact of higher tax rates in 2011. Those higher rates and the lower levels of investment could result in another economic downturn.

FINANCIAL SERVICES REGULATION

The Senate and House have both passed the conference report on financial services regulation reform legislation. The Dodd-Frank legislation has some positive components, but on balance may well act as a drag on economic growth. The new legislation will require over 350 regulatory rulemakings, 47 studies, and 74 reports. The legislation is a lobbyists' and litigators' dream. We can only hope it does not turn into the American economy's nightmare.

However, the legislation's failure as a piece of "reform" legislation has as much to do with the issues the legislation ignores as what it contains.

The most glaring failures of the Dodd-Frank financial reform legislation are its failures to resolve the insolvencies of Fannie Mae and Freddie Mac currently under conservatorships administered by the Federal Housing Finance Agency and to place housing finance on a sound basis.

Alex Pollock, former President of the Federal Home Loan Bank of Chicago and a resident scholar at the American Enterprise Institute, observed that one cause underlies all financial crises – poor loan underwriting standards. The recent global financial crisis is no different.

A number of well-intentioned, but ultimately destructive federal policies encouraged the widespread deterioration in residential mortgage loans underwriting standards. Enacted in 1977, the Community Reinvestment Act (CRA) requires commercial banks and savings institutions to meet the credit needs of borrowers in all of communities, including low- and moderate-income neighborhoods. Federal regulators must consider the CRA record of a commercial bank or savings when considering applications for acquisitions and mergers. So-called community organizations such as ACORN learned to use the CRA to protest bank acquisitions and mergers until the surviving institutions agreed to increase their lending in low- and moderate income neighborhoods, especially for residential mortgage loans.

Both President Bill Clinton and President George W. Bush sought to increase the home ownership rate among low-income and minority households. For more than a decade, federal regulators encouraged commercial banks and savings institutions to weaken traditional credit underwriting standards for residential mortgage loans to make it easier for low- to moderate-income households to buy a home. As home prices rose, federal regulators even promoted exotic residential mortgage loan products such as interest-only and negatively amortizing loans to households that could not make a standard down payment or qualify for a fully amortizing residential mortgage loan to shoehorn them into buying a home that they could not really afford. Many of these unfortunate households defaulted on their exotic residential mortgage loans after the housing bubble burst.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 directed the Secretary of Housing and Urban Development to establish affordable housing goals for Fannie Mae and Freddie Mac in each presidential election year for the following four years. At first,

Fannie and Freddie could meet their goals through their normal course of buying conforming residential mortgage loans from commercial banks, savings institutions, and mortgage bankers, placing them in agency residential mortgage-backed securities (RMBSs), and then selling these agency RMBSs to the public. After Secretary Andrew Cuomo significantly increased the affordable housing goals for Fannie and Freddie during 2001 to 2004 in October 2000, Fannie and Freddie could no longer meet their goals through their normal course of business. So Fannie and Freddie decided to meet these higher affordable housing goals by purchasing private label RMBSs containing subprime and Alt-A residential mortgage loans.

Federal policy contributed to the explosive growth of subprime and Alt-A residential mortgage lending from 2001 to 2006. Commercial banks, savings institutions, and mortgage banks willingly underwrote subprime and Alt-A residential mortgage loans knowing that these risky loans would not remain on their books but would be sold to investment banks to be placed into private label RMBSs. With a regulatory-induced demand, investment banks worked overtime to issue private label subprime RMBSs for Fannie and Freddie to buy to satisfy their affordable housing goals.

During the last two decades, Fannie Mae and Freddie Mac exploited their status as government-sponsored housing finance enterprises. Despite official denials, financial market participants assumed (correctly, as it turned out) that the federal government would protect the creditors of Fannie and Freddie if they were to fail. Consequently, Fannie and Freddie were able to borrow virtually unlimited amounts from credit markets at very low interest rates regardless of the riskiness of their investment portfolios. Essentially, Fannie and Freddie could socialize any losses, but keep any profits for their senior management and shareholders. This encouraged senior management of Fannie and Freddie to balloon the size of their balance sheets in part through the purchase of risky private label subprime and Alt-A RMBSs after 2000.

Once the housing bubble collapsed, the losses at Fannie and Freddie mounted. On September 6, 2008, the Federal Housing Finance Administration declared Fannie and Freddie to be insolvent and placed them into conservatorships. So far, taxpayers have lost \$147 billion in Treasury subsidies to Fannie and Freddie. Financial expert Peter Wallison estimated that taxpayers will eventually lose more than \$400 billion on Fannie and Freddie. Moreover, both Fannie and Freddie

admit in the filings with Securities and Exchange Commission that can never return to profitability under their current structure.

Fannie and Freddie are the proverbial “800 pound gorillas” of housing finance. Until their future is resolved, private investors and institutions are unlikely to recenter housing finance in any significant way. Ironically, housing finance is more dependent than ever on Fannie, Freddie, and the Federal Home Loan Banks. Thus, determining the final resolution of Fannie and Freddie is necessary step to place housing finance on a sound long-term basis, yet the Obama Administration and Congress put off this issue until 2011. Nor does the Dodd-Frank legislation repeal the CRA or the requirement of affordable housing goals for Fannie and Freddie that encouraged lenders to weaken the underwriting standards for residential mortgage loans. Incredibly, the Dodd-Frank legislation leaves the failed structure of housing finance in place.

TRADE POLICY

International trade continues to be a lifeline for the U.S. economy. U.S. two-way trade of goods and services fell from a peak of 28.5 percent of GDP in second quarter of 2008 to a trough of 24.6 percent of GDP in second quarter of 2009 due to the global recession, before rebounding to 27.0 percent of GDP in the first quarter of 2010.

While the progressive liberalization of international trade continues around the world, the United States has largely been inactive due to the lack of leadership from President Obama. As a result, the United States has forfeited leadership opportunities on international trade issues, sacrificed potential market share of U.S. exports in foreign markets, and jeopardized the international competitiveness of American companies in certain regions.

A recent report issued by the Republicans on the Agriculture Committee and Ways and Means Committee in the U.S. House of Representatives shows that our delay in the implementing a free trade agreement with Colombia caused a 48 percent decline in U.S. agriculture exports to that country in 2009. American farmers lost market share to Argentina and Brazil in such key sectors as corn, wheat, soybeans and soybean oil. Moreover, key U.S. agricultural sectors could see reductions in exports of nearly \$57 million if Canada and Colombia implement their agreement ahead of the U.S. agreement.

Because of the phase-in schedules of tariff reductions, countries with free trade agreements that enter into force with U.S. trading partners prior to similar agreements with the United States are likely to benefit from comparative lower tariffs for up to 15 years.

The United States has undertaken several “protectionist” measures during the first two years of the Obama Administration. President Obama has yet to find a successful solution to lift the ban on Mexican trucks from U.S. highways. This ban causes the U.S. to be in direct violation of North American Free Trade Agreement (NAFTA) obligations and costs U.S. businesses, farmers and ranchers \$2.4 billion in punitive tariffs annually. The “Buy American” provisions in the American Recovery and Reinvestment Act of 2009 delayed stimulus projects, increased costs to local and state governments, and invited retaliation by foreign governments that could impair the ability of American companies to sell their products and services overseas.

In his State of the Union address earlier this year, President Obama proposed a “National Export Initiative” with the goal of doubling U.S. exports within five years. This is a welcome announcement. It demonstrates the President’s recognition that international trade is an important engine for economic growth. To increase exports by this amount, the President will need to open foreign markets to competitions from U.S. exports and U.S. multinational firms, including through passage of the pending free trade agreements with Colombia, Panama, and South Korea.

Recently, President Obama announced that the U.S. is on track to achieve the goal of doubling exports within five years as exports have increased significantly in 2010 relative to 2009. However, it is important to note that in 2009 U.S. exports suffered the steepest decline since 1932, dropping from \$1.83 trillion to \$1.55 trillion, which means that U.S. exports will need to increase to \$3.1 trillion by 2015. Thus, some of the growth in U.S. exports attributed to this initiative will merely reflect the normal rebound in trade volume as the global economy recovers from a severe recession. Further market-opening policy initiatives are necessary to supplement continued U.S. export growth.

A bright spot for U.S. trade policy is the announcement of the Obama Administration that the United States will move forward with talks to join the Trans-Pacific Partnership (TPP). These negotiations build on an existing agreement that initially included Brunei, Chile, New

Zealand, and Singapore, and have already expanded to include Australia, Peru, and Vietnam. The TPP could become a state-of-the-art regional free trade agreement that would access 163.6 million customers for American manufacturing, technology, services and agriculture.

The Asia-Pacific region is an increasingly important market for U.S. exports. It accounts for 60 percent of the world's GDP and almost half of global trade. The United States must have a foot in the door and a level playing field in the fastest growing market in the world.

Together, TPP partner countries represent the United States' sixth largest trading partner, with two-way goods trade of nearly \$132 billion in 2008. If the United States moves forward, the TPP could boost U.S. competitiveness and strategic presence in the vitally important Asia-Pacific region and strengthen U.S. ties with key allies, increase market access for U.S. workers and industries, and spur much-needed domestic growth.

CONCLUSION

We could address several other aspects of the administration and majority's agenda that pose a serious threat to the economic well-being of the nation and future prospects for growth, including the pursuit of an extremist environmental agenda that will drive energy costs through the roof and employment in many industries into the basement.

The fact remains that too many American families have experienced job losses, declines in housing wealth, and declines in values of their retirement accounts and stock holdings. The economy faces significant challenges in the months and years ahead. In facing these challenges, there are a number of noteworthy points to consider, including:

- We need to keep taxes low. In the current environment, it is important that taxes not be raised on American individuals, families, and businesses. It is equally important to preserve, extend, and build upon pro-growth tax changes that have been implemented in recent years, including lowering tax rates on capital gains, dividends, and income. Economic policy decisions that have lowered taxes on American households and

allowed American families to keep more of their hard-earned incomes have paid dividends for the Nation's citizens.

- We need to promote the expansion of international trade. It is important, especially in light of the robust contributions to domestic growth from U.S. exports over the past several years, to resist the disturbing trend toward protectionist sentiments and policy recommendation.
- We must leave a small footprint in crafting regulations. It is important, in considering how best to reform regulation and oversight of our Nation's financial system, not to implement excessively onerous regulations. Consumers and other financial market participants deserve protections that ultimately flow from transparency and judicious oversight. Nonetheless, regulations that are too restrictive and onerous only serve to inhibit free enterprise and often hurt those who benefit from financial innovations, including the needy and low-income Americans.
- We must focus on the distinction between economic stimulus measures and measures designed to implement increased government spending and expanded government. Measures to expand the size of government through long-term spending projects are not stimulus measures, even when implemented under the guise of stimulus. We need to focus on increasing investment in the private sector that will create permanent and sustainable growth in output and employment.
- We need to avoid the temptation to implement social and industrial planning under the guise of stimulus. Government has not historically done an efficient job of picking winners and losers in industry.

Despite the daunting challenges facing our nation and recent steps by the majority in the wrong direction, we remain confident that the entrepreneurial spirit and drive of America will survive and prosper. It will emerge—not with the interference of an expansive government, but with the hard work, thrift, and determination of its people. Harnessing that work, thrift, and determination requires that government help provide a transparent and fair playing field, but also requires that government let its working families and productive enterprises flourish by allowing them to reap the benefits of their activities.

Higher taxes and expanded government serves to diminish rewards to entrepreneurial efforts, however well intentioned policymakers that seek to serve as social and economic planners may be.

Senator Sam Brownback
Ranking Minority Member

Representative Kevin Brady
Senior House Republican