EPI TESTIMONY

TESTIMONY GIVEN BY

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"The Safety Net and the Recession"

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INTRODUCTION

The safety net—the programs that protect families from ruin when the economy fails them—is being tested by the greatest economic stresses since the Great Depression. Even though the unemployment rate has not hit the 10.8% peak of the 1981-82 recession, the tremendous loss of national wealth and the extraordinary growth in unemployment, especially long-term unemployment, reveal the unique severity of the current downturn. Maintaining and even strengthening the safety net is vital, not just to the survival of millions of families, but to the success of the recovery itself.

The United States has already experienced the sharpest rise in unemployment and the longest recession since the Great Depression in the 1930s. This current "Great Recession" is doing serious harm to many lives, will impoverish millions, and do massive damage to a generation of children, permanently scarring them in ways not easily overcome. It is also doing damage to our long-run growth potential.

The Administration's and Congress' effort to offset the recession was bold and effective, and given the extreme situation, needed to be the largest policy intervention in the economy in several generations. It has undoubtedly slowed the economy's free fall and made recovery possible, but much more must be done to generate robust job growth, restore incomes, create consumer demand, and generate sustained economic growth.

This testimony will discuss:

- why the recession happened and how deep it is;
- the persistent unemployment that lies ahead;
- the damage being done;
- what the recovery plan does, and how it's working; and
- why the recovery plan won't be enough, why we need to do more, and what can be done.

STRUCTURAL PROBLEMS

Before describing the recession, it is important to review some key developments over the last 30 years and to understand the deep structural problems that lie at the heart of the current mess. Foremost among those problems is a huge growth in inequality of wealth and incomes, greater than in any other advanced nation, and the greatest inequality of our nation's history.

Unbalanced Growth

Since 1989, the bottom 90% of Americans received only about 16% of all the income growth in our economy. On the other hand, the top 1% obtained three-and-a-half times as much—56%. Even more astonishing, the upper one-tenth of that top 1% (representing about 13,000 households) reaped more than one-third of all the income growth of the last 20 years. That was quite an accomplishment, but it was no accident—it took concerted political power and policy to accomplish this vast, upward redistribution of income.

The feverish growth of the financial sector and its compensation helped drive this unparalleled inequality. By diverting capital from the productive sectors of the economy—pouring money into the kind of derivative trading and securitization that ultimately brought down the economy—economic policy and financial deregulation over the last two decades helped enrich a narrow slice of society to a degree unseen since the Gilded Age. It also generated tremendous risk that resulted in our current economic calamity.

The Disconnect Between Productivity and Pay

At the heart of this dynamic is the fact that, in recent decades, the typical worker became much more productive but received hardly any of the benefits of the greater amount of goods and services that he or she produced. Productivity—the ability to produce more per hour worked—grew throughout the last 60 years. But it was only in the early postwar period that the compensation of the typical worker grew in tandem with greater productivity. Since 1973, there been a huge and growing gap between productivity and pay.

The greatest gap, however, was in the 2002-07 recovery, when productivity surged at historically high rates but the hourly compensation of both high school and college graduates did not grow at all.

It should not be surprising then that this last business cycle, from 2000 to 2007, was the first on record during which the typical working family was no better off at the end of the recovery than it was before the recession began.

To summarize, things were not going well even before the current recession.

THE GREAT RECESSION

Unemployment/Underemployment

The recession officially started in December 2007, but unemployment started rising in the Spring of 2007 and has now more than doubled to 9.8%. We would already have unemployment exceeding 10.0% if there had not recently been an actual drop in the size of the labor force over the last year. The steep rise in unemployment we have seen, up 5.5 percentage points, is even greater than the rise in unemployment in the deep recession of the 1980s. Of course, the unemployment rate doesn't capture all of the folks who are working part time but want full-time work, or those who are not included in the labor force but want a job. Adding them into consideration shows an *underemployment* rate of 17%, or 26.6 million people.

We Are Now Short 10.7 Million Jobs

We have lost 8.0 million (incorporating the announced data revision) jobs so far, a 5.8% drop in total employment and the sharpest drop in employment of any recession since the 1930s. However, because the population continues to grow, we need to create 127,000 jobs each month to keep unemployment from rising. Therefore, we are actually short 10.7 million jobs needed to return to the unemployment rate at the start of the recession.

Wage Deceleration

High unemployment adversely affects those who actually have jobs as well because wages grow more slowly. Furloughs, reduced hours, and losses in benefits are other ways people are impacted. Gallup reports that a third of workers fear their wages will be reduced, and a survey conducted for the Economic Policy Institute by Hart Research Associates found that 44% of households have already experienced job loss or cuts in pay or hours.

Unemployment: The Full Picture

So far, I have dealt with *averages*, and we all know that there is no "average person" walking around on the streets. Unemployment affects different populations differently. While average unemployment is 9.8%, it is 50% higher for blacks (15.4%), a third higher for Hispanics (12.7%), and below average for Asians and whites. Men are at nearly 11% unemployment, blue-collar workers have 50% higher unemployment than the national average, and white-collar unemployment is 6.3%, which may seem low but is higher than all but the two of the worst months of the 1980s recession. College graduates have half the average unemployment (4.9%), but it is the highest on record for that group.

Long-Term Unemployment Explodes

The statistic that most stands out in the current recession is the high rate of long-term unemployment: 5.4 million people have been jobless for more than six months, representing 3.5% of the total labor force. This far surpasses the previous peak of 2.6% set in June 1983. The cause of this lengthening unemployment is clear: there is only one job vacancy for every six persons unemployed.

Needless to say, if Congress had not acted to extend unemployment benefits to a maximum of 79 weeks, millions would have been cut off from their only source of income. More than 2 million workers have already been unemployed for more than a year.

Unfortunately, there are still more job losses and rising unemployment ahead.

THE UNEMPLOYMENT AHEAD

I anticipate that unemployment will keep rising until mid-2010 or even until the end of 2010, topping out at 10.3 to 10.5%. According to many forecasts, the unemployment rate may still be as high as 8% at the end of 2011. Eight percent is higher than unemployment has been for 25 years, and I consider that an unacceptably high unemployment rate that policy must address. When national unemployment surpasses 10%, unemployment will be much higher for minority communities: 16% for blacks and over 13% for Hispanics.

When the unemployment rate surpasses 10%, we will have an underemployment rate of 18% each month. Since people flow into and out of unemployment, we will have over a third of the workforce unemployed or underemployed at some point during 2010. In the African American and Hispanic communities, about 40% of those workforces will be unemployed or underemployed at some point in 2010.

THE PAIN AHEAD

So, there is a great deal more pain in the pipeline. Families will have fewer members working and they will be working fewer hours each week, at lower hourly wages, and with fewer benefits.

And this will go on for a number of years.

Hardest hit will be children, whose poverty will rise by half, from the 18% level in 2007 to 27%. For black children poverty will rise from the already unacceptable level of a third in 2007 to over half in the year or two ahead.

The recession will cause income declines among families at all income levels, but it will hit low-income families the hardest. Over the four years from 2008 to 2011, the average low-income family will have incomes averaging 7.2% (about $1,200 annually) less than they earned in 2007 before the recession, a total loss of over $4,600. An average middle-class family will see losses of roughly $3,500 a year for those four years with incomes 5.6% below their 2007 levels. The situation will, of course, be much worse for those families that experience unemployment.

THE RECOVERY PACKAGE

Matters would have been far worse if Congress had not passed a recovery plan. The American Recovery and Reinvestment Act has been effective, pumping $175 billion into the economy and generating about 200-250,000 jobs each month since April. The fact that the job situation remains so dismal only reflects how deep a hole had been dug by the flawed policies that led to this recession. For the most part, those who deny the effectiveness of the recovery package are the very ones who supported the anything-goes free market policies that pushed us into this huge hole.

The Deep Hole

The economic downturn is far worse than what economists predicted last November. The consensus had predicted unemployment would hit 6.9% in early 2009, but it actually hit 8.1% in the first quarter and reached 8.5% in March—before the ink was even dry on the recovery legislation. The loss of $14 trillion in housing and stock market wealth, the credit freeze, and business retrenchment were worse than economic forecasters anticipated.

GDP Decline

The economy was headed steeply downward last winter and in early 2009. The recovery package interrupted that decline and created actual growth starting this summer. In the second quarter of 2009, the economy's only area of positive growth was government consumption and investment, which increased by 11.4% over the previous quarter. Private consumption, investment, and net exports were all negative. Without the Recovery Act, total government expenditures would have fallen and gross domestic product would have dropped 4.0%. Instead, the economy declined by only 1.0%, which saved between 600,000 and 750,000 jobs in that quarter alone.

How Does the Recovery Act Work?

The problem we have faced is that there has been insufficient demand for the goods and services that businesses produce. Households have reduced their consumption as their wealth fell and have increased their savings in the face of uncertainties. Businesses have reduced investment and employment in the face of reduced sales opportunities. Exports have flagged due to the global nature of this recession. Consequently, the only way to spur demand and therefore maintain employment (or forestall employment erosion) has been for government to step in. The recovery package accomplished this in several ways which I will illustrate for the second quarter, the period from April through June.

- There was some growth in government spending and infrastructure—$5.2 billion that helped generate demand for goods and services and therefore jobs. This area of spending will be a major source of job creation next year but is not a leading source yet.
- A bigger impact was from the quick injection of funds to the states—the state relief—of over $25 billion. This fiscal relief not only limited layoffs by state and local governments, but it also limited the cutbacks in firms which offer goods and services to states. Plus, there is a "re-spending effect:" those that maintained employment in public-sector jobs and in supplier firms generate further job creation as they spend their salaries on services and goods. This re-spending effect is responsible for almost half the total jobs impact. We estimate that half the jobs generated by state fiscal relief occur in the private sector.
- Recovery Act funds also went directly to people who have spent it—there was $13 billion provided to Social Security recipients, and an equal amount to the unemployed.
- Tax cuts to businesses and to workers also flowed in the second quarter. Individuals' tax withholdings were lowered in April, and every paycheck since then reflects the Making Work Pay tax credit.

The package was designed to get money out fast and to follow up with a down payment on public investments in education, training, science, infrastructure, and renewable energy that will create jobs and provide long-term productivity benefits. Most of the infrastructure spending is only now beginning to put people back to work.

MORE NEEDS TO BE DONE

The fundamental problem in the economy today is excess capacity—both too many people unemployed and facilities that are underutilized. The solution is to increase demand. People lost wealth and income and thus cut back on spending. Businesses lost customers and thus pared back. Exports fell as the world economy declined. That vicious cycle is continuing, though at a slower pace, which is why government has to intervene.

At this point, the greatest need is to create jobs. As long as employers are creating only a single job for every six unemployed workers, consumer sentiment and unemployment will worsen, and the recession will continue.

Serious, large-scale job creation will require a five-part approach

- We need to strengthen the safety net and provide relief for those directly impacted by the recession. There is a direct boost to GDP (and therefore to employment) from unemployment compensation, COBRA continuation, and food stamps. This is probably the single most effective way to boost demand and create jobs. All of the Recovery Act provisions to improve and extend benefits to the unemployed should be renewed for another year. This Subcommittee and its Chairman should be applauded for your leadership in providing 13 additional weeks of unemployment compensation for workers in high unemployment states.
- We need to provide more fiscal relief to the states. Helping state and local governments avoid job cuts is as effective as creating new jobs. Nothing is more clearly an obstacle to recovery than another round of public employee job losses and cutbacks in state spending on goods and services contracted out to the private sector. As Paul Krugman puts it so well, we cannot afford to have the states become 50 little Herbert Hoovers, cutting back spending and raising taxes as the economy struggles to recover. With budget gaps expected to exceed $150 billion in the year ahead,

the states need federal revenue sharing as never before. Goldman-Sachs has estimated that state adjustments to their budgets will slow GDP growth by 0.6% to 0.7% over the next 12 months. This alone would cost the nation roughly 700,000 jobs. There is also an erosion of needed public services. This can and must be avoided.

- We need direct creation of public service jobs. It is time to put people to work in jobs that benefit local communities and make good use of human capital. This is a direct and cost-effective way to create jobs. Congress funded jobs for 750,000 people in communities across the nation in 1978, and a bigger program is needed now. Any unemployed worker should be eligible; the jobs should pay prevailing wages; and great care should be taken to prevent displacement of public employees. Such a program can be targeted at distressed communities and will be needed for many years to come as unemployment remains high.
- There needs to be a new job tax credit to spur job creation in both the private and nonprofit sectors. It is possible to encourage a burst of hiring by providing refundable tax credits of 10-15% of wages for each new hire over the next two years. Employers who are uncertain about the near future could overcome their doubts and reluctance to hire if offered a substantial incentive.
- More spending on infrastructure, especially school construction, maintenance, and repair. The $13 billion of Recovery Act highway and transit funds under contract have created 122,000 job months already, a number that is doubling each month. The nation's schools could quickly and effectively spend $10 billion on repairs and maintenance alone, putting to work some of the million and a half construction workers who remain jobless.

Many Members of Congress believe that the Recovery Act and the bailout of the financial sector have exhausted our ability to act or at least exhausted the public's appetite for intervention. Neither is true.

A recent poll commissioned by the Economic Policy Institute and conducted by Hart Research shows that the American people understand these needs. While they believe the Recovery Act has helped and want it continued, they also want to see more direct action to create jobs. Large majorities support a public jobs program and job creation tax credits, and a majority supports more aid to the states. The public feels that Congress has helped the banks and financial institutions and should now act boldly to help average Americans find jobs. Given a choice between deficit reduction or more spending to create jobs, voters support more job creation by a two to one margin.

As a matter of pure economics, the government's anti-recession spending so far has been less than half as large as pure Keynesian analysis calls for. University of California Berkeley Professor of Economics J. Bradford DeLong and Nobel Laureate Paul Krugman argue that we cannot afford *not* to make another large investment to accelerate GDP growth and that failure to intervene further could result in a "lost decade" of economic stagnation like Japan's in the 1990s. The long-term costs of an extended recession will far outweigh the additional interest payments on the national debt required to fund a major intervention. Some of those costs are set out in my colleague John Irons' recent report, *Economic Scarring: The Long-Term Impacts of the Recession*. The primary reason we have a large fiscal deficit at this point is that we are in a major recession. The best way to tackle the deficit is to generate more jobs and get us firmly on a path to recovery.

The Deficit Dimension

Any effort to generate jobs through fiscal policy—additional spending or reduced revenues (because of the jobs tax credit)—will necessarily raise the fiscal deficit for the next year or two. This is entirely appropriate and will not damage the economy. In fact, it will prevent the damage to future growth that occurs as a result of the recession's impact on children's learning, lost innovation, reduced investments, and so on.

A jobs package, however, can be deficit neutral or even deficit reducing over a 10 year period. I would recommend that a jobs package be coupled with the implementation of a financial transactions tax that takes effect in two years and is permanent thereafter. Such a tax would be levied on both the buyers and sellers of all financial transactions—stocks, bonds, derivatives, futures, etc. Think of it as a very small sales tax on financial transactions, somewhere between 0.1% to 0.25% of the value of the transaction. A reasonable rate could produce revenues from $100 to $150 billion dollars each year. The finance sector not only caused the recession and the need to generate jobs, but it has also helped to drive up the deficit because of the costs of the financial bailout, some of which will not be repaid. A financial transaction tax seems an entirely sensible vehicle to provide the revenues we need to support federal spending and for offsetting the costs of a current jobs package.

CONCLUSION

We face a major jobs crisis that requires immediate attention. We need to help families weather this storm and do what we can to generate jobs and a robust recovery. Thank you for allowing me to share my thoughts with you.