Policy Memorandum

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# GENERATING JOBS FOR A ROBUST RECOVERY

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The safety net—the group of programs such as unemployment insurance and food stamps that protect families from ruin when the economy fails them—is being tested by the greatest economic downturn since the Great Depression. With unemployment rapidly approaching double-digit levels, and millions of people unemployed for more than six months, 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.

This current "Great Recession" is doing serious harm to many lives. It will impoverish millions, and do massive damage to a generation of children, subjecting them to problems which are not easily overcome such as greater poverty, lack of adequate housing, difficult learning environments, and stressed parents. It is also doing damage to the country's long-term growth potential.

The Recovery Act that Congress passed earlier this year was bold and effective and, given the severe nature of the crisis, it was necessity the largest policy intervention in several generations. Recovery Act investments have clearly 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.

## STRUCTURAL PROBLEMS

Before describing the widespread pain the recession is causing, 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, which is greater than in any other advanced nation, and also at its greatest level in our nation's history.

### Unbalanced Growth

Since 1989, the bottom 90% of Americans received only about 16% of all the income growth in the U.S. economy. On the other hand, the top 1% received 56%, or three-and-a-half times as much. Even more astonishing, the upper one-tenth of that top 1%, a very small group comprised of about 13,000 households, received 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 into activities such as derivatives trading, 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 produced. Productivity, the amount produced 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 has been a huge and growing gap between productivity and pay. The gulf was greatest 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 (2000-07) was the first on record during which the typical working family was no better off at the end of the cycle than it was at the beginning, even though the overall economy expanded.

The average worker was not doing so well even before this current recession began.

## 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%. Unemployment would be above 10% already, had there not recently been an actual drop of 615,000 in the size of the labor force over the last year when normally we would expect a growth of nearly 1.5 million. The steep rise in unemployment, up 5.5 percentage points since the start of the recession, is even greater than the rise in unemployment in the deep recession of the 1980s. Moreover, the unemployment rate doesn't capture all of the people 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

The United States has lost 8.0 million jobs during the recession so far, the sharpest drop in employment of any economic downturn 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 actually need 10.7 million new jobs to get back to the 4.9% unemployment rate at the start of the recession.

### Wage Deceleration

High unemployment hurts those who have jobs as well because wages grow more slowly and furloughs, reduced hours, and losses in benefits become more common. 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

Much of the data cited so far is based on averages, but in real life, there really is no "average person" walking around on the streets. Unemployment affects different populations differently. While average unemployment was 9.8% as of

September, it was 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 worst months of the 1980s recession. College graduates have a comparatively low (4.9%) rate of unemployment, but that is the highest jobless rate on record for that group.

### Long-Term Unemployment Explodes

One of the most troubling features of 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. That 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 people unemployed.

If Congress had not acted to extend unemployment benefits to a maximum of 79 weeks in some states, 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

EPI anticipates 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. To offer some context, 8% is higher than unemployment has been for 25 years. It is an unacceptably high unemployment rate that policy makers must address. When national unemployment surpasses 10%, unemployment will be much higher for minority communities: at least 16% for blacks and over 13% for Hispanics.

When the unemployment rate surpasses 10%, underemployment will reach 18%. 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 workers 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. This will continue for a number of years.

Hardest hit will be children. High and rising unemployment will push the child poverty rate up from 18% in 2007 to 27%. For black children poverty will rise from the already unacceptable level of a third in 2007 to more than 50% in the year or two ahead.

The recession will reduce incomes for 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%, or $1,200 a year 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 lost income 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 already pumped $175 billion into the economy by the end of September and generated about 200,000 to 250,000 jobs each month since April. The fact that the job situation remains so dismal only reflects how deep a hole we

were in. Many of those who suggest the Recovery Act isn't working are the very ones who supported the anything-goes free market policies that set the stage for this long and deep downturn.

## The Deep Hole

The economic downturn is far worse than what economists predicted last November. At the time of the Presidential elections, the consensus forecast among economists was that unemployment would hit 6.9% in early 2009. But it hit 8.1% in the first quarter and reached 8.5% in March, before the ink was even dry on the recovery legislation.

## GDP Decline

The economy was headed steeply downward last winter and in early 2009. The recovery package interrupted that decline and started to create actual growth during the 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 recession has resulted in 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 an uncertain outlook. Businesses have reduced investment and employment in the face of reduced revenue and lower revenue expectations. 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 are illustrated below with data for the second quarter, the period from April through June.

- *Increased government and infrastructure spending.* $5.2 billion of stimulus spending helped generate demand for goods and services and therefore created jobs. This area of spending will be a major source of job creation next year but is not a leading source yet.
- *Aid to the states.* State relief of more than $25 billion not only limited layoffs by state and local governments, but it also limited cutbacks at companies that offer goods and services to states. These funds also had a "re-spending effect:" those who maintained employment in public-sector jobs and in supplier firms generate further job creation as they spent their salaries on services and goods. EPI estimates that half the jobs generated by state fiscal relief occur in the private sector.
- *Direct cash transfers to people.* 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, all of which supports spending that generates jobs throughout the economy.
- *Tax cuts to businesses and to workers.* 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 make public investments mostly in the second year of the program) in education, training, science, infrastructure, and renewable energy that will create jobs and provide long-term productivity benefits.

## MORE NEEDS TO BE DONE

The fundamental problem in the economy today is excess capacity. Too many people are unemployed and too many facilities are underutilized. The solution is to increase demand. People have lost vast amounts of wealth and income and cut back on spending. Businesses have lost customers and pared back. Exports fell as the world economy declined. That vicious cycle is continuing, though at a slower pace, and that is why government has to intervene. At this point, the greatest need is more jobs. As long as employers are creating only a single job for every six unemployed workers, consumer sentiment and unemployment will remain, and the recession will continue.

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

- *Strengthen the safety net and provide relief for those directly impacted by the recession.* Unemployment compensation, COBRA subsidies and food stamps all provide a direct boost to overall demand and spending and to GDP, and therefore, to employment. 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.
- *Provide more fiscal relief to the states and local governments.* Helping state and local governments avoid job cuts is as effective as creating new jobs. Widespread cutbacks in state spending and in public employee jobs have created a major obstacle to recovery. As Paul Krugman has stated, 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, and eliminate many important public services. That outcome can and must be avoided.
- *Create 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 cost-effective way to create jobs in the public and nonprofit sectors. Congress funded jobs for 750,000 people in communities across the nation in 1978, and a bigger program is needed now. The jobs should pay prevailing wages, and be designed so they do not displace existing public employees. Such a program can be targeted at distressed communities. This sort of public service jobs creation program will be needed for many years to come as unemployment remains high.
- *Pass 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 they were offered a substantial incentive.
- *Increase 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.

The recent poll, *Tracking the Recovery*, commissioned by the Economic Policy Institute and conducted by Hart Research shows that the American people understand that more needs to be done. They believe the Recovery Act has helped, but 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 and 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. These economists maintain that failure to intervene further could result in a "lost decade" of economic stagnation like Japan saw 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 the report, *Economic Scarring: The Long-Term Impacts of the Recession*, by EPI's Research and Policy Director John Irons. 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 additional spending or a jobs tax credit, will raise the fiscal deficit for the next year or two. This is entirely appropriate in the context of this Great Recession, 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, and reduced investments.

A jobs package, however, can be deficit neutral or even deficit reducing over a 10-year period, even if it raises the deficit in the next two years. One good option is a jobs package coupled with a new financial transactions tax that takes effect in two years. Such a tax would be levied on both the buyers and sellers of all financial transactions, including stocks, bonds, derivatives and futures. This would be a very small sales tax on financial transactions in the range of 0.1% to 0.25%, and could produce revenues from $100 to $150 billion dollars each year. The finance sector was not only a major contributor to the recession and the resulting loss of 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 is a sensible vehicle to generate the revenues needed to support federal spending and to offset the costs of a current jobs package.

# CONCLUSION

The country's jobs crisis requires immediate attention. We need to help families weather this storm and do what we can to generate jobs and a robust recovery.