EPI TESTIMONY

TESTIMONY GIVEN BY

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BEFORE THE JOINT ECONOMIC COMMITTEE HEARING ON

"What Should the Federal Government Do to Avoid a Recession?"

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Mr. Chairman and members of the Committee, I am Lawrence Mishel, President of the Economic Policy Institute. Thank you for this opportunity to explain why the U.S. economy needs a large economic stimulus to boost demand for goods and services and to prevent a serious and protracted loss of jobs and rising unemployment. My testimony will make three key points:

1. Because the economy, and especially the labor market, is in serious trouble, immediate intervention of sufficient size is needed to prevent a vicious cycle of job loss and reduced consumer demand and spending.
2. The right stimulus will have the biggest bang for the buck, which comes from increasing unemployment compensation, providing state fiscal relief, issuing targeted tax rebates, and direct federal spending on low-income families through such means as increases in food stamps.
3. Infrastructure spending, especially school repair and maintenance, can be done quickly and can efficiently put a million people to work. But even if it takes a year or more to employ large numbers of workers on infrastructure projects, the impact will be timely and important in counteracting rising unemployment and the kind of glacially slow job creation we saw following the 2001 recession.

The economy has been broken for some time, and the economic growth we have seen has not reached the vast majority of families. This will probably be the first business cycle where, at the end of the recovery (last full year being 2007), the typical family will have lower incomes than they did at the start of the downturn (2000, the last full year of recovery). Fixing this disconnect between growth and the pay and incomes of the vast majority of Americans requires a policy agenda on health care, retirement, labor policy, trade policy, and work/family policy that is much more substantial than what we will be talking about today. The focus today should be on offsetting the rising unemployment and the corresponding income losses that families will shortly face.

1. THE ECONOMY AND JOB CREATION NEED A BOOST

The economy is taking hits from all sides. December's declining retail sales figures show that consumers are already hurting. Housing prices declined by a record 6.7% on an annual basis, according to the most recent S&P/Case-Shiller Home Price Index, and given the record inventories of unsold homes, they are expected to fall further.[1] Home foreclosures are on the rise: the largest U.S. mortgage lender, Countrywide Financial Corp., reported that foreclosures and late payments rose to their highest levels on record in December 2007.[2] And, over the next six months, the number of adjustable rate mortgage re-sets will exceed those that occurred in all of last year.

Let me be clear that we need to keep our eyes on rising unemployment and weak job growth and not on technical issues of whether output (GDP) actually contracts. Even slow but still positive economic growth can lead to sharply rising unemployment from job losses or very modest job gains. Job growth slowed over the past year, and that weakness has shown up in the unemployment rate, which jumped to 5% in December, significantly higher than the 4.5% unemployment rate in the second quarter of 2007. A jump of this size is usually the sign of a recession, and analysts at Merrill Lynch and Goldman Sachs believe that a recession has already begun.[3] Goldman Sachs projects that the unemployment rate will reach 6.2% by the end of 2008, which will put additional downward pressure on wages and incomes, further reducing consumer demand.

If the economy is to avoid a cycle of declining consumer demand that fuels more job losses, which in turn reduce consumer demand, Congress must act quickly. If bold action isn't taken, we are likely to see a repeat of the 2001 recession and the years of jobless recovery that followed it. EPI released a plan last week, which I have submitted as an attachment, that provides $140 billion of stimulus—1% of GDP— which would begin to reverse our economic course by creating an additional 1.4 to 1.7 million jobs.

The stakes are high. In the last recession, the economy received only a mild boost from the 2001 tax legislation, primarily from a provision that provided a $300 rebate to most taxpayers. The bulk of the legislation was vastly misdirected and provided, little immediate stimulus. The consequences were a sustained rise in unemployment and no job growth until late in 2003: job growth, wages, and incomes all stagnated well beyond the "official" end of the recession.

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[1] See S&P, "Broadbased, Record Declines in Home Prices in October According to the S&P/Case-Shiller® Home Price Indices" at http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_Release_122622.pdf

[2] Reuters, "Countrywide says foreclosures highest on record" January 9, 2008, at http://www.guardian.co.uk/feedarticle?id=7211734.

[3] See BBC News, "Recession in the U.S. 'has arrived", January 8, 2008, at http://news.bbc.co.uk/2/hi/business/7176255.stm

2. UNEMPLOYMENT COMPENSATION EXTENSIONS AND STATE FISCAL RELIEF SHOULD BE THE HEART OF ANY STIMULUS STRATEGY

The Democratic leadership has announced that any intervention should be "timely, targeted, and temporary," and I agree. Targeted should mean targeted where it can be most effective as stimulus, and it is a fact that all so-called stimulus is not equal. In fact, the key to maximizing its effect is to put money into the hands of consumers who will spend it most quickly and to create jobs, breaking the cycle of job loss and falling consumer demand. The fastest, most efficient way to get an infusion of money into the economy quickly is direct government spending on people who need help.

Estimates by the U.S. Department of Labor and by Mark Zandi of Moody's Economy.com rank unemployment compensation at the top of the list of possible stimulus choices, increasing demand by $1.73 to $2.15 for each dollar. By contrast, Zandi finds that tax cuts—of all possible cuts—rank lower, and reducing the estate tax ranks lowest of all possible stimulus choices.

High "Bang-for-the-Buck" stimulus	
Extend unemployment benefits	$1.73
Provide state fiscal relief	$1.24
Enact a one-time uniform tax rebate	$1.19
Increase Child Tax Credit	$1.04
Lower "Bang-for-the-Buck" stimulus	
Adjust Alternative Minimum Tax exemption levels	$0.67
Reduce marginal tax rates	$0.59
Increase tax breaks for small business investment	$0.24
Cut taxes on dividends and capital gains	$0.09
Reduce estate tax	$0.00

Extend unemployment benefits

Along with the National Employment Law Project, the Coalition on Human Needs, National Women's Law Center, the AFL-CIO, and many unions, we strongly recommend immediate creation of a one-year emergency unemployment compensation program with 20 weeks of supplemental benefits in all states and 13 additional weeks in "high unemployment" states (those with a three-month average unemployment rate of 6.0%); a $50 per week benefit increase; and additional administrative funding. Congress should not wait for further damage to the economy before making these changes: unemployment is already 0.7 % higher today than it was when the recession began in

2001, and the percent unemployed for 27 weeks or more is higher than when the 2001 recession officially ended (17.5% vs. 13.9%). These changes would cost about $8 billion over 12 months. We also recommend federal funding for modernization of state unemployment systems, including extension of benefit eligibility to low-income workers (by using each employee's most recent work history); to workers who are only available for part-time work; and to workers who leave their jobs for compelling family reasons.

State fiscal relief

During times of recession, state budgets are hit particularly hard. Reductions in tax receipts and cyclical increases in state spending put pressure on budgets—and since most states have balanced budget requirements, they are forced to either reduce spending or increase taxes in times of decreased economic activity. These actions perversely add to economic troubles by decreasing the total demand for goods and services, and thus intensify a recession. As such, direct federal assistance to states can help prevent these outcomes and stimulate the economy. In the last recession, Congress provided $20 billion in aid to the states, split between general revenue sharing and a temporary increase in the federal match for Medicaid. The same kind of assistance should be provided to the states once again, with $30 billion split equally between a general block grant and an increase in the Medicaid match.

There is mounting evidence that states are already feeling the pinch. Twenty-four states are either facing a shortfall for fiscal year 2009 or are expecting problems in the next year or two. According to the Center on Budget and Policy Priorities, just 13 of these states face a combined $23 billion shortfall.

3. INFRASTRUCTURE REPAIRS

At a time when softening demand is leading many private-sector employers to think about cutting back, public investments that create jobs directly can create demand and help break a downward economic spiral. Managed wisely, federal investment in infrastructure can be both well-targeted and timely. America's unmet needs are enormous and growing. The state of disrepair in America's public schools, for example, is a disgrace that impedes both teaching and learning. GAO and the National Center for Education Statistics agree that deferred maintenance has created a backlog of more than $100 billion in needed repairs in U.S. public schools, and the situation worsens every year.

We recommend that Congress distribute $20 billion for school repair and maintenance through existing formulas to school districts across the country.

The benefits of this ought to be obvious. School repair and maintenance work is highly labor intensive. A $20 billion investment should create about 280,000 jobs, most of them construction jobs doing roofing, electrical wiring, carpentry, painting, and masonry that would employ many of the more than 200,000 construction workers laid off over the past year—and the thousands more who will lose their jobs in the coming months as the economy stumbles. The benefit in terms of improved learning and the safety of students and teachers as schools are brought up to safety codes is reason enough to make the investment.

Those who doubt that the money would be spent well and quickly need only look at the recent experience of New York City. In 2005, New York's schools were given $1 billion to improve school buildings as the result of a court order. Within four months the entire $1 billion was committed to projects that were completed over the next 12 months. City officials assure us that they could easily spend another $1 billion just as quickly, and a summary of the NYC schools' several billion dollars of unfunded infrastructure needs is attached to my testimony.

State and local officials in every jurisdiction we contacted, including Michigan, Illinois, New Jersey, and California, affirm that the school maintenance needs are so well known and pressing that no time will be wasted trying to figure out what to do with the funds.

The replacement and/or repair of deficient bridges or critically important sewage treatment systems can also be timely and effective as economic stimulus. Almost every economist agrees that the Federal Reserve should act to lower interest rates, but the impact of that action won't be felt for as long as a year or more. Recent experience shows that when there is the will to get working, there is a way. Work on the I-35 bridge replacement in Minneapolis began in October 2007, just 2 months after the collapse, and is scheduled to be completed at the end of this year. Similar projects begun in mid-2008 would continue throughout 2008 and early 2009, when the job creation and economic stimulus they provide would still be badly needed, if the last recession is any predictor.

There are several key advantages of infrastructure spending as part of a stimulus package. Unlike tax rebates, all of the money will be spent and none will be saved—perhaps 50% or more of a tax rebate will be saved (which does not boost demand). Another advantage is that infrastructure spending has barely any leakage to imports—all the spending boosts domestic activity. In contrast, about 10 percent of consumer spending is for imports, boosting other economies not ours. Last, an advantage of spending on infrastructure relating to schools, water, bridges, and other areas is that we need to do this anyway: we get a short-term boost to demand and a long-term boost to productivity (and well-being).

The economy failed to add a single net new job until two and a half years after the 2001 recession began. The nation must do better this time, and we recommend that a total of $40 billion be spent on infrastructure maintenance, repair, and replacement to ensure a strong recovery. These are needed investments that should be accelerated to impact the economy now, when it would make the most difference.

TAX POLICY

A final word on tax policy. Tax cuts can be an effective stimulus, but only if done on a temporary and "downscale" basis. Tax reduction should be targeted to those who are most likely to spend it immediately. Low- and moderate-income taxpayers are those who will face the most immediate budget squeeze due to the recession, and thus most likely to spend any extra money received through changes in tax policy. An effective way to add a broad-based boost to consumption in order to quickly generate economic activity and job growth is to provide an immediate, one-time, refundable rebate to anyone who has paid either payroll or income taxes for 2007.[13] A total expenditure of $65 billion would yield approximately $350 or more per individual, and $700 per married couple.[14] Basing the tax rebate on payment of either payroll tax or federal income taxes ensures that the rebate will effectively target low- and moderate-income taxpayers, many of whom do not pay federal income taxes.

Thanks you very much for allowing me to participate in this hearing. I look forward to your questions.