Prepared Testimony before the Joint Economic Committee

Hearing on "The 2016 *Economic Report of the President*"

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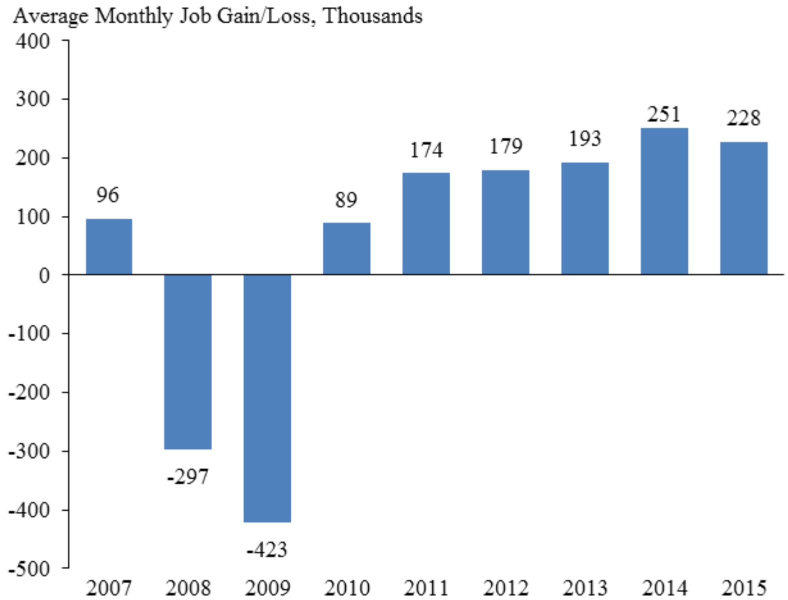
Chairman Coats, Vice Chairman Tiberi, Ranking Member Maloney, and Members of the Committee: Thank you for the opportunity to appear here today to discuss the 70th annual *Economic Report of the President*, which the Council of Economic Advisers released last week. This year's *Report* reviews the substantial progress that the U.S. economy has made in recent years, describes the headwinds posed by the global economic situation, and outlines a number of key areas to promote robust, sustainable, and shared long-run growth.

As we note in this year's *Report*, 2015 was a year of continued strength in the domestic economy despite substantial headwinds from abroad. This was particularly clear in the ongoing robust recovery in our labor markets. At the end of 2015, the United States marked the strongest two years of job growth since the 1990s (Figure 1) and the largest two-year decline in the unemployment rate since the 1980s, all while continuing the longest streak of monthly private-sector job growth on record.

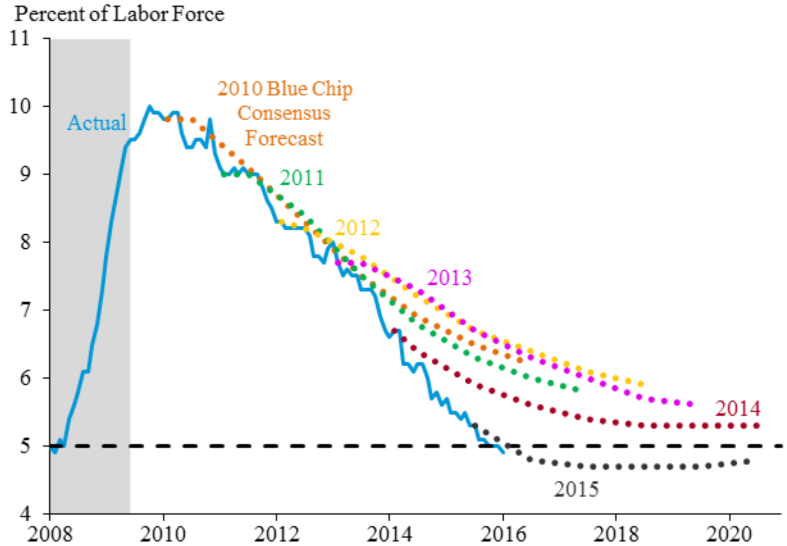
Figure 1
Average Monthly Total Nonfarm Job Growth by Year, 2007–2015



Source: Bureau of Labor Statistics, Current Employment Statistics.

As of January, the unemployment rate stood at 4.9 percent, its lowest level since February 2008. As recently as 2014, many economists expected that the unemployment rate would remain above 5.0 percent until at least 2020 (Figure 2). At the same time, the labor force participation rate was relatively stable over the past year, as improving economic conditions partially offset the drag on participation from the retirement of the Baby Boom generation. And perhaps most importantly, over the past six months, nominal hourly earnings for private-sector workers have grown at their fastest pace since the Great Recession—although more work remains to boost wages and middle-class incomes. As the labor market continues to improve, we will not need to maintain the same pace of job growth to keep unemployment low. In fact, CEA estimates the break-even rate of employment growth—the rate needed to maintain a constant unemployment rate over the next year if the labor force participation rate moves in line with demographic trends—at 78,000 jobs per month.

Figure 2
Actual and Consensus Forecast Unemployment Rate, 2008–2020



Note: Annual forecasts are current as of March of the stated year. Black dashed line represents December 2015 value (5.0 percent). Shading denotes recession.
Source: Bureau of Labor Statistics, Current Population Survey; Blue Chip Economic Indicators.

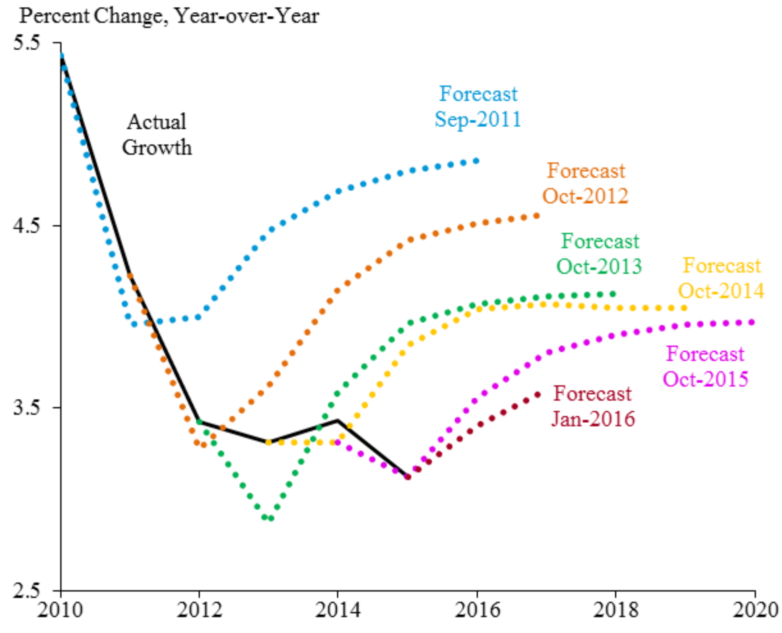
Other indicators also point to continued strength in the domestic economy in 2015. Over the past four quarters, multiple survey measures of consumer confidence reached highs not seen in over a decade. Real domestic demand grew, with personal consumption and fixed investment increasing 2.7 percent over the four quarters of 2015, bolstered by solid growth of real disposable personal income, continued potential for residential investment growth, and record-setting investment in research and development. Finally, CEA estimates that the economy saw a modest direct positive boost from the recent steep decline in oil prices, as the benefits to consumers exceeded the costs to domestic energy producers.

The United States has had the strongest productivity growth of any of the G-7 economies over the past ten years, but this growth has lagged our historic performance. As a result, while U.S. job growth has outperformed expectations, real GDP growth has failed to do so. CEA analysis, discussed in this year's *Report*, finds that a substantial portion of the slowdown in productivity growth reflects diminished investment in the wake of the Great Recession. To the extent that investment rebounds, and to the extent that the economy benefits from the rapid growth of private research and development—currently at its highest-ever level as a share of the economy—stronger productivity growth would be expected in the future. Continued monitoring of this important aspect of the economy will be important in the years ahead.

Our domestic progress is all the more notable in light of the substantial headwinds that the United States faces from the global economy. The International Monetary Fund estimates that global economic growth was 3.1 percent on a year-over-year basis in 2015, the slowest since 2009 and a continuation of downgrades to the global growth forecast (Figure 3). The United States had the highest growth rate of any major advanced economy, and growth in the euro area is estimated to have picked up slightly, but slowing growth in a number of large emerging markets weighed heavily on the global economy in 2015. On a year-over-year basis, China, for example, saw its slowest real GDP growth in decades, while both Brazil's and Russia's economies contracted sharply.

Weak growth abroad served as a drag on U.S. exports, with exports subtracting 0.1 percentage point from real GDP growth in 2015, down from a positive annual contribution of 0.5 percentage point in 2013 and 2014. This decline in exports was a key reason that U.S. GDP growth slowed to 1.9 percent during the four quarters of 2015 after growth of 2.5 percent in both 2013 and 2014. The Administration expects continued headwinds from the global economy in the year ahead, and we will continue both to monitor these developments and to engage with our key trading partners across both advanced economies and emerging markets to work to improve global growth.

Figure 3
IMF World Real GDP Growth Forecast, 2010–2020

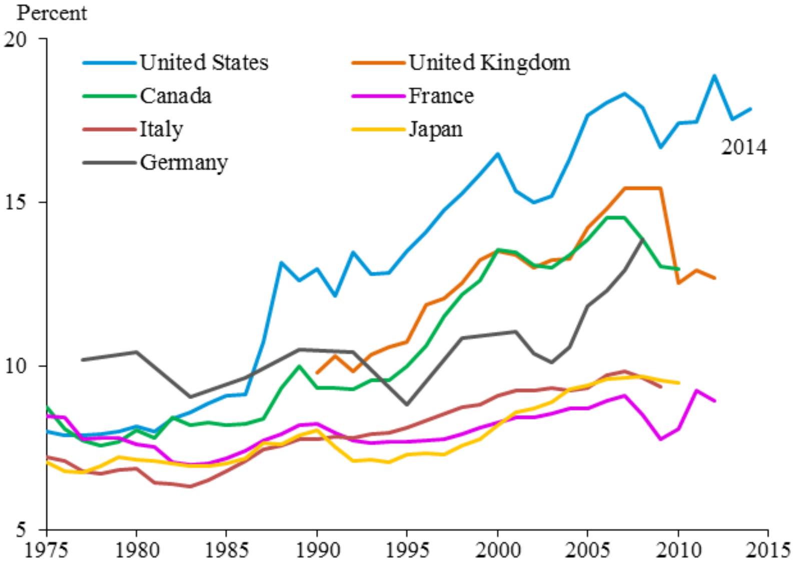


Source: International Monetary Fund (IMF).

Particularly in light of both recent global productivity data and these adverse developments in global demand, it is important that we work to strengthen domestic growth by boosting productivity and dynamism in the U.S. economy. It is also critical that we work to ensure that the benefits of economic growth are shared broadly, and, to this end, the 2016 *Economic Report of the President* lays out the President's agenda for "inclusive growth." Despite progress since the Great Recession, the highly unequal distribution of income, wealth, and opportunity remains one of the greatest challenges facing our economy. While the problem is not unique to the United

States, inequality in the United States is higher and, in recent decades, has risen faster than in other major advanced economies (Figure 4).

Figure 4
Share of Income Earned by Top 1 Percent, 1975–2014



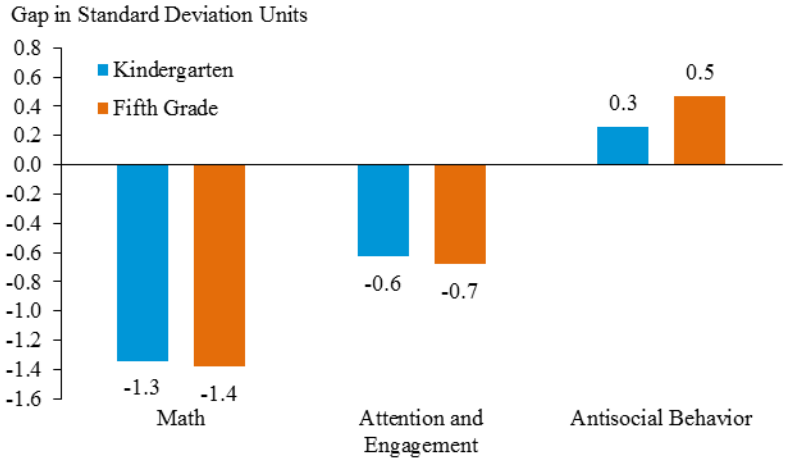
Note: Data for all countries exclude capital gains.
Source: World Wealth and Income Database (Alvaredo et al. 2015).

Some of this increase is a natural consequence of competitive markets—a result of differences in productivity as technology evolves. But some of the increase may reflect the rising influence of "economic rents," income captured by companies and workers beyond what their productivity justifies. The apparent increase in rents in recent decades and their increasingly unequal distribution have contributed to overall inequality without boosting productivity, providing opportunities to improve both efficiency *and* equity in the U.S. economy.

The President's agenda for inclusive growth addresses both sources of inequality, making competitive markets work better by increasing opportunity and by combatting the trend of rising, unequally divided rents. Competition most effectively promotes economic growth when it is open to the widest pool of talent—so the President supports promoting equality of opportunity by investing in education, supporting children in low-income families, and ensuring a fair criminal justice system. And the President supports policies to make markets more competitive by reducing overall economic rents—through promoting more open and competitive markets, balanced intellectual property rules, and a smarter approach to occupational licensing regulation, among other policies—and policies to ensure those rents are divided more fairly, by encouraging worker voice and raising the minimum wage. This agenda for inclusive growth can help ensure that the benefits of our resurgent economy are shared with all American households.

Other sections of this year's *Report* lay out additional steps we can, and should, take to ensure a strong domestic economy that benefits all Americans. One chapter focuses on disparities in opportunity that appear at an early age and the long-run benefits of investment in the education, health, and well-being of children. Comparisons show persistent, large gaps in early health and cognitive skills of young children across households of different income levels, different races and ethnicities, and different family structures (Figure 5). Research demonstrates that direct investments in children can help to close gaps in these important outcomes and can have lasting, positive effects.

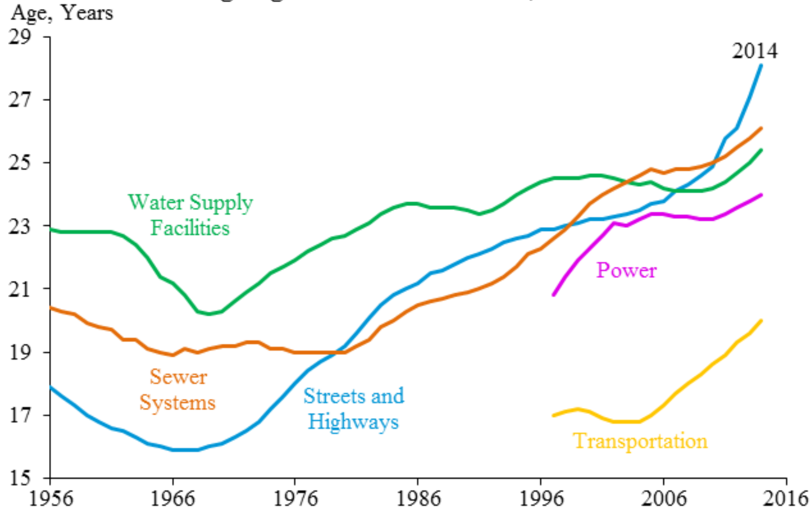
Figure 5
Cognitive and Non-Cognitive Skills SES Gaps are Mostly Established by Kindergarten



Note: SES refers to socioeconomic status. Calculations by Duncan and Magnuson (2011) based on data from the Early Childhood Longitudinal Study - Kindergarten Cohort. Kindergarten test scores were measured in 1998—1999; fifth grade test scores for the same students were measured in 2004.
Source: Duncan and Magnuson (2011).

Another chapter highlights the critical importance of infrastructure to economic growth and productivity. The quality of U.S. infrastructure has deteriorated since the mid-2000s, and the age of our public structures has increased in recent years (Figure 6). Efficient infrastructure investment boosts the productive capacity of our economy and can also protect the environment by shifting users towards cleaner forms of transportation, like public transit, and supporting the use of clean and renewable energy to reduce carbon emissions.

Figure 6
Average Age of Public Structures, 1956–2014



Note: Water supply facilities and sewer systems exclude Federal structures—which account for at most 6 percent of the value of their combined capital stock—because disaggregated Federal data are unavailable. Data for power and transportation fixed assets begin in 1997 because disaggregated data are unavailable for years prior to 1997.
Source: Bureau of Economic Analysis.

The *Report* also discusses a variety of developments in innovation, with attention to recent technological changes and their implications for productivity growth and for American workers. On the occasion of CEA's 70th anniversary, this year's *Report* also takes a look back at several key moments in the Council's seven-decade history and reviews CEA's role in economic policymaking across twelve Administrations.

I look forward to discussing these and other topics with you all today.