Written testimony to the Joint Economic Committee for hearing titled "Building a Strong Foundation: Investments Today for a Competitive Tomorrow".

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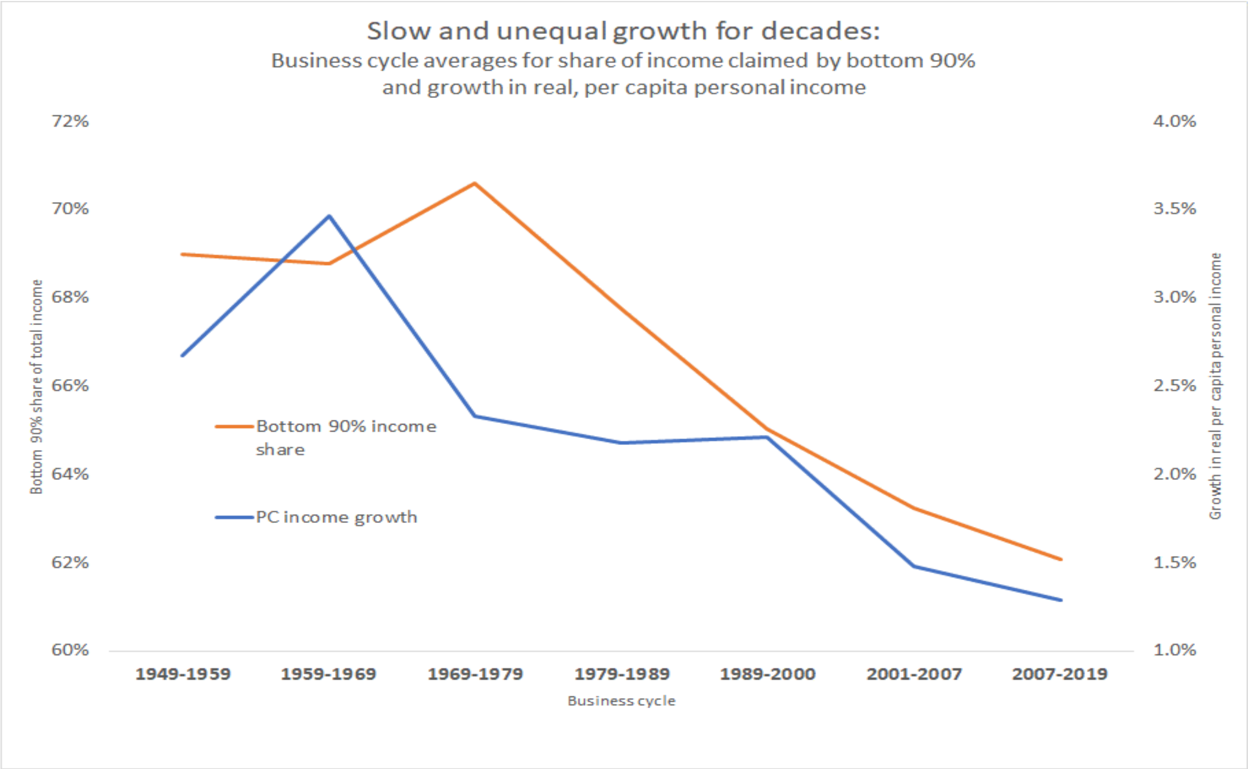
Chairman Beyer, Vice-chair Heinrich, Ranking Member Lee, and all members of the committee, thank you for the opportunity to testify today on "Building on a Strong Foundation: Investments Today for a More Competitive Tomorrow". My name is Josh Bivens and I am the research director of the Economic Policy Institute (EPI) in Washington, D.C. EPI conducts research and analysis on the economic status of working America, proposes public policies that protect and improve the economic conditions of low- and middle-wage workers, and assesses policies with respect to how well they further those goals. Today I will discuss the importance of public investments for delivering better economic outcomes and greater security for these low- and middle-income families. My main points are:

- Before the pandemic struck, economic growth in the United States was too-slow and too-unequal for decades. This was largely due to a series of intentional policy choices that shifted bargaining power away from workers and towards capital-owners and corporate managers, and which ramped-down crucial public investments.
- Because the fiscal policy response to the pandemic recession was far more ambitious this time than during past economic crises, the recovery has been far stronger.
- However, stabilizing the economy quickly after a shock is just a necessary, not a sufficient, condition for reversing the slow and unequal growth of recent decades. A full reorientation of policy to significantly boost incomes and economic security for the vast majority requires continued public investments in both infrastructure and people.
- Blocking these investments in the name of fighting the recent rise in inflation makes no sense from either an economic or a policy perspective.
    - Fighting inflationary surges by throttling back demand growth is not a job that Congress is nimble-enough to do. That's why the Federal Reserve is the nation's first line of defense against inflationary surges.
    - Most recently proposed public investment packages are not fiscal stimulus. The spending is spread out over a long period of time and is fully paid-for. These investments will hence not be inflationary.
    - The evidence linking the inflation of 2021 and early 2022 to "overheating" caused by too-generous fiscal relief passed in early 2021 is exceedingly weak.
- Going forward, both the fiscal response to the COVID-19 shock and further federal investments will make future inflationary outbreaks like we've seen in the past year far less likely. The past year's inflation has its roots in past policy failures – most conspicuously the failure to invest enough both in fighting recessions with proper force and in building up the nation's full productive capacity.

Growth was too-slow and too-unequal in the pre-pandemic period

By now, most know about the rapid rise in inequality in the U.S. economy that occurred after 1979. What they might know less about is how tightly linked this rise in inequality is to slowing *overall* growth. **Figure A** charts the share of income claimed by the bottom 90% of households in the United States and growth in real (inflation-adjusted) per capita personal income. It shows the average of both measures over full business cycles to show structural trends. The upshot of this should be clear – economic growth in the U.S. before the pandemic hit was already too-slow and too-unequal.

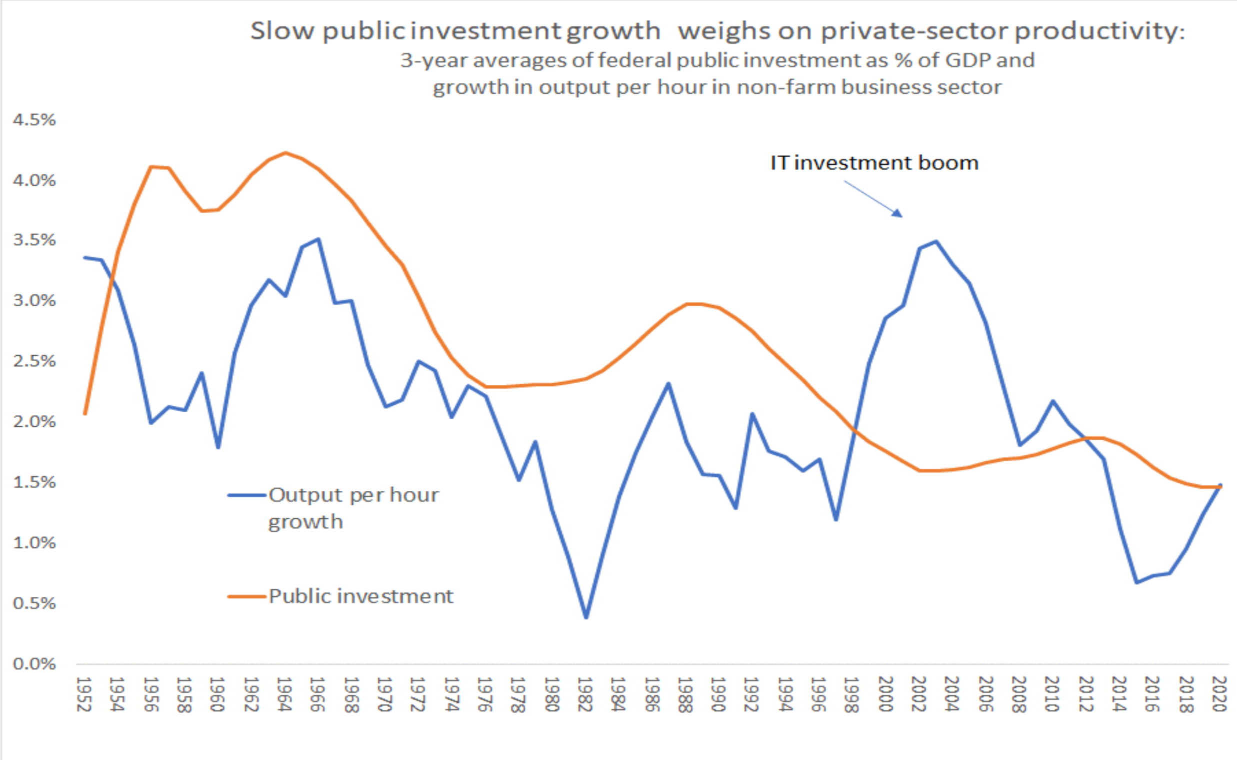
Figure A



Note: Data on growth in real per capita personal income from the National Income and Product Accounts (NIPA) of the Bureau of Economic Analysis (BEA). Data on bottom 90% income share from the Distributional National Accounts data maintained by Gabriel Zucman at: https://gabriel-zucman.eu/usdina/

Both the rise in inequality and the slowing of growth have complicated and multi-faceted causes. But part of the slowdown of overall growth can be linked to a steady and significant decline in federal public investment. **Figure B** shows this federal investment as a share of gross domestic product (GDP) and the growth rate of productivity (or real output produced in an hour of work) in the non-farm business sector. Public investment has declined steadily since the 1970s, and its decline is associated with declining productivity growth. The one period that saw a productivity surge without an increase in public investment is the late 1990s and early 2000s. But this surge is easy to explain and unlikely to be replicated: it resulted from a very large investment effort to hook the nation's business sector to the Internet, with investments in information and communications technologies (ICT) rising by more than 40% in some years. Once this big push was accomplished, productivity growth drifted back down to its post-1979 norm (and even below for a time).

Figure B



Note: Data on public investment from the BEA Fixed Assets program. Data on output per hour in the non-farm business sector from the Bureau of Labor Statistics major sector productivity and costs program, accessed through FRED from the Federal Reserve Bank of St. Louis.

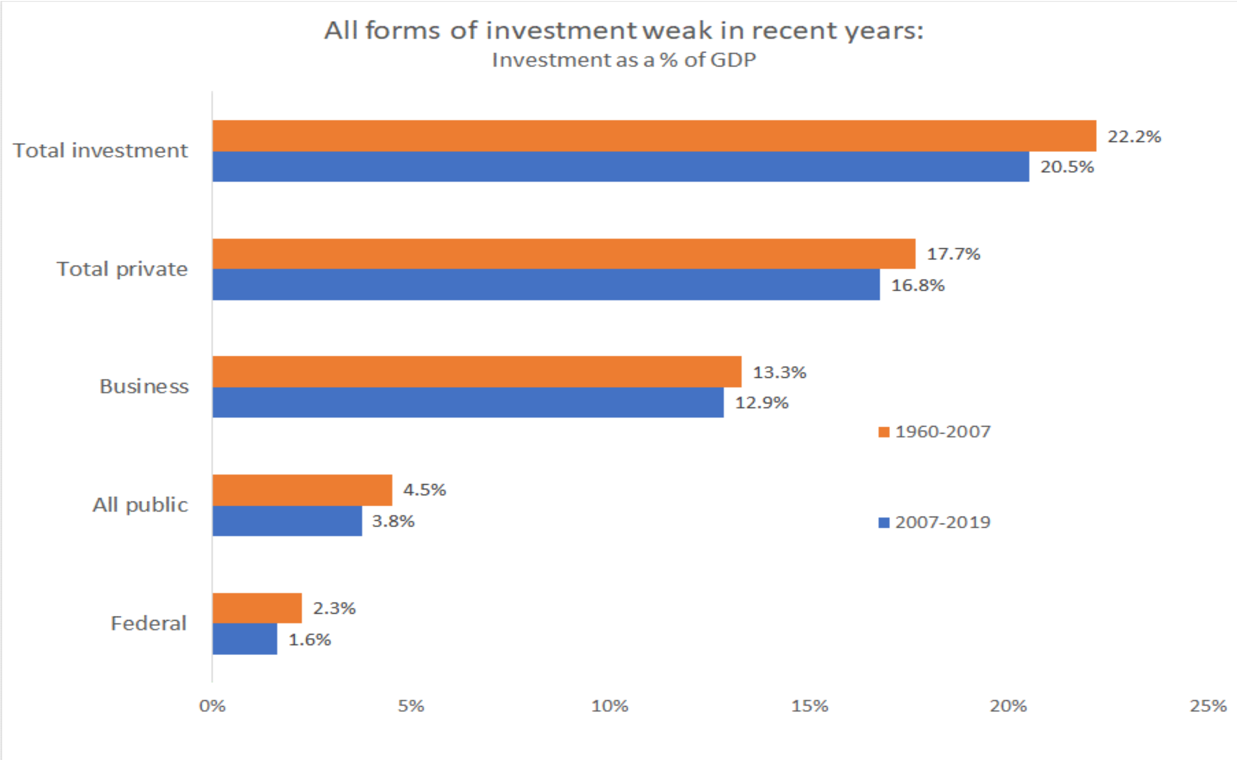
The association in the figure is supported by more-detailed econometric studies, which find the contribution to economic growth stemming from public capital to rival or exceed the contributions made by private capital.[1] This is particularly important because *all* forms of investment (both private and public) have faltered badly in the past 15 years. **Figure C** below shows the average of investment as a share of total GDP by various types between 1960 and 2007 (1960 is the first year that disaggregated data is available) and over the 2007-2019 business cycle. Overall, investment is down by 1.7% of GDP in the latter period, and private and public investment each contributes almost exactly half to this shortfall.[2] Both sides – public and private – should be addressed by policymakers. But, while there are some policy tools available to induce private businesses to invest more, the most direct way for policymakers to reliably the nation's capital stock is simply to undertake a greater scale of public investments. [3]

[1] See Bivens, Josh (2019) "The potential macroeconomic benefits of investing in infrastructure", Economic Policy Institute for a review of much of this evidence. The average output elasticity of output with respect to public capital identified in that review rivals what is generally identified as the elasticity of output with respect to private capital. Vollrath (2021) "The elasticity of aggregate output with respect to capital and labor", for example, finds that including public capital increases estimates of this elasticity.

[2] Just to be clear – 1.7% of GDP is a large number. In dollar terms it is roughly $400 *billion*.

[3] The weakest tools to boost investment are tax cuts and broad-based assaults on federal regulations. On the weakness of corporate income tax cuts as a measure to boost investment, see Brun, Gonzalez, and Montecino (2022), "The aggregate and distributional consequences of capital taxation". On the weakness of regulatory rollback as a strategy for boosting investment, see Eberly, Janice (2011), "Is regulatory uncertainty holding back

Figure C



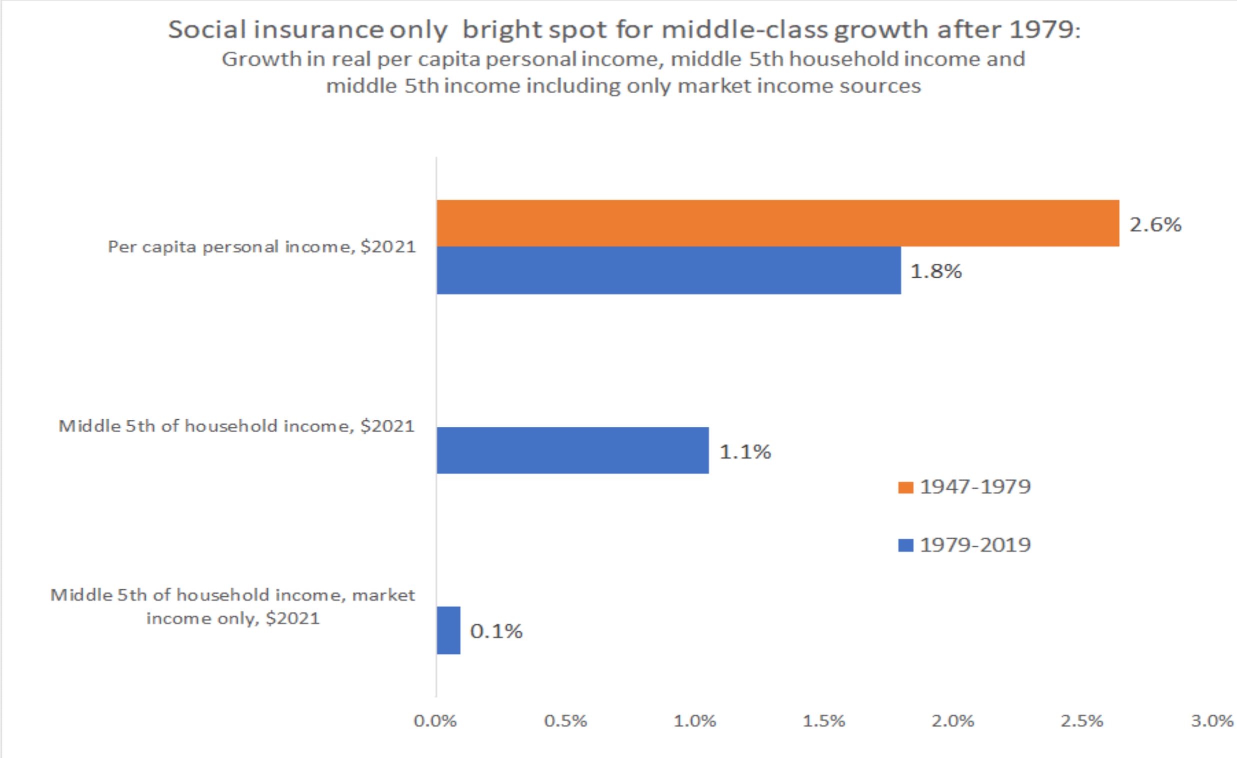
Note: Data from BEA NIPA table 5.1

Some of the legacies of past ambitious efforts to boost federal investments in families' economic security – like Social Security, Medicare, and Medicaid – were some of the only bright spots for boosting income growth broadly in the post-1979 period. **Figure D** shows growth in overall real per capita personal income, growth in income for households in the middle 20% of the income distribution, and growth for these households in market-based incomes only. The top two bars again highlight the rapid decline of growth in overall personal incomes since 1979. The next two bars highlight that growth for the middle-fifth of households lagged far behind this overall growth – the definition of rising inequality. Perhaps most strikingly, if families in the middle-fifth only had market-based incomes to rely on over this time-period, then their incomes would have been essentially stagnant (growing at just 0.1% annually).[4]

job-growth". An underrated strong tool for boosting business investment is consistently running high-pressure labor markets to induce businesses to invest in labor cost-saving measures. See Bivens, Josh (2017), "A 'high-pressure' economy can help boost productivity and provide more 'room to run' for the recovery". A range of measures like direct regulation or market-based measures to price the emissions of greenhouse gases or subsidies to induce the purchase of energy-efficient goods and services could likely go a long way to inducing private-sector investment in these areas.

[4] "Market-based" incomes essentially include wages and salaries, dividends, rental payments and other private income flows, but exclude transfer payments from government like Social Security, Medicare, Medicaid, unemployment insurance or other social insurance or means-tested transfers.

Figure D



Note: Data on real growth in per capital personal income from the BEA NIPA data. Data on growth in middle-fifth household incomes (market and post-tax/transfer) from the Congressional Budget Office data on the distribution of household income, maintained here: https://www.cbo.gov/publication/57061

Recovery from the COVID-19 economic crisis has been far more rapid

In 2007, the last year before the Great Recession, the unemployment rate hit a business cycle low of 4.3%. It did not re-attain this level until a full decade later, in 2017. This is 10 years in the careers of U.S. workers that were hamstrung by the failure of policymakers to take effective measures to push the economy closer to full employment.

The most-glaring failure was excessively austere fiscal policy. Had public spending following the Great Recession followed the same trajectory it undertook in the early 1980s recovery, for example, the 4.3% unemployment of 2007 would have been re-attained at least *four years earlier*.[5] In short, just matching previous performance would've cut the time in half when U.S. workers had their livelihoods hampered by a weak economy.

Following the COVID-19 economic crisis, fiscal policy was made far more supportive of recovery. The fruits of this different approach can be seen in **Figure E**, which shows the trajectory of economy-wide employment over the course of the Great Recession, the COVID-19 recession, and associated recoveries. After the much-larger fall during the COVID-19 recession, the upward slope of employment in the recovery is far steeper following the COVID-19 shock. This much

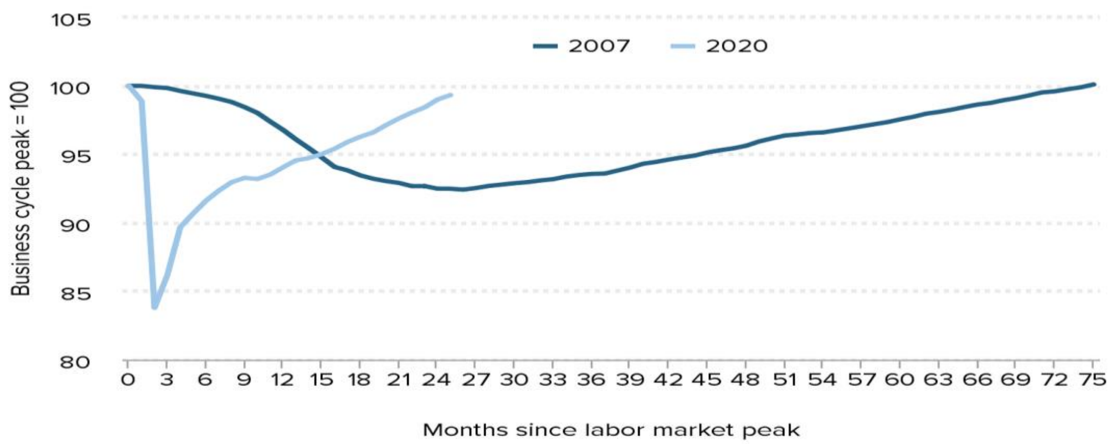
[5] For documentation of the role of fiscal austerity in prolonging elevated unemployment, see Bivens, Josh (2016), "Why is recovery taking so long – and who is to blame?".

more-rapid recovery is not accident, it is due directly to fiscal policy being *far* more supportive of recovery efforts this time around. [6]

Figure E

Federal fiscal relief at the scale of the problem led to a faster recovery from the pandemic recession

Private-sector employment change since business cycle peak, December 2007 and February 2020



Source: EPI analysis of Bureau of Labor Statistics' Current Employment Statistics public data series.

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Continued public investment is needed – and inflation is no reason to block it
The more-rapid pace of recovery documented in **Figure E** above is a huge policy victory. Allowing labor market damage inflicted by recessions to fester for years without pushing the economy quickly back to full employment has been a key contributor to all sorts of economic dysfunction in recent decades. To take just one example, in a recent study we undertook to identify the policy levers contributing to the anemic pace of wage growth for the large majority of U.S. workers in recent decades, the single biggest contributor was the failure to consistently maintain tight labor markets with low unemployment and plentiful job opportunities. [7]

But stabilizing the economy much more-quickly after an adverse shock is just a necessary, not a sufficient, condition for reversing the slow and unequal growth we highlighted before. Given the contribution that strong public investments make to overall growth (**Figure B**) and to the ensuring the fruits of growth are shared more equitably (**Figure D**), they need to be a key part of how the nation doesn't just emerge from the pandemic recession, but emerges with a stronger and fairer economy going forward.

[6] The job-creation advantage of the current recovery is even more pronounced if one focuses solely on private-sector employment, as public employment has suffered disproportionately during the COVID-19 economic crisis.
[7] See Bivens, Josh and Lawrence Mishel (2021), "Identifying the levers generating wage suppression and wage inequality".

Some have argued that the burst in inflation in the past year argues against the desirability of making such investments. This argument makes no economic sense and deeply misunderstands the proper division of labor among macroeconomic policymakers.

Fiscal policy is a weak and unreliable tool for restraining inflation

That main reason Congress should not see itself as responsible for dampening outbreaks of inflation is that they are just poorly equipped to do it institutionally. Put simply, fiscal policy is nowhere near nimble-enough to respond to relatively sudden bursts in inflation. By the time Congress recognizes the burst, debates the proper response, compromises on a bill, navigates its signing by the President, and then sees the policy effects hit the economy, the inflationary shock is likely to be past and the policy might well restrain growth just as the economy is already slowing. These considerable lags are a key reason why the Federal Reserve is given the primary job of restraining inflation through throttling back on demand growth if that's what's needed to fight inflation (whether or not that *is* currently needed is debateable – which I'll say a bit more about below).

Given that the excessively austere fiscal policy following the Great Recession has just been noted, it's also worth noting a deep inconsistency in how too many in Congress see their role in macroeconomic stabilization now versus then. There is no advantage that Congress has over the Federal Reserve in *restraining* demand growth to tamp down inflationary pressures. But, there actually *was* a large advantage that Congress had over the Federal Reserve in boosting demand and spurring faster recovery from the Great Recession: the Fed's main policy tool was ineffective during that time. The Fed generally cuts interest rates to spur faster recovery, but, by 2008 the interest rate they directly control had already hit zero and could not be cut any further.

This collision with the "zero lower bound" on interest rates argued strongly that fiscal policymakers should have stepped in to help pull the economy out of its depressed state.[8] A key indicator that such strong fiscal medicine was needed was inflation that was far below the Fed's preferred target - a shortfall that essentially lasted a full decade. Yet during the time when fiscal policy really could have helped solve a pressing problem of macroeconomic stabilization, was there a groundswell in Congress to weigh in then and restore the inflation rate to its proper target? There was not.

Failing to act *then*, and yet demanding action *now* to restore inflation to its proper rate is the kind of policy asymmetry that has harmed the U.S. economy for decades. For some reason, a surge of inflation above its target is seen as a spur to Congressional action – even when their tools for addressing it are weak and unreliable and the Fed's tools are strong. And yet a period of extended and damaging excess unemployment was not such a spur – even when fiscal policy tools for addressing it were strong and reliable and the Fed's tools were weak.

Investments being debated today are not stimulus and will not be inflationary

Since the passage of the American Rescue Plan (ARP) in early 2021, subsequent proposals for increased federal investments have drawn criticism for potentially adding to the "overheating" of the economy and putting upward pressure on inflation. But, proposals since ARP – whether

[8] For the technical argument why more-expansionary fiscal policy would have been extraordinarily helpful during that time, see DeLong, Brad and Lawrence Summers (2012), "Fiscal policy in a depressed economy".

passed (like the Infrastructure and Investment Jobs Act (IIJA)) or still under debate – are quite unlike the ARP and hence would be extremely unlikely to spur inflationary pressures.
Most importantly, the ARP really was meant to be fiscal stimulus – it was intentionally designed (appropriately so, at the time) to be extremely front-loaded in how quickly the money was disbursed. Of the $1.9 trillion overall cost of ARP in the 10-year budget window, more than 70% was disbursed in the first year. For IIJA, less than 10% will be disbursed in the first year. And even the now-stalled Build Back Better proposals saw just over 5% of the total 10-year budget window spending set to hit the economy in the first year. Again, these post-ARP proposals have not been aimed at providing fiscal *stimulus*, but at providing steady and long-lived public investments.

Equally as important, many of these proposals include substantial revenue provisions that would make them either deficit-neutral or even deficit-reducing.[9] Many of these revenue provisions are good policy in and of themselves, and they would also ensure that the near-term stimulative effect of the overall public investment plans was not inflationary.

In essence, current proposals that are long-lasting and paid-for would solve pressing social problems (like slow and unequal growth) by slightly increasing the public sector footprint in the U.S. economy. But there is no relation at all between measures of the simple size of the public sector and inflation. **Figure F** below, for example, shows that recent inflation accelerations have if anything been smaller in countries with a larger public sector. This figure also highlights how limited the size of the public sector in the United States is relative to advanced country peers. In 26 countries with comparable inflation data to the U.S., only Lithuania, Switzerland, and Ireland have smaller shares of general government spending in the economy (and the Irish measure is likely quite non-comparable[10]).

Evidence linking recent inflation to too-generous COVID-19 fiscal relief is weak
Despite the huge quantitative and qualitative differences between the ARP and subsequent proposals for public investment, many continue to insist that the ARP is the root cause of recent inflation and hence any further fiscal policy interventions should be blocked in the name of reining in this inflation. These arguments rest on extraordinarily flimsy evidentiary grounds.
For one, across countries there is no significant correlation at all between the size of fiscal policy responses to COVID-19 and the inflation of acceleration in the past year. As shown below in **Figure G**, if anything the correlation is negative, but it's essentially trivial either way.

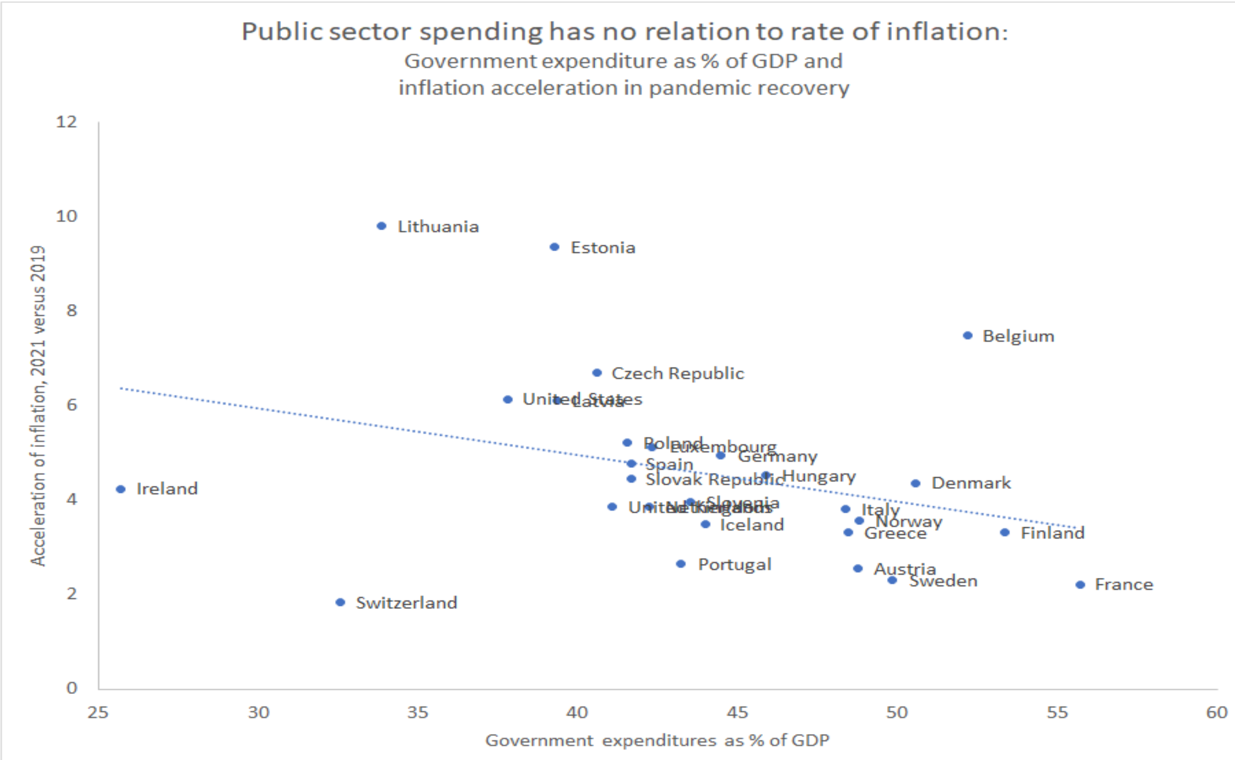
There is, however, suggestive evidence consistent with a hypothesis that it is not fiscal stimulus driving inflation, but is instead simply the persistence of COVID-19 related economic distortions. In the same 26 countries examined in **Figures F** and **G**, the acceleration of inflation in 2021 is

[9] For an excellent overview of many of these revenue proposals, see Chye-Ching Huang's testimony before this committee in October 2021, "Written Testimony for Hearing, "Building Back Better: Raising Revenue to Invest in Shared Prosperity""

[10] The extraordinarily large presence of foreign multinationals (particularly pharmaceutical and tech companies domiciled there largely for reasons of tax evasion) in Ireland boost their gross *domestic* product substantially over gross *national* product. But because an extraordinarily large share of the income generated by these multinationals is repatriated each year to shareholders, it provides little benefit to Irish residents, and hence GNP is likely a better measure of Irish welfare than GDP, unlike for many other countries.

faster (6.3%) in countries with above-average cumulative COVID-19 cases over that time than in countries with below-average cases (where the inflation acceleration has been 4.6%).[11]

Figure F



Note: Data on inflation is the harmonized consumer price index data from the Organization for Economic Cooperation and Development (OECD). To measure recent inflation acceleration, we subtract the percent growth in prices from December 2018 to December 2019 from (annualized) percent growth between December 2020 and February 2022. Data on general government expenditures as a share of GDP from the stats.oecd.org database.

Finally, we should note that the larger hypothesis that recent inflation has been driven clearly by macroeconomic overheating (whether spurred by the ARP or not) lacks crucial evidence as well. For example, the main channel through which economic overheating is generally thought to drive inflation is through wage growth that matches (or even exceeds) the sum of inflation and economy-wide productivity, leading to wage-price spirals. Over the past 40 years, the evidence is unambiguous that tighter labor markets lead generally to real wage *increases*, not losses, and other strong evidence indicates that the labor share of income should rise when labor markets tighten. This pattern is the opposite of what we have seen so far in the current recovery.[12]

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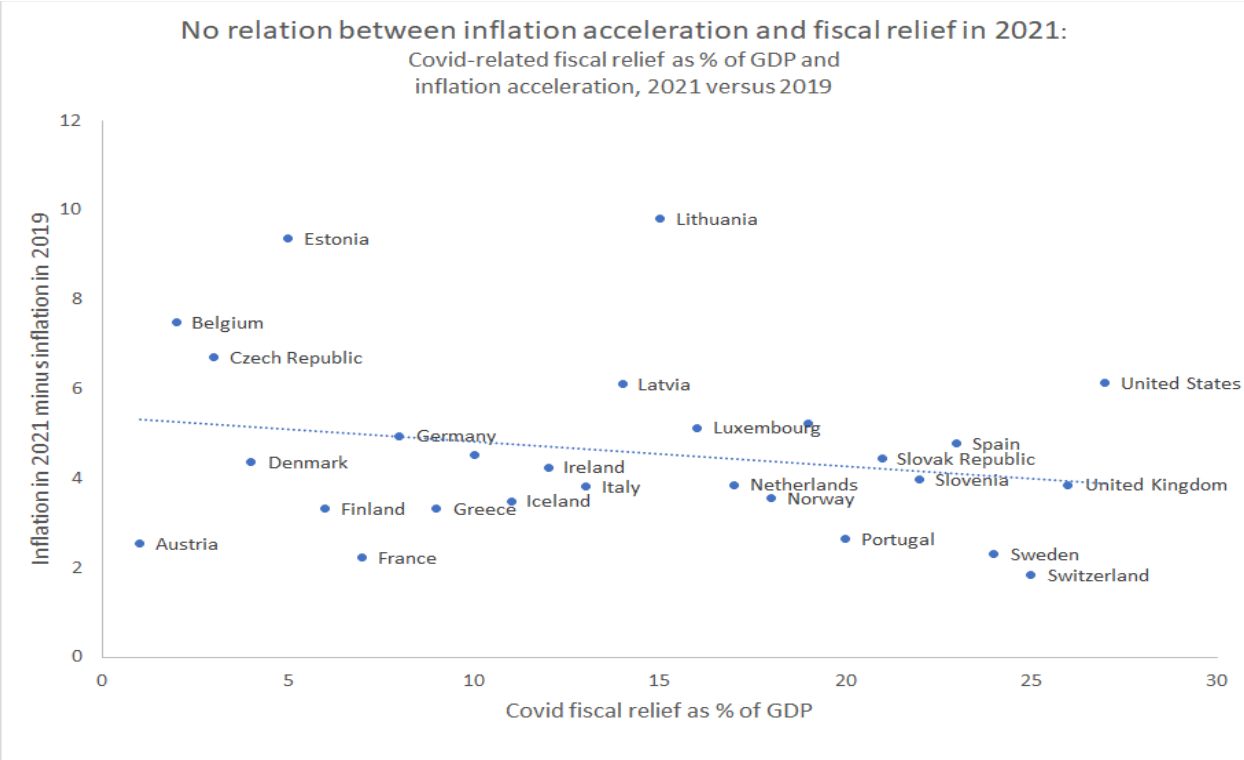
[11] For the economic channels running from the pandemic distortions to a burst of inflation beginning in 2021, see Bivens, Josh (2022) "Inflation and the policy response in 2022".
[12] For longer versions of this argument, see Bivens, Josh "Corporate profits have contributed disproportionately to inflation: how should policymakers respond?" and Baker, Dean "If wage growth is driving inflation, why is workers' share of income falling?"

Figure G



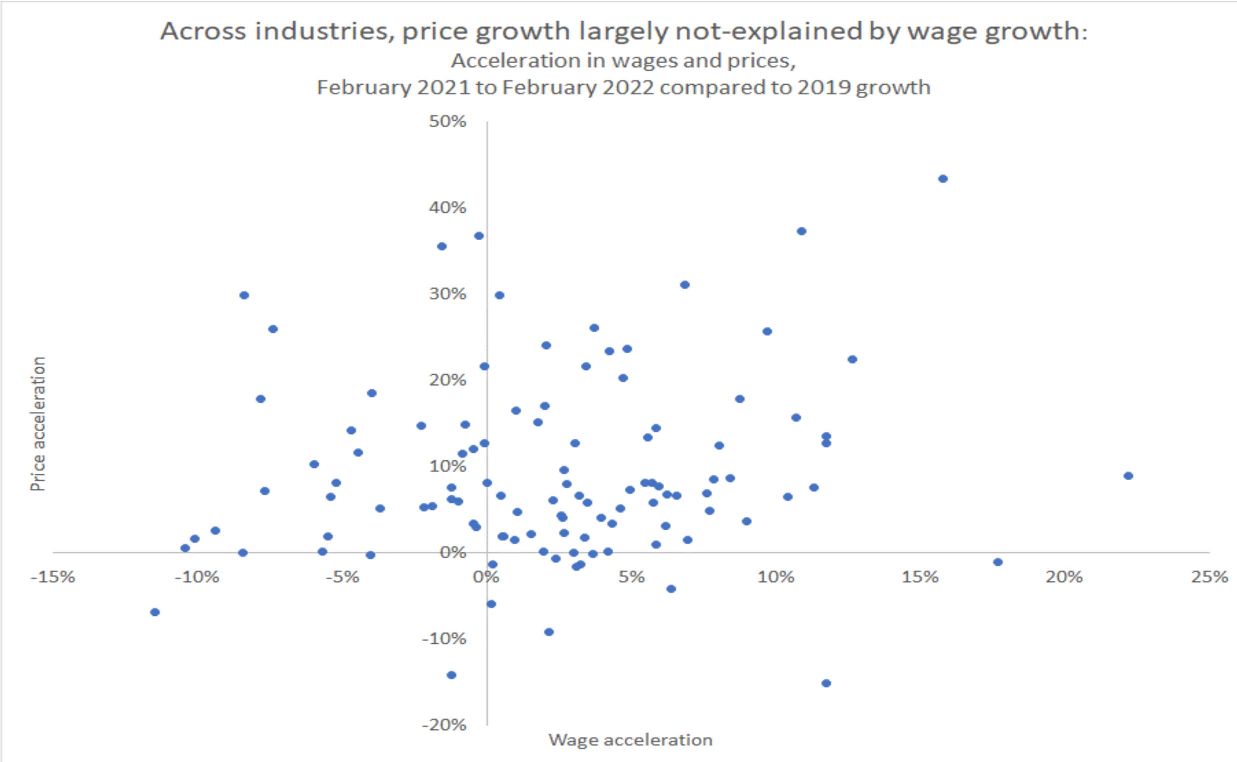
Data on inflation is the harmonized consumer price index data from the OECD. To measure recent inflation acceleration, we subtract the percent growth in prices from December 2018 to December 2019 from (annualized) percent growth between December 2020 and February 2022. Fiscal relief in response to Covid-19 from the International Monetary Fund Database of Fiscal Policy Responses to COVID-19, maintained at: https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19

Price growth in the current recovery has not been driven by excess wage growth stemming from an overheated labor market, but has instead been driven by a hugely disproportionate contribution of corporate profits to costs. So long as growth in nominal wages falls short of price inflation plus productivity growth, then labor costs actually are dampening, not amplifying, inflationary pressures.[13]

One way to see this lack of inflationary pressure coming from the labor market is to compare price growth and wage growth across detailed industries. **Figure H** below highlights the very loose correlation between these measures through February 2022. Industries with exceptionally rapid price growth are not those with rapid wage growth and vice-versa. Until the vicious cycle begins where wage growth begets price growth which begets further wage growth, evidence that the economy has overheated due to a macroeconomic mismatch of supply and demand seems quite weak.

[13] For a fuller explanation of the relationship between nominal wage growth and inflation, see Bivens, Josh "A vital dashboard indicator for monetary policy: Nominal wage targets".

Figure H



Data on industry-level price inflation from the BLS Producer Price Index (PPI) program. Data on industry-level wage growth from the Current Employment Statistics (CES) payroll survey. For both measures, percent growth from December 2018 to December 2019 is subtracted from percent growth from February 2021 to February 2022.

Conclusion

Before the pandemic hit, the U.S. economy generated growth that was too-slow and too-unequal. Both of these problems were the result of intentional policy decisions that disempowered U.S. workers and invested too little in public goods and the economic security of typical families. This same disinvestment also left the nation's infrastructure poorly prepared to absorb a large but temporary increase in durable goods demand without mammoth supply-chain failures. Further, past failures to effectively fight recessions and restore full employment quickly left U.S. employers convinced that customers would be scarce but workers abundant in the first few years following any recession. Given this expectation, these same employers have been caught completely flat-footed by a strong recovery where customers are abundant but workers scarce.

These problems call out for serious fixes, and a new program of public investment that helps make growth faster, more equal, and more resilient to shocks is one such serious fix. If we define the pressing economic problems facing U.S. families today as only restoring inflation to more-familiar levels in the coming year, we will be setting the bar for success far too low and will simply repeat the policy mistakes of recent decades.