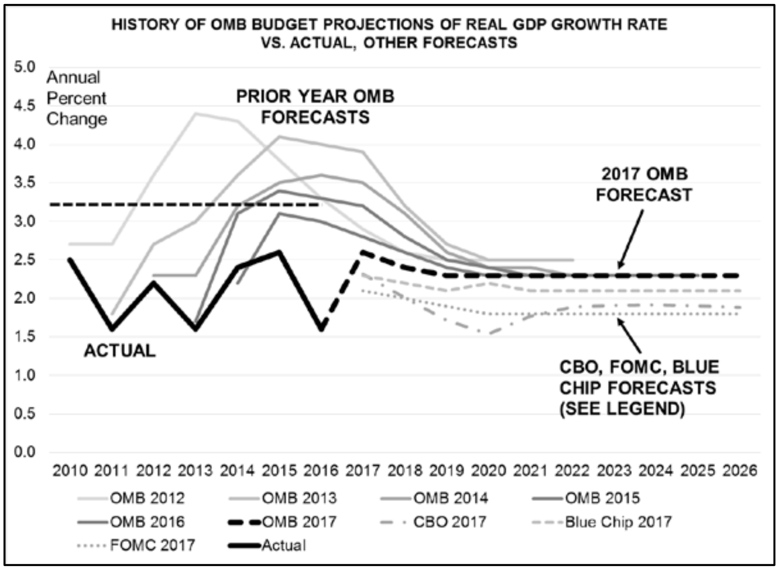
CHAIRMAN'S VIEWS

The Obama Administration's final *Economic Report of the President and the Annual Report of the Council of Economic Advisers* (*Report*) continues the pattern of previous reports that have misdiagnosed the reasons for our slow economic recovery and advocated misguided policies as a response. These policies have led to a steady decline in America's economic potential. The Joint Economic Committee (JEC) Majority offers a different vision that will unleash our economy's capacity to grow, produce, create jobs, boost wages, and compete in the 21st century.

No Resurgence from the Recession

The economy never surged back from the last recession despite the Obama Administration's repeated promises. Since the beginning, the Administration predicted again and again that its policies would accelerate economic and job growth. As each year passed without a growth surge, it postponed the projected timing and tempered its outlook but did not give up on predicting a surge until its final forecast in 2016. That forecast projected virtually flat annual growth of real Gross Domestic Product (GDP) for the next ten years, far below the postwar average of 3.2 percent (the straight dotted line on the left side of Figure 1).

Figure 1



A low unemployment rate does not mean that if more jobs were available there would not be workers to fill them, nor does a long string of job gains by itself imply anything about potential employment or hours worked. The lower line of Figure 2, representing employment gains in proportion to population size since the end of the last recession captures how weak the jobs recovery is that the Trump Administration is inheriting from the Obama Administration and that many people who could work do not have a job (see Chapter 2 for a detailed discussion). In contrast, the upper line in Figure 2 shows the proportional employment gains during the Reagan recovery from the country's previous severe recession.

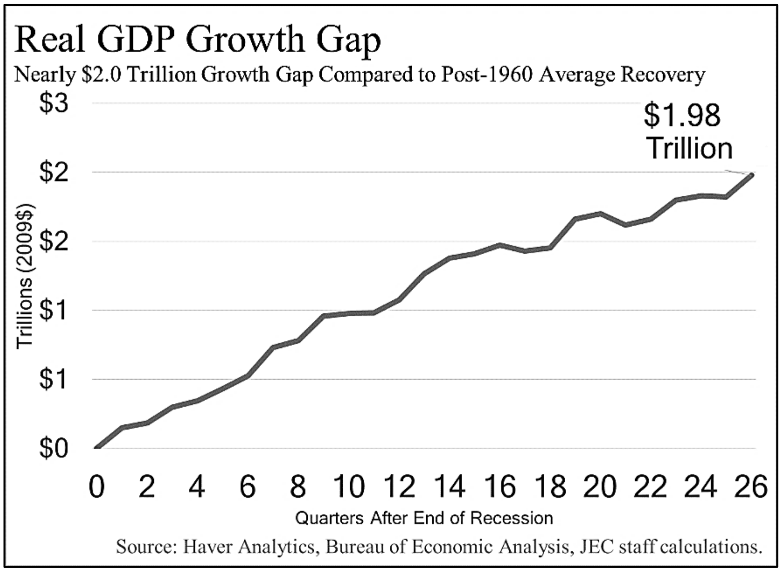
Figure 2

EMPLOYMENT-TO-POPULATION RATIOS

Source: "Economics One," a blog by John B. Taylor, "Economic Exasperation," April 8, 2016.

The Committee Majority has documented the large shortfall in jobs and GDP through the recovery, most comprehensively in its JEC *Response* to the Obama Administration's 2014 *Report*. The GDP gap relative to the average of other postwar recoveries was $1.5 trillion at the time. The JEC *Response* of 2016 reported a gap of $1.98 trillion in 2009 dollars (see Figure 3),[1] but this recovery has taken so long that ongoing comparisons to the past lose some meaning because prior recoveries had growth surges that ebbed as the economy returned to potential.

Figure 3



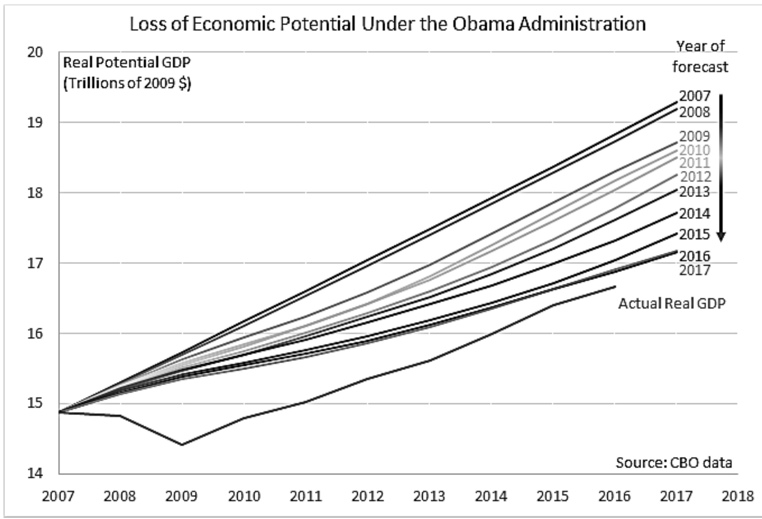
With each disappointing year of the Obama Administration, its excuses continued: the recession was worse than expected, its financial origins held back the recovery, other countries were recovering too slowly, the population is aging, and secular stagnation has set in. But the excuses did not raise anything new or unforeseen. For example, in January 2009, the incoming Administration released its first projection of a vigorous rebound resulting from its stimulus package when the unemployment rate was 7.8 percent and rising rapidly, and it was obvious at the time that a severe financial crisis had just occurred.[2] The impending retirement of baby boomers also was no surprise. Additionally, economic recoveries usually are slower in other major countries than in the United States, and "secular stagnation" is merely a label applied to speculative theories of why an economy may fail to grow.[3]

From the outset, the Obama Administration overestimated and oversold its policies and never admitted it.[4]

Constrained Potential

The failure to surge back has left the economy below its potential output. CBO has repeatedly delayed the projected return of the economy to potential even as it has repeatedly lowered its estimate of what that potential output could be (see Figure 4).[5]

Figure 4
POTENTIAL GDP



Slack in the economy is also the reason why seven-and-a-half years after the recession ended the Federal Reserve (Fed) is still holding the Federal funds rate close to zero and maintains an enormous balance sheet nearly four times the pre-crisis size. This extraordinary monetary policy risks asset bubbles among other distorting effects, and several Federal Open Market Committee (FOMC) members have wanted to retreat from it for a long time. The Fed vice chair had signaled four rate increases in 2016, but due to economic weakness, there was only one 0.25 percentage point increase implemented at the end of the year.[6]

The lackluster recovery and the diminished economic potential have real consequences. Only 5.5 million more people are gainfully employed compared with the pre-recession peak in November 2007, while the U.S. working age population has increased by 21 million since then. The ranks of the long-term unemployed swelled, millions of working age people no longer even bother to look for work, and many people are working part-time because they cannot find full-time jobs.

Among the long-term consequences are slow wage growth and heightened fiscal pressures from accumulating public debt. Large and expanding debt is driven by growing mandatory spending programs and Federal revenues that are lower than they could be due to slow economic growth.

The Obama Administration's Perspective

The *Report* recognizes the importance of economic growth for employment and income when it credits the *American Recovery and Reinvestment Act* with mitigating the recession's job loss (p. 152), but post-recession it praises expanded government benefits and increased taxes on high earners for reducing inequality (pp. 152-3).

First, the problem is not inequality, but persistent poverty that government handouts cannot solve. Artificially raising the income of struggling Americans with government transfers does not lead them to self-sufficient, middle-income status, and *lowering* the income of top earners does not help low-income families. For the *Report* to represent the latter as an accomplishment is peculiar to say the least. In fact, since most of the top earners are small business owners, reducing the income they could use to create and expand jobs or pay higher wages destroys opportunities for low-income Americans to earn a better living.

The number of people below the poverty line rose steeply during the recession and only declined somewhat in the last two years. It remains above 40 million people, a higher level than in more than half a century. Throughout the weak recovery, unemployment rates among minorities have been much higher than the average rate, particularly among African Americans. The *Report* claims the Administration's policies raised average household incomes and lessened inequality but does not mention the dire conditions faced by many who cannot find employment. Faster economic growth and job creation are critical to the welfare of those in greatest need and are far more important for their long-term prospects than any government program. (See Chapter 3 for initiatives to help move Americans out of poverty.)

Second, government transfers should not be central to the economy and the society; they should provide a safety net and have a structure that does not interfere with private incentives to create and make the most of economic opportunities.

To increase Americans' standard of living, the most urgent need is to accelerate economic growth and raise it back to its full potential.

What Ails the Economy?

The U.S. economic growth potential has been repeatedly downgraded because the government has continually tightened and added policy constraints on the private sector. With every new regulatory burden on production or permit delay to break ground on a new project, every increase in cost from a government-mandated benefit, and every tax increase (or failure to address international tax disadvantages), business is forced to curtail how much it invests, produces, hires, and raises wages, leading to fewer jobs and a smaller supply of U.S. goods and services. Similarly, with every government transfer payment or benefit, the supply of labor shifts to the left as well. These constraints have ratcheted output ever further below potential. This is what explains Figure 4.

Raising our Economic Potential

Our most pressing problem from a macroeconomic perspective is slow economic growth and a growing Federal debt burden. The solution to slow growth is lifting the artificial constraints and disincentives imposed by government on the private market economy—this can be done through tax and regulatory reform. The solution to the Federal debt problem is faster economic growth and holding Federal spending to a lower, relatively stable, share of the economy, which requires containing mandatory spending programs that are on an unsustainable path. If we take steps to limit mandatory spending growth and grow the economy, we can head off market worries that the debt will hamstring the government and crowd out private sector spending.

Borrowing should not be a way to avoid making necessary choices. Every administration has its priorities. Those of the Obama Administration were different from those of the one before it and those of the Trump Administration again are different. But a policy debate must take place within the limits of a budget.

The previous Administration has left much less fiscal space as publicly held debt has more than doubled in size relative to the economy. Cutting waste is one important part of managing spending and deficits but another crucial part is to make credible progress on deescalating future spending commitments that cast a shadow over current spending requirements and future U.S. creditworthiness. That will help to keep financial markets calm and create room to deal with any national emergencies that may arise. (See Chapter 2 for analysis and some specific recommendations.)

Long-term Productivity and Long-term Growth

Of course, we must position our financial, tax, health care, and educational systems for long-term stability, and with the right incentives to increase productivity and serve our citizens well. (Chapters 4, 5, 6 and 8 offer technical discussions.) The United States has attained success, at times even excellence, in some aspects of all these areas, and provided positive examples that other countries emulated. The U.S. model that achieved good results always relied on the private market economy and the resourcefulness of the American people before involving the government too heavily. We must return to that approach to be successful again.

This also applies to being good stewards of the environment and the global climate. We must explore ways to make the biggest possible difference in preserving the earth while playing to our economic and technological strengths. Many areas around the world live in poor economic and environmental conditions and some are giving rise to increasing greenhouse gas emissions. Economic development and technological advancement can be the answer to all three problems, and the United States can help through expanded trade and investment.

Untapped Export Potential

The last Administration executed its environmental policy with mandates and constraints on the domestic economy and turned away from various resources and technologies. It made no concerted effort to direct American commercial know-how to major sources of pollution and greenhouse emissions outside our borders. Trade and foreign investment can bring home earnings to the United States and create good manufacturing jobs, while producing equipment and American fuels for export, if the investment is focused and conditioned appropriately. We should explore opportunities for increasing U.S. exports of domestic resources and technical equipment to locations where they could do much to raise incomes and living standards, improve environmental conditions, and reduce greenhouse gas emissions by commercially beneficial deals. (Chapter 7 provides further detail.)

CONCLUSION

The last Administration has left a legacy of severe economic challenges in multiple areas that we now must address after losing nearly a decade to meet them. Chapter 1 provides an overview of these challenges. Notwithstanding the degree of difficulty and the shortness of time, we should be optimistic that the American economy can rise to the occasion once the government gets out of the way and allows it to reach its full potential.

The following chapters respond to corresponding chapters in the *Economic Report of the President*; they conclude with specific policy recommendations. The final *Response* chapter addresses tax reform, a subject the 2017 *Economic Report of the President* failed to discuss in a meaningful way.

[1] Report of the Joint Economic Committee of the United States on the 2016 Economic Report of the President, March 1, 2016, p. 35.

[2] "The Job Impact of the American Recovery and Reinvestment Plan," by Christina Romer and Jared Bernstein, released January 10, 2009. Dr. Romer was President Obama's first CEA chair and Dr. Bernstein was Vice President Biden's first chief economist and economic advisor.

[3] Former National Economic Council Director Larry Summers has invoked the concept after leaving the Obama White House. Conceived initially in the Great Depression, the postwar economic boom proved it wrong.

[4] President Obama did finally admit that there were fewer "shovel ready" infrastructure projects than anticipated.

[5] Interestingly, Larry Summers, the Obama Administration's former National Economic Council's director has drawn attention to the CBO's progressive downgrading of the economy's potential.

[6] Federal Reserve Vice Chairman Stanley Fischer Speaks with CNBC's Steve Liesman on "Squawk Box," CNBC, January 6, 2016; http://www.cnbc.com/2016/01/06/cnbc-exclusive-cnbc-transcript-federal-reserve-vice-chairman-stanley-fischer-speaks-with-cnbcs-steve-liesman-on-squawk-box-today.html.