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FALTERING ECONOMIC GROWTH AND THE NEED FOR ECONOMIC STIMULUS

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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SECOND SESSION

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THURSDAY, OCTOBER 30, 2008

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met at 10:00 a.m. in room 106 of the Dirksen Senate Office Building, the Honorable Vice Chair Carolyn B. Maloney, presiding.

Senators present: Bennett.

Representatives present: Maloney, Hinchey, Cummings, and Brady.

Staff present: Heather Boushey, Nate Brustein, Nan Gibson, Colleen Healy, Aaron Kabaker, Justin Ungson, Ted Boll, Chris Frenze, Bob Keleher, Tyler Kurtz, Gordon Brady, Robert O'Quinn, and Jeff Schlagenhauf.

OPENING STATEMENT OF HON. CAROLYN B. MALONEY, VICE CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Vice Chair Maloney. The hearing will come to order. I believe a meeting should start on time. I know that other members are on their way.

Unfortunately, Chairman Schumer is unable to attend today's hearing, "Faltering Economic Growth and the Need for Economic Stimulus," and he has asked me to chair this meeting.

I would like, first, to welcome our panel, Dr. Steve Landefeld, Director of the Bureau of Economic Analysis; Dr. Nouriel Roubini; Dr. Simon Johnson; and Dr. Richard Vedder. I thank all of you for coming, and I welcome my colleague, Mr. Hinchey.

Today's news is bleak. The Gross Domestic Product, which is the broadest measure of our economy, fell by 0.3 percent, and consumer spending fell by 3.1 percent in the third quarter.

This news comes on the heels of this week's dismal report that the Consumer Confidence Index plunged to an all-time low in October.

All of this provides further confirmation that unless we act to bring real relief to Main Street, families will continue to suffer serious economic hardships.

These data indicate that Speaker Pelosi has been right in pressing for additional economic stimulus, as Congressional hearings this month have shown.

Over the past year, we have seen the subprime crisis turn into a full-blown financial crisis. Many economists now warn that we are in the midst of a recession, quite possibly the worst in decades, and the impact on families may be devastating without government intervention.

This Committee has been tracking the unfolding economic crisis for over a year. In our monthly hearings on the unemployment situation, we have seen how the private sector has shed nearly a million jobs in 2008, and U.S. workers have lost all of the wage gains they had made during the 2000 recovery.

There is now a growing consensus that Congress should enact a second stimulus package and that it should be larger than the one we passed in January.

During recent testimony in front of the House Budget Committee, Federal Reserve Chairman Ben Bernanke, gave his support to another round of significant economic stimulus, and I quote, "With the economy likely to be weak for several quarters and with some risk for a protracted slowdown, consideration of a fiscal package by the Congress at this juncture, seems appropriate." End quote.

As detailed in a Joint Economic Committee report released yesterday, the need for stimulus is urgent. A consumer- or export-led recovery is unlikely, because this downturn follows the weakest recovery on record.

[The report, "Stemming The Current Economic Downturn Will Require More Stimulus" appears in the Submissions for the Record on page 50.]

Even as the economy expanded over the last eight years, household incomes never recovered from the last recession.

Falling home values and rising debt have driven family balance sheets to their worst condition in decades, while, at the same time, banks have been curtailing access to credit. As consumers cut back on their spending, this drags down the economy further.

Economists are also encouraging Congress to recognize that during a potentially protracted and deep downturn, concerns about budget deficits must be secondary to the goal of getting the economy back on track.

Former Treasury Secretary, Lawrence Summers, has said, and I quote, "The idea seems to have taken hold in recent days, that because of the unfortunate need to bail out the financial sector, the nation will have to scale back its aspirations in other areas such as healthcare, energy, education, and tax relief. This is more wrong than right." End quote.

Congress has already taken numerous steps to help buffer families from the effects of the downturn. More than 130 million American households have received a recovery rebate, and 3.1 million unemployed workers, have received extended unemployment benefits.

In July, Congress enacted a housing package aimed at stemming the tide of foreclosures. As the financial crisis worsened this Fall, Congress began a sweeping investigation to examine the root of the crisis and lay the foundation for action on common-sense regulation of the financial and housing industries.

This is grim news today, but I expect that this Congress will act with the current President and the next President to get the economy back on track and get America back to work.

Clearly, we need a new direction on economic policy. American families need more help to weather this economic storm.

I want to thank our distinguished panel of witnesses for appearing before us today, and thank Chairman Schumer for calling this hearing. I look forward to your testimony, as we work and help to lay the groundwork for the next economic stimulus package.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 63.]

Vice Chair Maloney. I welcome all of my colleagues, and I now call on the Ranking Member, Mr. Brady, for his comments. Thank you for being here.

OPENING STATEMENT OF THE HONORABLE KEVIN BRADY, A U.S. REPRESENTATIVE FROM TEXAS

Representative Brady. Thank you. I join Vice Chair Maloney in thanking the panel of witnesses before us today.

Congress and the Bush Administration have taken extraordinary steps to address this once in a lifetime global financial crisis, to unlock the credit markets, restore investor confidence, and work with other nations to prevent a worldwide financial meltdown.

Given the resilience of the American economy, averting a sustained global recession, will, no doubt, allow us to recover much more quickly and strongly.

But whether these actions are proven a success or a failure, depends a great deal on how smartly and timely they are implemented. The question now, is not how many more financial bills we can force down the market's throat, but how effectively they are administrated and given time to work.

It would be wise, as well, for the financial institutions receiving this help, to act responsibly. Hoarding these taxpayer dollars or simply using them to swallow smaller competitors, does nothing to increase credit for the creditworthy or address the crisis in confidence facing this nation.

If these banks choose to use these dollars simply to further a competitive advantage, rather than contribute to the recovery of our economy, I imagine there will be plenty of bipartisan scrutiny within Congress to those irresponsible actions.

As for the need for a second stimulus package, I seriously question its effectiveness. Already, there is ample evidence that it will simply become a Christmas tree of pet Congressional projects, from Amtrak to Medicaid, adorned with financial handouts to local and state governments, whose spending has outpaced even that of Congress, a remarkable feat, given that this Congress is the Usain Bolt of spending.

Should there be help for the unemployed and struggling states? Of course. Are there pro-growth tax measures that could help kickstart our economy? Yes, especially, in my view, lowering for one year, the tax levy that prevents American companies from flowing back an estimated $350 billion in foreign profits from overseas, and investing them in new jobs and research here at home.

Could we create jobs by injecting a boost of funding in our crumbling highway and bridge infrastructure? If done right, probably, but only if we bypass the Federal Department of Transportation and inject those dollars directly into bid-ready construction projects that can churn over the next 12 months.

But in the end, there is reality. The last stimulus did not work in a meaningful way. The dollars were negated by high gas prices, and, to their credit, taxpayers who chose to save their checks.

The last time Congress provided financial aid to the Governors, in 2003, many states chose simply to pad their growing payrolls, which has only made worse, the financial crisis they face today.

Given the size of our $14 trillion economy, the stimulus package is likely too small to have any significant impact. To put it in real terms, if the American economy were the size of a football field, the stimulus package represents only one yard, or if it grows larger, as some propose, two.

It is difficult to see how that impacts the economic game in any meaningful way.

Congress needs to do all it can to help this economy get back on its feet, but cannot forget the dire financial crisis of its own. Republicans, to our discredit, did not control spending and left control of Congress with an annual deficit of $160 billion.

Democrats, in their first year of control, tripled the federal deficit to over $400 billion—tripled, in just one year. Worse, at the end of the current fiscal year, Congressional Democrats can boast the largest deficit in American history.

And in the good news/bad news scenario, that's what counts for good. The bad is that it doesn't yet factor in the cost of the financial rescue plan, or the nearly $60 trillion in unfunded liabilities in Social Security, Medicare, and Medicaid.

Any stimulus package Congress considers, should be debated in the context of both the current economy and the shaky financial foundation of the Federal Government. Given that the growing American deficit and the looming entitlement crisis, was a concern of world markets before the current financial crisis, perhaps one signal Congress could begin to send, is that we, too, are going to begin to act financially responsible, as well.

With that, Madam Chairman, I yield back.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 64.]

Vice Chair Maloney. I thank the gentleman for his statement today, and I welcome all the panelists here.

I would like unanimous consent to put into the record, Chairman Bernanke's testimony before the House Budget Committee, concerning the second stimulus, and also the survey that came out in USA Today, where 74 percent of the economists surveyed, backed a second stimulus as a way to soften the blow.

They did not feel that it would prevent the recession, but they believed it would prevent a worse and deeper recession.

[The statement of Ben S. Bernanke before the House Budget Committee appears in the Submissions for the Record on page 66.]

[The USA Today survey appears in the Submissions for the Record on page 69.]

Vice Chair Maloney. I would now like to welcome the panel and introduce the panel. Also, I welcome all of my colleagues that are here today, including Mr. Cummings, Mr. Hinchey, Senator

Bennett, and, of course, Mr. Brady, representing the Ranking Member.

Dr. Steve Landefeld, has served as Director of the Bureau of Economic Analysis since 1995. Previously, he served as Chief of Staff for the Presidents Council of Economic Advisors.

He holds a PhD in Economics from the University of Maryland.

Dr. Nouriel Roubini, is a Professor of Economics at New York University's Stern School of Business and is also the Co-Founder and Chairman of RGE Monitor, an innovative economic and geostrategic information service.

He received an undergraduate degree at Boccini University in Milan, Italy, and a PhD in Economics at Harvard University.

Dr. Simon Johnson is the Ronald A. Kurtz Professor of Entrepreneurship at the Sloan School of Management, MIT, and recently finished two years as the Director of the IMF Research Department.

Professor Johnson's research focuses on the institutions that affect growth and crisis through their impact on entrepreneurs of all kinds.

Dr. Richard K. Vedder, is a Visiting Scholar at the American Enterprise Institute, as well as the Edwin and Ruth Kennedy Distinguished Professor of Economics and Faculty Associate with the Contemporary History Institute at Ohio University.

He received his PhD in Economics from the University of Illinois.

Welcome. Dr. Landefeld, you're recognized for five minutes.

STATEMENT OF DR. J. STEVEN LANDEFELD, DIRECTOR OF THE BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE, WASHINGTON, DC

Dr. Landefeld. Thank you very much, thank you for inviting me to discuss the GDP accounts, especially this morning's release. I'll present the highlights, and I ask that the GDP release itself, be included in the record.

In the third quarter of 2008, real GDP decreased, as you said, Madam Chair, 0.3 percent, at an annual rate. By comparison, it had increased 2.8 percent in the previous quarter.

The decrease reflected declines in consumer spending, residential investment, and business non-residential fixed investing. By contrast, government spending, net exports, and business inventory investment, increased.

The price index for gross domestic purchases, which measures the prices paid by U.S. residents, increased 4.8 percent, following a 4.2 percent increase in the second quarter.

Consumer spending also, as you said, decreased 3.1 percent in the third quarter, following an increase of 1.2 percent in the second. The quarter decline in consumer spending, was the largest decline since the second quarter of 1980.

Consumer spending on goods, fell 14 percent, with motor vehicles accounting for most of that decline.

Consumer spending on nondurable goods, fell 6.4 percent, which is a rather significant decline for nondurable goods.

In contrast, spending on services grew 0.6 percent.

To the other part of the household sector, spending on residential investment, fell 19 percent in the third quarter, compared with a decline of 13 percent. This is the 11th consecutive quarter in which residential investment has now fallen.

Since its peak in the fourth quarter of 2005, residential investment has fallen over 40 percent.

Business nonresidential fixed investment, fell one percent in the third quarter, compared with an increase of 2.5 percent in the second. Third quarter spending on durable equipment and software, fell 5.5 percent, whereas spending on nonresidential structures, increased eight percent, much of that being in oil and gas drilling and some in manufacturing.

Business inventory investment contributed this time to growth, adding about a half a percentage point to growth. Last quarter, it subtracted 1.5 percentage points from growth.

Exports of goods and services, increased six percent in the third quarter, compared with an increase of 12 percent in the second. Exports have now increased for 21 consecutive quarters.

Imports of goods and services, decreased 1.9 percent in the third quarter, compared with a decrease of 7.3 percent in the second.

Spending on goods and services by the Federal Government, increased 14 percent in the third quarter, compared with an increase of 7 percent in the second.

Most of the increase was in defense spending. Spending by state and local governments, increased 1.4 percent in the third quarter, compared with 2.5 percent in the second.

During the third quarter, Hurricanes Gustav and Ike, struck the Gulf Coast region, especially impacting coastal Texas and Louisiana. Because the effects of these storms are not separately identified in our source data that we use to estimate GDP, we can't estimate their overall effect on GDP, but their impact is included in these estimates.

In particular, disruptions to oil and gas extraction and to petroleum and petrochemical producers, are reflected in our estimates for inventory change in the nondurable manufacturing and wholesale trade industries.

As I mentioned earlier, the price index for gross domestic purchases, increased 4.8 percent in the third quarter, excluding food and energy prices, the price index for gross domestic purchases, has increased 3.1 percent in the third quarter, after increasing 2.2 percent in the second.

The personal consumption expenditures price index, increased 5.4 percent in the third quarter, after increasing 4.3 percent in the second. Excluding food and energy prices, the PCE price index increased 2.9 percent in the third, after increasing 2.2 percent in the second.

Turning to the household sector, real disposable personal income, fell 8.7 percent in the third quarter, after increasing 11.9 percent in the second. The third quarter personal saving rate was 1.3 percent, compared with 2.7 percent in the second and 0.2 percent in the first.

The second quarter increase in real disposable income, was boosted by tax rebate payments authorized by the Economic Stimulus Act.

Excluding these payments, real disposable income increased 0.3 percent in the third quarter, after decreasing 0.4 percent in the second.

Thank you, Madam Chair.

[The prepared statement of Dr. J. Steven Landefeld appears in the Submissions for the Record on page 70.]

Vice Chair Maloney. Dr. Roubini.

STATEMENT OF DR. NOURIEL ROUBINI, PROFESSOR OF ECONOMICS AND INTERNATIONAL BUSINESS, NEW YORK UNIVERSITY, NEW YORK, NY

Dr. Roubini. Madam Chair, members of the Committee, thank you for this opportunity to speak in front of the Joint Economic Committee.

I would like to give you my outlook on the U.S. economy and on the need for a major fiscal stimulus package, and try to dampen the fact of a severe recession on the economy.

The first observation I will make, is that this is clearly the worst financial crisis the U.S. and other advanced economies have experienced since the Great Depression. Hopefully, given the significant policy actions, the economic consequences are not going to be, of course, as severe as the Great Depression, but this is a most severe financial crisis.

The second observation, which is confirmed by the data this morning about the third quarter GDP, is that the U.S. right now is in a recession, and in my view, and based on the analysis I've been doing for quite awhile, this is likely to be the most severe recession the United States has experienced in a number of decades.

The last two recessions were relatively short and shallow; they lasted about eight months each, in 1991 and 2001, but even in 2001, when the economy bottomed out in November of 2001, job losses continued all the way through August of 2003, for a cumulative loss of jobs of over five million jobs.

Therefore, even in a situation of a relatively short and shallow recession, the economic consequences in terms of falling income and employment, can be severe and protracted.

Based on my own research on the weaknesses of the various components of aggregate demand, consumption, cutbacks in spending by the corporate sector, residential investment, I expect that this recession is going to last at least 18 months, if not 24 months.

This is going to be much longer and more severe and more protracted than the average U.S. recession that lasts only ten months.

In a typical U.S. recession, the cumulative fall in output is on the order of two percent, and during the last recession, that fall in output was only 0.4 percent.

Unless there is a significant fiscal policy stimulus action taken, I expect that this recession might experience a cumulative fall in output of over four percent. It is the worst we've had since World War II.

So, things are very, very much stressed, and the most important point here, is that the condition of the U.S. consumer is very, very strained right now. The last time we had a single quarter of fall in real consumption growth, was the 1991 recession. In the 2001 recession, it was cut backs in spending by the corporate sector went bust.

And as you know, consumption spending is about 71 percent of GDP. You have a U.S. consumer that is shopped out, saving less, debt burden, and now buffeted by negative shocks, falling home prices, falling equities, falling employment, falling consumer confidence, high and rising debt ratios and debt-serving ratios.

No wonder that the third quarter has seen a very sharp fall in consumption spending. And this consumption spending fall is going to continue for the next few quarters.

Unfortunately, the first stimulus package, through the direction of tax rebates, were saved by consumers. Why? They are worried about jobs, they are worried about paying down their credit cards and mortgages, and, therefore, I think that is now a need for a second fiscal stimulus package.

This second fiscal stimulus package, will have to take the form of more direct spending by the Government, on goods and services, because, currently, the private sector is not spending, households are not spending, corporations are now worried about the economy and are going to cut back significantly on their capital spending.

And if the private spending is going to fall sharply and tax incentives are not going to work, the only other way to incentivate and stimulate aggregate demand and prevent an even more severe recession, is going to be direct government spending in goods and services.

Of course, you want to have this spending on things that are productive, like infrastructure, like investments in maybe alternative energy or renewable energy, and you also have to provide aid and income to those parts of the economy that are more likely to spend it.

So, aid to state and local governments, is going to be effective; increasing unemployment benefits, food stamps to people that are poor.

Another part, of course, of the adjustment, is going to be that there is a huge amount of households that are right now very much distressed, buried under the burden of mortgage debt, credit cards, auto loans, student loans, and we need also some reduction through loan modification, of this debt burden, because as long as this debt burden stays high, consumers are not going to be able to consume.

So I think that I see the role for a very significant fiscal policy package. It has to be large, at least $300 billion, or even $400 billion, to compensate for the fall in private demand, which in the next year, could be on the order of $500 billion.

And this action has to be taken right away, and soon; we cannot wait until the next Congress in February, because three months from now, the collapse of spending, consumption, and investments, will be so sharp that the economic contraction could become even more severe.

So, action has to be taken now, soon, and in a large amount. That's going to be the only way we're going to try to make sure that this recession is going to be shorter and more shallow than otherwise. Otherwise, it's going to be very, very severe. Thanks.

[The prepared statement of Dr. Nouriel Roubini appears in the Submissions for the Record on page 86.]

Vice Chair Maloney. Dr. Johnson?

STATEMENT OF DR. SIMON JOHNSON, RONALD A. KURTZ PROFESSOR OF ENTREPRENEURSHIP, MIT, CAMBRIDGE, MA

Dr. Johnson. Thank you, Madam Chair. I'd like to make three points this morning: The first is that we are undoubtedly in a period of unprecedented global slowdown. I think, measured at the world level, we will see a recession of the kind and magnitude that we haven't seen since World War II.

It is very hard to find any country around the world, that is immune from this slowdown, and it's very hard to find a country that doesn't face severe pressures in its financial system.

As I speak today, these pressures have continued to mount in emerging markets, for example, in East Central Europe, but also in Latin America and also in parts of Asia.

These problems are not confined in their implications, to those places, because, as we have learned the hard way in the past few weeks, the extent of interconnections through finance and through trade, means that a problem in one part of the world, becomes a vulnerability and then a crisis in some other part of the world.

In particular, I would stress the dangers of connections for emerging markets to western Europe. I think that the inflexibility of policy in the Euro zone and the rigidities of labor markets in the European Union, create the potential for a very large problem in, of course, the U.S.'s largest single trading partner region.

The second point I'd like to make, is with regard to countercyclical policies in the United States. I do think that a great deal of progress has been made on this front since late September.

In particular, I think that monetary policy, very broadly defined, has sprung into action, a little bit late, but now they're working very hard. In my opinion, Mr. Bernanke is working from the anti-deflation play book that he essentially published in a speech he made on November 21, 2002, before the National Economists Club in Washington, DC.

He outlines there, very clearly, what one should do, if one is running the Federal Reserve and the threat of falling prices and all that entails, looms on the immediate horizon.

I think the Fed continues to be very innovative, and I would commend them on the progress that has been made, but I also think that some of the measures taken by Treasury, particularly the recapitalization of the banking system and the moves made towards recapitalizing the insurance industry, are very helpful and supportive in this context.

I would also point out that the measures announced or perhaps pre-announced yesterday with regard to housing and restructuring mortgages, are a major step in the right direction. I think they're coming about a month later than I would have preferred, but if they can implement that program and if they can, in particular, find ways to restructure mortgages that are locked up inside mortgage-backed securities, then we will have an important part of the overall approach in place.

All of this means that measuring the scale of monetary policy response, is incredibly difficult. It is very hard to assess the impact of the amount of liquidity that has been placed into the U.S. system and into the global system, including, remarkably, the extension of swap lines, again, yesterday, to four emerging markets, from the Federal Reserve.

The third point is directly on the fiscal stimulus. I think it is very hard to judge exactly, today, given the global dimensions of the crisis, and given the fact that countercyclical monetary policy, in particular, is working hard, with help from other supportive policies, it's very hard to know exactly how much fiscal stimulus will be required.

I think we probably have a month or perhaps two months to really see the direction of the economy. I would agree completely with people who think that now is the time to prepare a large fiscal stimulus, and because I am so concerned about the global dimensions of this crisis and the way those can come back to the United States, my written testimony recommends, in detail, that we consider a fiscal stimulus on the order of $450 billion, let's say, roughly three percent of U.S. GDP, which would be an extraordinary measure to take under any circumstances, unless you think that we are entering into a potentially serious and prolonged recession.

The timing of your hearings is extremely fortunate, and I would strongly recommend that you consider drafting and hopefully finding a way to pass this legislation, if it is needed, by the end of this calendar year.

I do think the amounts of money that I'm outlining, can be spent well. I outline in detail, some particular recommendations in my written testimony, and I'd be happy to answer any specific questions you have in that regard. Thank you very much.

[The prepared statement of Dr. Simon Johnson appears in the Submissions for the Record on page 96.]

Vice Chair Maloney. Dr. Vedder?

STATEMENT OF DR. RICHARD VEDDER, DISTINGUISHED PROFESSOR OF ECONOMICS AT OHIO UNIVERSITY AND VISITING SCHOLAR, AMERICAN ENTERPRISE INSTITUTE (WASHINGTON, DC), ATHENS, OHIO

Dr. Vedder. Thank you. I guess the economy must be in trouble, for the JEC to have a hearing less than a week before an election.

I thank you for the opportunity to speak. I wish to make two or three brief points.

First, economic history tells us that in periods of sharply eroding public confidence in financial markets, that this erosion does have significant negative economic consequences.

But it is important to note that these periods do pass, and there is some indication that that may be starting to happen already.

I would observe also that this crisis is not simply an example of market failure, of irrational exuberance trumping common sense. I'm convinced that it's largely a reflection of a series of public policy miscues, and in the absence of these governmental mistakes, I think this financial crisis would never have happened.

Third, I am very concerned that an overly zealous Congress, will craft an economic program that will have adverse economic effects, and, unlike the previous witnesses, I am concerned that an expansionary fiscal policy in the form of higher government spending, would be the wrong thing to do, aggravating a potential explosion in inflationary expectations, already noted in today's statement of a 4.8 percent rise in the GDP deflator.

And I am concerned that if consumer confidence revives suddenly—and it does have a tendency to be volatile—this could have detrimental effects on markets.

Of special concern to me, is the call for the second economic stimulus package. If we learned one lesson from the era of large budget deficits in the 1970s and so on, it is that fiscal stimulus does not promote economic recovery.

I would note that the earlier stimulus package that went into effect, has been followed by a period of falling GDP and rising unemployment, rather than the reverse.

Even in the heyday of Keynesian domination of the economics profession, scholars freely admitted that funding governmental infrastructure projects, was a dubious way to stimulate the economy, simply because of the practical difficulties of timing. It takes years, not months, for new appropriations in infrastructure, to actually lead to, for example, new roads or school construction.

Very often, any stimulus provided by such construction, comes long after recovery has already occurred, creating inflationary conditions that could be avoided.

If you're going to have a stimulus package—and I am dubious, given the fact that deficits are likely to be in the $600 billion to $1 trillion range, anyway—if you're going to have a stimulus package, certainly a tax cut or reduction, is preferable to a spending increase that would certainly take time to implement.

And, of course, a tax cut would have some more positive long-run incentive effects.

In conclusion, I would urge you not to panic. The Federal Government has taken the most aggressively interventionist position ever taken to deal with a crisis of investor confidence..

The impact of all of this, may be to prevent an imminent collapse in the financial system—and I think it probably has been—but, only, perhaps, at the price of future stagflation, declining income and wealth, and a rise in national malaise, reminiscent of the 1970s, not the 1930s.

As I calculate it, the misery index is currently approaching 11; it was seven or eight or nine a few years ago, which means, in effect, that rising inflationary expectations may already be taking hold, and we are already in a situation where we cannot move up the Phillips Curve in the way that Keynesian economics would suggest.

I think, in other words, you perhaps have done enough for now—maybe more than enough. Maybe the time has come to relax, wait a month or two, and allow the healing properties of the markets to be asserted again. Thank you for your attention.

[The prepared statement of Dr. Richard Vedder appears in the Submissions for the Record on page 104.]

Vice Chair Maloney. I thank all of the panelists for their testimony. Your complete testimony will be part of the record.

My first question to each of the panelists, is a simple one: Is the United States economy in a recession? And, give us any comment you'd like to make about it. Dr. Landefeld—and let's get everyone on the record. Are we in a recession?

Dr. Landefeld. Sometimes people use rough rule of thumb that two successive quarters of declining real GDP, is a recession. We at BEA do not use that rule.

We defer to the National Bureau of Economic Research, who makes these determinations of the data in business cycles and they look at a lot of variables, including real GDP, but, prominently, employment figures, in their numbers.

Whatever we may call it, certainly we are seeing a period of dramatic slowdown in economic activity, from a growth rate of 2.8 percent in the previous four quarters, to zero.

I discussed the sharp decline in consumer spending. We all know there's been a huge loss of consumer wealth during this period. Household disposable income share going to energy, has certainly gone up considerably over time, and the economy is growing at a rate too slow to generate new jobs, sufficient to keep up with labor force growth, population growth, and growth in productivity.

And that's the reason we've seen the uptick in the unemployment rate over the past 12 months, and the loss of jobs over that period. Thank you.

Vice Chair Maloney. Dr. Roubini?

Dr. Roubini. I do believe we are already in a recession, and, actually, my analysis suggests that this recession started already in the first quarter of this year, when the NBER states that business cycle—they tend to look at five economic variables: GDP, income, employment, sales and production.

If you look at the historical data, all five of these variables, peaked between October of last year and February of this year. So, I expect that when NBER is going to decide eventually—and they usually are cautious and wait until the recession is over, before they date the beginning of it, and they're going to date the beginning of this economic contraction to the first quarter.

Already, the fourth quarter of 2007 data, were revised downward from positive to negative, and I expect that when re-benchmarking of the labor data by the BLS, it will be down again. Even the first quarter of this year is going to be revised to negative, and, eventually, the NBER is going to date the beginning of this recession to the first quarter of this year.

Certainly, the third quarter number now suggests that there is a significant contraction of economic activity. Not only has GDP fallen, but if you exclude now, inventory adjustment, then the fall in the sales of domestic product, is even larger.

So, when it walks and quacks like a recession duck, it is a recession duck, and we are in a recession. Everybody out there feels it is a recession. It's obviously a recession. The only debate at this point, is how severe, how long, and how protracted, in my view.

Vice Chair Maloney. Dr. Johnson?

Dr. Johnson. I think the U.S. economy is in recession. I think it entered into recession, dramatically, in the late summer and particularly in September, with the global crisis of confidence in credit.

I think the danger now, is that we're moving from a potential—what was seen previously to be a potential mild recession scenario, to a much more dramatic fall and a slow recovery.

And, in that context, I would just highlight only one point in addition to what the two previous witnesses said, which is, the appreciation of the Dollar that has come about because there is so much global fear and so much running into Dollar assets, particularly U.S. Treasury assets. The Dollar has risen in value, dramatically, particularly over the past month, and, this, of course, hurts the U.S. in terms of its ability to export.

That is the brightest part of the picture presented by the BEA this morning, and it's been the brightest part of the picture for some time.

So, in addition to all the problems that we've become accustomed to in the past six months, and, particularly, in the past six weeks, the intensification, we also have to add on to that, I'm afraid, a more appreciated Dollar and a much harder time for the export sector in the U.S.

Vice Chair Maloney. Dr. Vedder?

Dr. Vedder. I like what Dr. Landefeld said, a lot, and I'll stick with that. I think the NBER makes the determination of when recessions are, not—obviously, we're not in good times. Maybe we will be in a recession at some future date, and I don't know where we stand with respect to that now.

An 0.3 percent drop in the GDP, in and of itself, does not constitute a recession.

Vice Chair Maloney. Thank you. My time is expired. I now recognize Mr. Brady for five minutes.

Representative Brady. Thank you. Congress doesn't need much of an excuse to spend more. We tend to do it naturally.

And we've seen this in the last number of years, in a major way. Dr. Johnson talked about, I think, appropriately, the scale of the monetary actions that have occurred.

I question the scale of the fiscal actions that would occur with the stimulus. We have a $3 trillion federal budget, we are overspending it by, this year, $500 billion.

I question whether increasing that to overspending by $650 billion, really meaningfully improves our economy: In fact, I think it does the opposite.

I think it raises more questions of consumer confidence, does little to improve investor confidence, especially in the financial foundation of our country.

When I look at the scale of the U.S. economy, what I do note, that is standing out like a sore thumb in a very good way, is our exports across the global marketplace.

One of the key reasons for government action across the world, is to avert a global recession or a sustained global recession. Exports have now become a major part of our economic growth, not just since a weak Dollar, but fully a year and a half beforehand, when the rate of growth of what we sell overseas, was better than the rate of growth of what we were buying into the United States.

There is a great effort, I think, to draw walls, to build walls, to become more protectionist in this country, rather than opening up new markets overseas. I would ask Dr. Landefeld and Dr. Vedder, is there a real concern, economic concern, that Congress's actions to either close off these markets or to refuse to open more markets in Colombia, South Korea, and Panama, will that have a negative effect, a significant economic effect on the U.S. economy?

Dr. Vedder?

Dr. Vedder. I'm not an expert on Colombia, so far, but as an economist, I would say that any attempt to prevent an expansion of trade, a move towards freer trade, is going to have adverse economic effects.

And what I do know about that agreement, is that the potential possible agreement, is that the effects are fairly severely negative. And, it's generally consistent with my overall view that much of what Congress has done in the last year or two, has not been promotive of economic growth, but destructive of it.

Representative Brady. So Congress's actions have hurt, rather than helped?

Dr. Vedder. That's right.

Representative Brady. Okay, Dr. Landefeld.

Dr. Landefeld. Well, as Director of a statistical agency, we don't comment on policy, but, certainly—

Representative Brady. But as far as the economic impact of exports—

Dr. Landefeld. The economic impact of net exports, it added about a percent during the previous four quarters, and it's now added almost a percentage and a half to growth, at a time when other things are moving in the other direction.

So, clearly, it's the bright spot in economic growth and one that's at least, up till now, accelerating in its contribution to growth.

Representative Brady. As far as economic scale, that's significant.

Dr. Landefeld. Oh, yes. You know, we're talking about a growth rate that fell from 2.8 percent to .8 percent over the relative four-quarter period.

Representative Brady. But exports are—

Dr. Landefeld. Actually—

Representative Brady [continuing]. Our ability to sell, manufacture, dramatically improved that financial picture?

Dr. Landefeld. Yes, by a percentage point in the last previous four quarters, and a percentage point and a half in the most recent quarter.

Representative Brady. So our ability to sell our goods and services across countries, really have been sort of the lifeline in our economy here the last four quarters, six quarters?

Dr. Landefeld. The last eight quarters, they have been a significant positive contribution to growth.

Representative Brady. Great. Thank you, Madam Chairwoman. I yield back.

Vice Chair Maloney. The Chair now recognizes Representative Hinchey. We're recognizing members in the order of their appearance at the Committee. Representative Hinchey.

Representative Hinchey. Chairman Maloney, thank you very much, and, gentlemen, thank you. It's very interesting to listen to everything that you've said.

One of the interesting things about it, is the continuing controversy as to whether or not we are in some kind of economic decline. It seems obvious to me, frankly, for a long time, that this was coming.

More than 18 months ago, we've been suggesting that our economic circumstances were in decline, and we've suggested that to people like Chairman Bernanke, but all across the board, including Secretary Paulson, the Chairman of the Securities and Exchange Commission, Chairman Cox, all of them have denied that we were in any economic problem, until September when the market collapsed.

So, it seems pretty obvious that that's the set of circumstances we're facing, and it's regretful that no positive action was taken to prevent this set of circumstances from happening the way that they have, and I think that there are things that could have been done.

One of the principal indicators, is the job loss. Normally, what we say, is, you need about 100,000 to 150,000 a month, just to sustain economic growth and development.

In August, we lost 84,000 jobs, and we've been losing jobs for a long time. In September, we lost 159,000 jobs. All through 2008, we have now lost more than 760,000 jobs.

The likelihood is that we will have lost perhaps a million jobs or more before the end of this year. So, it's pretty clear that we are suffering a very serious set of economic conditions here, and we need to act upon them.

And so the idea of a stimulus package, just makes perfect sense, provided it's done in the right way. And we have obvious, long-time, ignored internal needs, and perhaps finally, this is the incentive that this Congress is going to need and this President, perhaps, is going to need—we may be able to get this done in November. There's a lot of interest now in that direction.

So it seems to me—and I would appreciate your comments on this—it seems to me that about $300 billion is necessary for internal development, and in simple things that are needed, like basic infrastructure, bridges, roads, railroads, advancing mass transportation, water supply facilities, sewer treatment facilities.

We know that with water supply facilities, for example, based upon history, you invest about a billion dollars, you get 47,000 jobs generated out of that.

So that's what we need, we need more jobs, we need more strength, we need a stable economy that's going to begin to grow, and we need to begin to meet the internal needs of this country, which have been ignored now for so long.

So I would appreciate what you might suggest about that, where we should be focusing our attention. I know that Dr. Landefeld has laid out a very clear analysis, but he's not going to be commenting on the policies very much, so I'd like to start with Dr. Roubini.

Dr. Roubini. I certainly agree with your points. Right now, we're facing a very severe contraction of most components of aggregate demand. Consumption is in free-fall, spending by the corporate sector is in free-fall, residential investment is still collapsing, and the only bright spot in aggregate demand, net exports, is going to slow down in improvement, for two reasons: A stronger

Dollar and the fact that there is now a recession in the rest of the world.

Our exports are the imports of other countries. We have a recession in Europe, in Canada, in Japan, and emerging markets, so there is going to be a sharp fall in our exports along the way.

So I think that we need to do something, and, private demand right now, is not going to be incentivated by tax rebates, because people are so worried about their debts, about their jobs, about their income, that they did not spend the first tax rebate.

So, if the private sector cannot spend and doesn't want to spend, the government can spend, and help to boost aggregate demand in a situation where aggregate demand is going to be very sharply falling, and if we don't do anything, we're going to have the most severe recession we've had in decades.

The other point I would like to make, is that until now, we've spent a fortune trying to help and backstop the financial system. Think about it: $30 billion for the Bear Stearns; $120 billion for AIG; $200 billion for Fannie and Freddie, all the new facilities of the Fed, TAF, TSLF, PDCF, swap lines, the commercial paper fund. The balance sheet of the Fed has been increasing from $800 billion to $1.8 trillion.

If you add up all the support you have given to Wall Street, it adds up to something like, already, $2 trillion, and we have done almost nothing for Main Street.

And even if we need to backstop Wall Street, because a collapse of Wall Street will have so much collateral damage on Main Street, unless we support, also, Main Street, by making sure that aggregate demand is not going to collapse, six months from now, everything we've done to backstop the banks, is going to be undone by collapse in aggregate demand, which is going to imply credit losses, non-performing loans, delinquencies, mortgage defaults, foreclosures, defaults by corporations, and, therefore, if we don't support Main Street, whatever we do to support Wall Street, is going to be undone.

Therefore, we have to do both things. Until now, we've spent $2 trillion ahead of us, for Wall Street, and have done close to nothing for Main Street, for real America.

Representative Hinchey. Unfortunately, my time is up.

Vice Chair Maloney. Senator Bennett is recognized for five minutes.

Senator Bennett. Thank you very much, Madam Chairman, and thank you for holding the hearing. It's very timely, and it's essential that we go forward.

I'd like a simple yes or no from each of you on this question. Forget all of the surrounding activities with it.

Was TARP a good idea, the $700 billion, was it a good idea? Yes or no? Dr. Landefeld.

Dr. Landefeld. Again, I'm going to have to dodge this.

Senator Bennett. Okay. Dr. Roubini.

Dr. Roubini. My answer is yes, as long as most of the money is used in order to recapitalize the banks with public injection of capital. I think that buying at high prices, toxic assets, was a bad idea, so the current implementation of it, is in the right direction.

Senator Bennett. Dr. Johnson.

Dr. Johnson. The original design of TARP, to buy distressed assets, was a bad idea and remains a bad idea. Using those funds to recapitalize the banking system and the insurance industry and other financial institutions that may need recapitalization, as we head into serious recession, is a very good, if not essential idea.

Senator Bennett. Okay, Dr. Vedder.

Dr. Vedder. The original proposal that the Senate voted on, I reluctantly supported. When you got through revising and doing combinations and permutations on it, I was sort of luke-warmly negative on it, and sort of neutral on the thing.

Senator Bennett. Okay. You add $700 billion to the national debt, our normal activities, independent of that, as has been pointed out, are going to add another $500 billion this fiscal year.

And whenever you go into a recession, revenues go down, because people aren't earning profits, and, therefore, they're not paying taxes on the profits, so the national debt goes up that much more, and now we're hearing calls for $350, $400, $450 billion in a stimulus package.

Dr. Roubini, I hear what you're saying about Main Street. I'm not sure I completely agree with you, but I understand the impulse in that direction, but I ask all of you—and you can do a toss-up as to who answers the question—what's the impact in terms of the national debt and what it does to America's competitive position, what it does—Dr. Johnson, you talked about the EU, our primary trading partner.

We are seeing enormous stress being placed on our fiscal condition overall, with these kinds of expenditures.

I've just got a grudging acceptance that the $700 billion addition to the national debt, was probably a good idea, for various reasons. Now we're going to add some more with this stimulus package.

Set aside the details of the package. I'd be happy to see our infrastructure get improved, not because of the financial stimulus, but because it's deteriorating and needs to be improved.

But talk about it from the debt standpoint. Who wants to do that? Dr. Vedder.

Dr. Vedder. Well, I think you're on to a good point, Senator. How are you going to pay for this? Are you going to print money? Are you going to raise taxes? Or, are you going to borrow the money?

Presumably, we're talking about borrowing. In a financially stressed situation, we're talking about going out and borrowing, with, if you add $300 or $400 billion on to what we're already doing, the better part of a trillion dollars, seven to eight percent of GDP.

I think that is a dangerous and somewhat fiscally irresponsible thing to do, and I think, in the long run, it will inspire a decline in confidence and will lead to inflationary expectations soaring, particularly since I expect that some of it will be monetized, because of political pressures, leading to greater inflationary conditions.

Senator Bennett. Anybody else? Dr. Johnson.

Dr. Johnson. Two points that I think you need to keep in mind: The first is that the United States, compared to almost all other industrialized countries, has very weak automatic stabilizers.

Other countries have bigger governments, so when they go into recession, automatically, they swing into a bigger deficit, and that tends to counter the cycle.

In the U.S., it requires a discretionary decision by Congress to have the same sort of countercyclical effect, so you have to make a decision to do what, in almost all other countries at this income level, happens automatically. That's the first point.

The second point is that the demand for U.S. debt around the world, is enormous. This is the counterpart of the lack of global confidence. There is one asset that stands out as being, without question, the safe place to park your money, and that's U.S. Treasury debt.

So I'm not proposing that you get of a path of medium-term fiscal stability and sustainability. Obviously, that would be a bad idea, but addressing these pressing needs right now, if the situation continues to deteriorate, and increase in the deficit, would be a good idea.

Dr. Roubini. I would add another point, that you have to ask yourself: What is the alternative? If the alternative is one in which there is no fiscal stimulus and the recession is something like a cumulative fall of GDP of 4 percent, then the collapse in revenue is going to lead to such a widening of the fiscal deficit that actually if you do this fiscal stimulus the total effect on the fiscal balance is going to be smaller than the alternative. So you ask yourself: If you don't act, what is going to be the alternative? And I see a very severe recession.

So paradoxically, by doing the spending you are going to make sure that the fiscal deficit is going to be smaller than otherwise.

Vice Chair Maloney. You are yielding back your time?

Senator Bennett. Yes. Thank you.

Vice Chair Maloney. The Chair recognizes Representative Cummings.

Representative Cummings. Thank you very much, Madam Chairwoman.

Dr. Roubini, you said something that I have been saying, and I am glad to hear somebody like you say it. We bail out, or we tried to bail out Wall Street because we were worried about the bleeding into Main Street. And I have said it over, and over, and over again: The people in my City are losing their houses. They are, with regard to employment they do not have Unemployment Benefits. They have run out. So a lot of the arguments you are making, Dr. Vedder, folks are suffering badly.

And as I listened to you, Dr. Vedder, I could not help but think about the many times I have sat in this hearing room right here and heard our experts come up there and said: Wait, wait, wait. Well the American people are suffering.

Now going back to you, Dr. Roubini, I believe that it is one thing to bail out Wall Street but when you have got people being foreclosed upon who do not have jobs, who are losing their houses, who cannot get consumer loans, and I can go on and on as you talked about, Dr. Johnson. So you are doing what you can on the upper end—that is, Wall Street—but you have got to have something down there, like for example the efforts by the FDIC to help folks with these mortgages.

That makes sense because you are stopping the bleeding down at the bottom. Because I don't care what you do up at the top, if you are not stopping the bleeding of the folks who are really suffering you have got a major problem. And it is like taking money and throwing it into a bucket with a hole in it, as far as I am concerned, if you are not dealing with that.

So the question that I've got, we spent yesterday in another committee that I sit on—and that is the Transportation Committee—we spent eight or nine hours talking about a stimulus package, a stimulus package which would include infrastructure repairs, schools, and also of course creating jobs.

This is my question: When I look at this total picture, I realize that one of the things that we want to do, yes, we want to inject money into our economy so that people will begin to spend, and so that everybody is affected, each job affects each construction job, which effects other jobs. The question is: What is the impact, and is it significant that it has impact, on consumer confidence and investment confidence?

Those are the questions. Because I was just wondering if there is more impact than just the creation of jobs, people working—and that is major; I understand that—but I am trying to figure out how do we get a handle on this whole problem. Because as you all have said, this is monumental.

The other thing I would ask you, Dr. Roubini, you stated that if we do not do something now, that we would basically see catastrophic results. And I want you to elaborate on that.

Dr. Roubini. Yes, to elaborate on some of your points, first of all I think there is definitely a perception out there in the public that a lot of what is happening right now is because of reckless lending and reckless investing and arrogance and greed on Wall Street, and now what are we doing? We are essentially bailing out those reckless lenders and investors.

Now we have to do it because the collateral damage to the real economy is going to be severe, but there is a perception out there, and that is why I think the House first voted against the TARP Legislation that we had privatized the profits and the gains, and now we are socializing the losses. This is like corporate welfare for the rich and for the well-connected on Wall Street, and there is an element of unfairness.

So people out there are going to ask you who are spending $2 trillion to backstop the financial system what are we doing for U.S. housing? What are we doing for Main Street? What are we doing for people who are suffering and losing jobs? It is a question of efficiency and fairness.

Leaving aside the fairness point, I think the crucial point right now is private demand is in freefall. If you look at the latest data on consumption, on residential investment, on cutback in spending, even before the shocks of September and October were dramatic and now there is a nasty credit crunch, aggregate demand was free falling and nothing is sustaining it.

We have gotten into a situation right now in which Central Banks who are supposed to be the lenders of last resort have become the lenders of first and only resort because banks are not lending to each other. Banks are not lending to corporations. And corporations do not have credit and cannot spend and invest and hire people.

So we have a nasty credit crunch. At this point, we have to start to do something for Main Street. Because as I said, if there is going to be a collapse of economic activity—and all the data suggest this is going to be the worst recession the U.S. has experienced in a decade—then bailing out Wall Street is not going to be enough. Because the losses, and the credit crunch, and the defaults are going to rise, and anything we do to recapitalize the banks are going to be undone.

So both in terms of efficiency and fairness, we have to do something for Main Street. We have spent $2 trillion of money right now to help Wall Street, we can find $300 billion to do something for infrastructure, for aiding state and local governments, for unemployed, for food stamps is good, is necessary, it's fair, and if you don't do it things are going to get much worse.

Representative Cummings. Thank you. I see my time is up.

Vice Chair Maloney. Thank you. Dr. Roubini, you have testified that the U.S. is more likely to experience deflation, or falling prices in the coming recession rather than experiencing high inflation. And while we have seen falls in oil prices recently and corresponding drops in gasoline prices, both headline and core inflation remain relatively high compared to previous years.

Could you elaborate on why you believe inflation will fall?

Dr. Roubini. My view is that six months from now the biggest problem that the Fed is going to have to face is the problem of deflation. And the same thing, by the way, happened during the last recession that was short and shallow by 2002, as you recollect, the worry was not inflation but deflation. And Chairman Bernanke wrote several speeches about what to do if we get close to deflation in terms of nontraditional monetary policy.

Why do I feel there is going to be deflation in the economy? Three reasons:

There is a slack in aggregate demand relative to supply. Aggregate demand is falling very sharply. And when that happens, the pricing power of the corporate sector is reduced. And by the way, we already have price deflation in the sectors of the economy where there is this excess of supply: housing, consumer durables, and automobiles and motor vehicles. We already have deflation in those sectors.

Secondly, there is a beginning of a very large slack in the labor market. The unemployment rate is sharply up. The job losses are mounting month after month. When there is a large increase in unemployment—it is going to peak above 8 percent—labor costs and wage growth costs are going to be dampened significantly.

The third reason is that oil prices have already fallen more than 60 percent from their peak in July, and other commodity prices have already fallen by something like 25 percent from their peak. In a very large U.S. and global economic slump, commodity prices are going to fall from the current level by another 20, 25 percent for a cumulative fall in commodity prices by 40 percent. So slacking in goods market, slack in labor markets, slack in commodity market, and the huge excess supply of production of goods—think about China that's investing 50 percent of GDP to produce more capital goods for export—this excess supply relative to falling demand is going to imply that six months from now the Fed, the CB, and most advanced economies are going to start to worry about deflation.

As we know from the experience of Japan, deflation can be very destructive. So that is what we have to worry about. Current headline inflation and core inflation are still high, and it is going to sharply decelerate in the next few months.

Vice Chair Maloney. What risk would falling prices, could you elaborate, what risk would falling prices have on the U.S. economy, to Main Street, to the working man and woman? And how would the stimulus package fit into this? Would the fiscal package help? How would it help? Could you elaborate further?

Dr. Roubini. Well deflation is dangerous for a variety of reasons, as the experience of Japan in the 1990s suggest where they had deflation and you had economic stagnation for a decade.

The first risk is that when prices are falling you want to postpone consumption until the future rather than consuming today, and that reduces further demand and supply.

Secondly, you get into a situation of a liquidity drop when if interest rates are going to go close to zero—and I think the Fed Funds soon enough is going to be at zero—if prices are falling, you cannot use interest rates below zero in nominal terms but the real interest rates are going up, because real rates are the difference between the nominal and inflation, so inflation becomes negative, real interest rates are going up.

When you have price deflation there is also this process of debt deflation where the real value of the debt, of those who have borrowed, increases over time rather than being reduced. That increases the debt servicing problems of the debtor, and in a situation in which prices are falling and profit margins of the corporate sector are falling, they tend to produce less. If you produce less, there is less income, less employment, and the vicious circle of the contraction in output and employment, income, consumption continues over time.

Situations of deflation are very, very dangerous and the situation in which the monetarist policy stimulus becomes ineffective. That's why in 2002 Chairman Bernanke wrote a series of speeches saying what can we do to prevent the deflation from occurring? We have to prevent it again this time around.

Vice Chair Maloney. How will a fiscal stimulus package help?

Dr. Roubini. It helps because in a situation of deflation demand is below supply, and because demand is below supply prices are falling. So you have to boost demand. And if the private sector is not spending and increasing demand by the public sector, government spending on goods and services hopefully productive stuff that are for the long run like infrastructure we need for things that are crumbling is going to boost demand and prevent deflation from occurring.

Vice Chair Maloney. My time has expired.

Mr. Brady.

Representative Brady. Thank you for holding this hearing. I think it is important to do that.

Secondly, it is, as we were talking, important to keep an open mind on the stimulus package. My concern is that we are offering false hope.

A year ago this Joint Economic Committee met to consider the first economic stimulus, and I recall Chairman Schumer, who is one of our most engaged and involved Members of Congress, state that the only thing standing between America and a recession is this Congress.

We know what occurred. I do not want to present, or market this proposed stimulus package as the magic beanstalk that will grow America's economy to the sky when it may in fact be closer to a bean, where just our deficit spending over the past year is three times—in direct spending—is three times the size of this proposed stimulus package.

So I do not think we ought to market it in a way that it cannot accomplish. And again, if we can move to help those who are unemployed in states that have no job hope, let's do it. If we can find ways to create jobs on Main Street, let's do it. But let's not present this as the only thing standing between an economic collapse and the American public. Because by no measure is it.

My question to the panelists is perhaps on the bigger picture. If you look at the last 30 years, we are remarkably resilient. We have bounced back from some huge hits, whether it is the '87 crash, the dotcom crash, the attacks of 9/11, amazingly resilient. It becomes much harder to bounce back in a global recession.

As economists, what should we be—as Members of Congress, what should we be looking for as signals on how deep the global recession is headed, or what measurements? How much time should we allot to see if these global, remarkable actions by governments are working? What signals? What measurements should we be observing to determine what the global picture is and how it is unwinding so that we can measure our responses here in the United States?

And I would open it up to just go down the panel, if you could. Dr. Landefeld?

Dr. Landefeld. Again, I think I will have to not answer this question because it tends to get into policy and when one should respond at what signal.

Representative Brady. Thank you.

Dr. Roubini. My view is that even before the very severe financial shocks of September and October, when you look at the data for the second quarter of this year, there was an economic contraction starting in the Euro Zone. The GDP growth was negative. GDP growth was negative in the UK, in the rest of Europe, in Japan, in New Zealand, in Canada. So about 60 percent of global GDP that is the part counted by most advanced economies was already contracting in the second quarter of this year, well before the very severe financial strains we have observed in September and October in the U.S., in Europe, in the emerging markets that have now led to more of a liquid and a credit crunch, more of a panic, more of a falling business and consumer confidence, and therefore there are actually a number of research firms on Wall Street like J.P. Morgan, or Goldman Sachs who are already estimating the third quarter and fourth quarter GDP growth globally is going to be close to zero, if not negative.

And unfortunately now the crisis that started in the U.S. and became European and the advanced economies now is starting to lead to a hard landing in a number of emerging market economies. There is a sharp slowdown of growth in China, in Asia, in Africa, in Latin America, in emerging Europe. There are about a dozen emerging market economies right now that have been subject to this financial tsunami that are on the verge of a financial crisis: the Baltic countries, Latvia, Estonia, Lithuania, Bulgaria, Romania, Hungary, Turkey, Belarus, Ukraine; going to Asia: Pakistan, Korea, Indonesia; in Latin America, Argentina, Ecuador, Venezuela, to name just a few.

So this is becoming a global financial crisis, and it is becoming also a global recession. And the consequence of what the U.S. is going to be to the rest of the world is contracting. The only bright spot in demand was exports. Exports are going to start to fall, and that becomes a more vicious circle. That is why we have to worry about it and do something about it.

Representative Brady. I'm sure there was my answer in there. Dr. Johnson?

Dr. Johnson. I suggest you can look at three things.

The first is the interest rates which the market is charging, or trading, emerging market debt. This is indicating eminent default for a number of countries that I prefer not to name in public. Eminent meaning within the next few weeks.

The second measure is stress within the Euro Zone. There you look at the probability of default in the credit default swap spreads that are traded for European governments. These have come down slightly in the last 24 hours, but they are at remarkably high levels. Really we have not seen anything like this since the 1930s for developed industrial countries.

The third measure is the dollar. When everything is going back in the world, if the world is going into a deep level of recession, people are going to come back to the dollar. Again in the last couple of days the pressure has come off the dollar a little bit, but the more the world gets worse the more investors are going to want to come into the dollar, the more they are going to want to buy U.S. Treasuries.

I think you will know a lot about where the world is heading, how deep and how sharp it is, in a month, one month.

Representative Brady. Thanks, Doctor.

Dr. Vedder. Well I am kind of old fashioned. When I look at the macro economy I look—and like Dr. Roubini—at the basic indicators, GDP, and unemployment growth. I do think looking at the dollar is fascinating, but I am not sure you can tell for sure.

But getting to your export point, the decline in exports, your point earlier, Congressman, about moving towards a greater free trade policy and away from protectionism, if there ever was a time to do this it would be now, it would seem, in order to promote our export growth.

Representative Brady. Right. Thank you, Doctor. I yield back.

Vice Chair Maloney. Mr. Hinchey.

Representative Hinchey. Thank you very much, Madam Chairman. This has been a fascinating hearing and I thank you, gentlemen, very much, for the insight that you are giving us here.

The Gross Domestic Product is the driving force of this economy, and now we are seeing that GDP begin to go down. We know that the Gross Domestic Product is driven by middle-income working Americans, mostly blue and white-collar working Americans. They drive the GDP by at least two-thirds.

And so we know that their circumstances are declining, and we know that in order to deal with this situation we are going to have to engage in economic growth that is going to create more jobs and deal with the internal issues of our country that have been ignored for so long.

I mean, basic, simple things like sewer treatment plants which have not been updated since the 1980s; water supply facilities, the same thing. You have water supply systems all over this country falling apart, just literally falling apart.

So all of these things, in addition to transportation, has to be addressed and dealt with. But it seems also that there's at least one other thing. That is, new technology. Very new, very sophisticated technology which in many instances is on the edge of really doing something very creative, particularly with regard to energy.

This year we are going to spend more than $400 billion buying oil from countries outside of the United States. We import 70 percent. Obviously we need a new system of energy generation. So I am wondering if you can give us some insight as to what you think about the development of this new technology, particularly new technology which would begin to make this country more energy independent.

Dr. Johnson, if you could begin I would appreciate it.

Dr. Johnson. Certainly. I think you are making a very important point. I think there is a longer term need to invest in new technologies relative to energy, and to develop alternatives to oil. Oil prices are obviously falling at the moment and I expect they will fall further as the recession develops, but this is a cyclical development, and I think that technology has great promise.

It takes years of course to bring that technology out of the labs, and it takes even more years to bring it to commercial fruition. I think though the right way to think about the stimulus is in terms of shorter term and longer term impact. So shorter term would be income support, it would be food stamps, it would be expanding Unemployment Benefits in ways I outline in my written testimony.

Some of the longer term things would also be the kinds of infrastructure you are talking about—water treatment, and roads, and so on—that would fit as part of the same package. And I think supporting technology in that framework makes a lot of sense.

It is going to be a long slog. I think the recession will be quite sharp, and it will be three or four really unpleasant quarters. And then I think we will start to grow again, but at a painfully slow pace, probably not creating enough jobs. So unemployment will continue to rise.

I think in that context what you are proposing, as long as there is a short-term impact, we need that I think starting as soon as possible, and realistically it is hard to get infrastructure going in the next three months, unless you are talking about money for maintenance. I think there is a lot of good maintenance ideas out there that can be used right away.

But in terms of developing your projects, that takes some time and technology takes a little bit longer. But I think we should be thinking out three, four, five years in terms of getting this economy back on what will hopefully be a sustainable longer term trajectory.

Representative Hinchey. Thank you, Dr. Johnson. Dr. Roubini, would you comment on that, please?

Dr. Roubini. I agree with you that the issue of energy security is going to be one of the most crucial economic, financial, and also national security issue for the United States, and you have to work on it both on the supply side and on the demand side.

On the supply side, I think there is a huge amount of new potential technologies, alternative energy, renewable energy that you can develop over time. I mean, it is embarrassing that a country like Germany where there is barely any sun is much more advanced in solar technologies than the United States because we have not given enough support to the development of these technologies. That's the first observation. So we can do a huge amount of investment in research in all these renewable and alternative energy.

On the demand side I think that the lesson is that probably a system of cap and trade is going to be beneficial for the U.S. and is going to essentially resolve four problems:

The revenue from these auctions is going to be able to reduce the budget deficit and/or finance investment in alternative energy. Our trade deficit is going to fall because our demand for imported oil is going to fall. Our dependence geopolitically on unstable states that are producers of oil and energy is going to be reduced. And we are also going to contribute to improvement in global climate change.

So you get four birds with one stone: lower budget deficit, lower trade deficit, less national security risk, and improving the environment. That is the direction we have to go both on the supply and on the demand side. [Applause.]

Representative Hinchey. Thank you very much. A lot of support here for that, too.

Dr. Vedder?

Dr. Vedder. Yes, well, how can you talk against technology? It's like talking against motherhood. I'm all for it. But to pick up on Dr. Johnson's point, there is a short-run problem we have now of a business cycle problem.

Long-term solutions may be desirable for the country for other reasons, and we could have that discussion, but I do not know that it is relevant in solving the current problems with respect to the economy at the moment.

In fact, if you want to do an energy fix that will have a more immediate effect, I would just simply let people drill more in places like Alaska, if that is the goal. But I am not versed—I am not an expert on our energy policies enough, except to say that I do not think it will do anything for the short term problem that we have.

Representative Hinchey. Thank you.

Vice Chair Maloney. Senator Bennett.

Senator Bennett. Thank you. I would be tempted to get into this energy debate, and if you want to create jobs you can create them a whole lot faster in ANWAR than you can with some of these other issues, but I will leave that, tempting as it is, and go back to this discussion of commodity prices.

Dr. Roubini, you say commodity prices are falling from their peaks. That's true. And isn't that a good thing? Certainly the falling price in oil is a major lifeline to the airlines. The newspapers are reporting this morning that some of the airlines made long-term commitments at $145 a barrel, and now they are stuck with those and they would love to scrap those and start making commitments at $65 a barrel.

That means more jobs in the airlines. That means more productivity in the airlines. The falling price of oil has enormous benefit to the chemical industry that is dependent on petrochemicals as feedstock for what they do. There is tremendous benefit to farmers because of the lower price of fertilizer, and that means falling prices in food, which deals with starvation around the world and helps that, which will increase demand.

So I am giving you an opportunity to go a little farther in this because your comment left the impression that the falling commodity prices is one of the things we have to deal with, and that's terrible, and I think it's true of housing, yes, housing prices are falling, but they are falling from unsustainable peaks. And we will not have stability in the economy until housing prices get down to their intrinsic level of where they ought to be as people buy housing for shelter rather than buying housing for the purpose of selling it to some speculator who is going to buy it to sell it to another speculator who is buying it to sell it to another speculator, and that is what got us in this trouble in the first place was prices peaked.

And now we are seeing the actual correction in those peaks. Take that and respond a bit, and then I would like some of the others to do it, as well.

Dr. Roubini. Senator, you certainly make a valid point in suggesting that eventually the fall in oil and energy price is going to be beneficial for the economy and for the strapped consumer, given the very sharp rise in transportation cost and energy was a very major drain on the disposable income of that sector.

But you have to ask yourself why are all energy and commodity prices falling so sharply. They are falling because in the commodity market in the short run the supply is very inelastic, and if you have a collapse of demand because there is a U.S., European, and global recession, then of course prices are going to fall sharply.

So the falling prices is a signal of a malaise or a disease that we are entering a recession. Of course once these prices are going to fall very sharply, that's going to boost over time disposable income and is going to be one of the reasons why we are going to spin into an ever declining recession. It's going to be the bottom of it.

An additional observation: While in the short run oil and energy prices are going to be falling because of the cyclical recession, ask yourself what is going to happen to oil and energy prices in the medium-run when the U.S. and the global economy gets out of this recession.

The demand growth for energy is going to be huge, because most of the growth in the global economy is coming from emerging markets, countries that are industrializing or urbanizing like China and India. Their demand growth is going to be very large, and the question you have to ask yourself is: How much growth in supply is going to be out there in oil and energy?

And unfortunately, most of the sources of supply of energy and oil are in a bunch of unstable petro states. One week you have trouble in Nigeria. The next week it is Venezuela. The next week is Iran. The next week is Iraq. The next week is Russia.

Senator Bennett. Sure, I—

Dr. Roubini. The growth of supply might be slower than the one of demand, and then we have to do something about the energy security because outside of this slump prices are going to start rising again and again we have the same problems.

Senator Bennett. I am conscious of the time, and just one quick comment. I buy the argument that long-term renewables and technology and sustainables are all the thing we ought to go to. I believe in that promised land.

The bridge to that promised land is built out of fossil fuels. That promised land is 20 years away. And if we do not start increasing our supply of fossil fuels in stable countries, including this one that is the third largest producer of fossil fuels in the world, then we are adding to the instability. So that is a separate question and a separate argument.

Dr. Johnson, you wanted to comment.

Dr. Johnson. Senator, I think you put your finger on a very important irony, or almost a paradox, which is how can falling commodity prices be bad? It obviously helps the U.S. consumer, it helps firms, as you said. The problem is that—and commodity prices falling by themselves, if that is the only thing that is happening, would not be bad; that would be good. But it is happening in this global context where there is downward pressure on other prices.

For example, the price of imported goods are going to come down. The dollar is appreciating and our exporters are going to be fighting very hard to sell to us. There is downward pressure on the price level as a whole. And that by itself does not necessarily add up to a problem unless it also pushes down wages. Almost all of our debts are fixed in nominal terms, if our wages fall in nominal terms and our debt burden has gone up. And when Chairman Bernanke gave his speech saying—which is entitled, November 2002, Deflation: Making Sure It Doesn't Happen Here, he meant not only deflation, he meant the Great Depression.

The key thing about avoiding the Great Depression is avoiding deflation. When our debts are in nominal terms, we have falling prices and falling wages, we are going to have a much, much bigger problem than the one we are considering and really focused on today.

Senator Bennett. Dr. Vedder.

Dr. Vedder. As an economic historian I am amused at this discussion. Between 1864 and 1896, wholesale prices in the United States fell more than 60 percent. We had a 4 percent economic growth, and we became the largest economy in the world.

In the 1990s, yes, Japan had, quote, "deflation," but it is interesting that the fiscal policy followed during that decade was one of great expansion, Keynesian expansion, along the lines that are being suggested here. A lot of good it did them.

Senator Bennett. I see my time is up. Thank you, Madam Chairman.

Vice Chair Maloney. Mr. Cummings.

Representative Cummings. Thank you very much, Madam Chairwoman.

You know I am just trying to put myself in the shoes of the people, the people like in every one of our Districts who never thought they would lose their job but they lost them and continue to lose them. In the City of Baltimore we have an unemployment rate of 7.1 percent, almost 20,000 people out of a population of less than 650,000 who do not have jobs.

The duration of unemployment has risen from an average of 16.7 weeks in September of 2007 to 18.4 weeks in September of 2008. Additionally, the percent of unemployed who are unemployed for more than 27 weeks has risen from 18.1 percent to 21.1 percent from September 2007 to September 2008.

BLS does not report statistics for unemployment greater than 27 weeks. However, since the average duration of unemployment has risen, and because more than 1 in 5 unemployed persons is unemployed for more than 27 weeks, is it not likely that there are a large number of unemployed persons who have exhausted their Unemployment Benefits even with the additional 13 to 20 weeks allowed in high unemployment states?

Also, isn't it likely that unemployment rates will rise over the next year, and that many more jobs will be lost adding further support for the need for more Unemployment Insurance?

The reason why I raise this is because, you know, Mr. Vedder, when Bernanke testified before the JEC, sitting in one of the same seats you are sitting in, and we talked about the housing situation, basically he said: It'll work out. Everything will be fine. It will be fine. We talked about the way unemployment was rising, he said: It'll be fine. It'll work out.

The problem is that a lot of people—I mean, everybody up here have people in their Districts who have lost jobs, and who will continue to lose jobs. You know, not long ago, everybody thought get a Whirlpool job, you know, you would be in good shape. You could retire and be fine. But people in Whirlpool today and other companies are losing their jobs.

People in New York, I know many of them have lost jobs. It is estimated that by the end of this year 1.1 million people will have run out of Unemployment Benefits. So talk about that, Mr. Roubini.

In other words, I was very glad to hear Mr. Brady say that perhaps we might want to look at trying to figure out how we can help people in areas where unemployment is high, but it did concern me—and I do not think there is anybody up here who is trying to create false hope.

It is not about false hope. It is trying to help the American people as they go through a very difficult circumstance. And you, Mr. Johnson, said—Dr. Johnson, I apologize, you talked about how long this could go. You said 18 months. Or longer? Is that what you're indicating?

Dr. Johnson. Yes.

Representative Cummings. Okay, or longer. And it seems to me that if you do not have a job, and let's say for example you had a consumer loan that you were trying to pay, you are not going to be able to pay it. I mean, that is why in some kind of way it seems to me we have got to address this whole issue of people on Main Street, and we have got to do it now.

We have got to have a sense of urgency, because the people that I represent, you know, they listen to all of this, it sounds nice, but they are trying to figure out how they are going to survive from one day to another, how they are going to be able to afford the gasoline even if it comes down to $1.99 a gallon. That is what they are trying to figure out.

So would you all talk about the unemployment situation and how you see it—Dr. Johnson, Dr. Roubini, and maybe even you, Dr. Vedder.

Dr. Johnson. Thank you. In my written testimony I suggest very strongly that Unemployment Benefits should be extended beyond the current expiration time. I think the Food Stamp Program needs to be expanded. I think loan modifications for distressed homeowners are very important both to help people appropriately and because of the macroeconomic effect. And I think that for the longer term programs, job retraining programs, or grants are extremely important. They take a little bit longer to work. And expanded student loans, and expanded small business loans would all address the issues that you are raising—part of a broader package that includes infrastructure.

But we are looking at four to five years, I think, of a problem, not a four- or five-year decline, but a sharp recession followed by a very slow recovery. There is plenty of time for all of these programs to work and to address exactly the concerns that you are raising, Mr. Cummings.

Representative Cummings. Dr. Roubini, did you have a comment?

Dr. Roubini. I think the issue with unemployment is going to be a very serious one. Even during the last recession in 2001 which was very short and shallow and lasted only eight months, and the fall in output was only a mere 0.4 percent, job losses continued all the way through August of 2003. There were 5 million jobs lost. And there is an agreement that this time around this is going to be a much more severe and protracted recession because at that time it was only a cutback in spending but the corporate sector was falling 10 percent of GDP. Right now, there is a beginning of a consumer recession and consumption is about 71 percent of GDP.

So you have a U.S. consumer who is shopped out. He is saving less. That burden of debt to disposable income of the average household has gone from 100 percent in 2000 to 140 percent. Now home prices are falling, so you cannot use your home as an ATM machine, borrowing against it. The value of your 401K has sharply fallen, 40, 50 percent. Debt service ratios are now rising because of the resetting of interest rates on mortgages, credit cards, auto loan, student loans. Consumer confidence is collapsing. So everything is going south for the U.S. consumer.

And people said until recently, yes, these are headwinds against consumption, but as long as there is job generation and income generation people are going to keep on spending. But guess what? Now for 10 months in a row employment in the private sector has fallen, and for 9 months in a row total employment including public employment has fallen. Every indicator of the labor market suggests that this rate of job loss is accelerating.

A few months ago we were losing 50,000 jobs per month. In August it was 80,000. In September it has already been 160,000 almost, and is getting worse. Indicators from initial claims for Unemployment Benefits, continuing claims suggest that the condition in the labor markets are worsening severely.

There was a piece in The New York Times this morning on the front page on massive job losses in New York and New York State, and it is not just finance. Everything is related to finance. It is tourism. It is restaurants. It is corporations. It is law firms. It is services. It is industrial production. This is becoming a very, very severe recession, and unless we do something to boost incomes and Unemployment Benefits, Food Stamps, fiscal stimulus and things to try to make the recession shorter and more shallow, this is going to be the worst recession we have had in decades. That is why it is urgent and important to do something about it.

Representative Cummings. Thank you.

Vice Chair Maloney. Thank you for that fine statement. I thank all of the panelists. You have really given us very insightful and important testimony today.

I would like to hear you all day long, but we have a second panel, residents from Main Street, who will tell us what it is like for them in their communities.

Again, I want to thank all of you for your service here today, for your research. It has been invaluable. We appreciate it deeply. Thank you, very much.

Vice Chair Maloney. I'd like to welcome the second panel. We are going to be hearing from community leaders from Main Street, but I would like to publicly thank my colleague and good friend, Representative Cummings, and his staff, especially Leah Perry, for their invaluable help in recruiting this panel of community leaders from the great state of Maryland.

I am calling upon Representative Cummings to introduce the panel, many of whom are from the District and state he is honored to represent.

Representative Cummings. Thank you very much, Madam Chairwoman. We are, indeed, honored to have three of Maryland's finest. I really mean that. I've known all of them for a long time.

They give their blood, sweat, and tears every day in their jobs, lifting people's lives.

Vincent DeMarco is President of the Maryland Citizens Health Initiative, a coalition of organizations that seeks to ensure better healthcare for Marylanders, by promoting universal and accessible health insurance.

Previously, he was Executive Director for the Maryland Children's Initiative.

Donald Fry is President and CEO of the Greater Baltimore Committee, the Central Maryland region's most prominent organization of business and civil leaders. Mr. Fry has also served in the Maryland General Assembly. As a matter of fact, we served together, and as a member of the Senate of Maryland.

He is one of only a handful of legislators, past and present, to have served on each of the major Budget Committees of the Maryland General Assembly.

Mr. Joseph Haskins, Jr., is the President of the Harbor Bank, one of the top ten African American-owned and operated financial institutions in these entire United States.

He serves as a Director on the Board of CareFirst, Blue Cross/ Blue Shield, Morgan State University Business School, and Security Title.

He is also a very good friend, and he serves as the Chair of the East Baltimore Biotech Urban Development Project and Associated Black Charities.

Thank you very much for the opportunity, Madam Chairwoman, to introduce these distinguished gentlemen, and I want to thank you all for being with us this morning.

Vice Chair Maloney. Thank you for helping us put this panel together.

Each panelist will be recognized for five minutes. We'll start with you, Mr. DeMarco, and then go to Mr. Fry and Mr. Haskins. Thank you.

STATEMENT OF VINCENT DeMARCO; PRESIDENT, MARYLAND CITIZEN'S HEALTH INITIATIVE, BALTIMORE, MD

Mr. DeMarco. Thank you, Madam Chairwoman Maloney and members of the Committee, and Congressman Cummings, who has been a hero of mine for many, many years.

I greatly appreciate the chance to talk with this Committee about how the economic downturn is hurting Marylanders' healthcare, and how this Congress can help resolve this problem.

Over the past few years, under the leadership of Governor Martin O'Malley, the State of Maryland has made significant progress in expanding healthcare access in our state.

Most importantly, because of the Governor's initiative, and after careful balancing of state priorities, Maryland went from 44th in the country, to 21st, in providing Medicaid coverage to adults, and uninsured Marylanders are responding.

In the three months since the law took effect, over 16,000 uninsured Marylanders have signed up for coverage, demonstrating the great need for this expansion.

Now, though, this healthcare coverage for tens of thousands of Marylanders, is directly threatened by the current economic crisis. As you know, the downturn is dramatically lowering sales tax revenues, forcing states to reevaluate priorities and to cut important programs.

Maryland is among these states, facing a deficit of hundreds of millions of dollars, despite having recently taken aggressive measures to deal with the structural budget problem.

Many of the people who would be hurt in Maryland, if Maryland's new Medicaid expansion is curtailed, are in particular need of healthcare coverage now because of the economic downturn.

Among the people who are eligible for the new expansion, are a plumber on Maryland's Eastern Shore—not named Joe—and a single mom in Prince George's County. Both of them had healthcare coverage through their jobs until recently when both of them lost their jobs and their coverage, due to workforce cuts made by their employers, necessitated by the economic downturn.

They both had jobs and coverage; the economic downturn comes, and they lost their jobs and their coverage.

The impact of not having healthcare is devastating. I'll give you just one example: There's a sad story of the 54-year old brother of Mrs. Judith Campbell of Baltimore City. Ms. Campbell told us, and I quote her, "My brother took his life earlier this year, because he found out that he had treatable, but potentially fatal cancer, and was turned down by the State for healthcare assistance."

He worked as a security guard for $8.49 an hour, and his company did not offer health insurance. Mr. Campbell would have been eligible for the new Medicaid expansion we enacted in Maryland. It would be very sad if the economic downturn prevented us from fully implementing this expansion and saving many other Marylanders from the economic distress, healthcare woes, and possibly even death that can result from the lack of healthcare insurance.

We strongly urge this Congress to move quickly to enact an additional economic stimulus package that would help states like Maryland, pay for critical healthcare needs.

Specifically, we ask that, in a new stimulus package, you include an increase in the Federal Medical Assistance Percentage, FMAP, that would provide additional Medicaid dollars to forestall significant cuts.

Increasing FMAP would help Maryland in two important ways: First, it would spur economic growth. According to a recent Families USA analysis, for every one million dollars in additional Medicaid funds that Maryland would receive, there would be $2.2 million in additional business activity, including 20 new jobs and $765,000 in additional wages.

A bill that didn't pass this Congress, S. 2819, would have given Maryland an additional $111.5 million in federal dollars, which would have generated $210 million in business activity, 1800 new jobs, and $724 million in additional wages. That would have been the FMAP increase.

In addition, if you do the FMAP increase that we're suggesting, it would put money directly into Maryland's Medicaid program, and we wouldn't have to cut people off who are now receiving healthcare coverage, people who really desperately need it.

The FMAP increase is the most important thing we believe you could do in the stimulus package.

In addition, though, besides the FMAP increase, we urge you to consider other ways to help keep healthcare alive and well in Maryland. Most importantly, pass the SCHIP law; the State Children's Health Insurance Program expansion and reauthorization. Congress previously passed SCHIP but unfortunately, it was vetoed. It's very important that you go back and pass SCHIP.

Additionally, we urge you to do whatever you can to remove obstacles that the Federal Government is putting in front of us. We want to work with you to achieve healthcare for all at the federal level, but until we reach that goal, please don't block us from doing what we need to do.

We passed in 2005, a great new prescription drug law that the Bush Administration blocked.

Please help us by supporting a bill that Representative Chris Van Hollen has put in and help us remove the Employment Retirement Security Act blocks on state programs.

[The prepared statement of Vincent DeMarco appears in the Submissions for the Record on page 111.]

Vice Chair Maloney. Mr. Fry.

STATEMENT OF DONALD C. FRY, PRESIDENT AND CEO, GREATER BALTIMORE COMMITTEE, BALTIMORE, MD

Mr. Fry. Madam Chair, members of the Committee, thank you very much for the opportunity to be here. First of all, I commend the Joint Committee for the foresight and initiative to pursue an aggressive agenda to achieve our economic recovery.

The Greater Baltimore Committee has been actively engaged in advocating for a significant investment in transportation infrastructure in Maryland for a number of years.

A focus on investment in infrastructure, in my opinion, is an appropriate and much needed step that will bring about positive results.

Our nation's infrastructure, both transportation and public utilities, are under stress. If we do not invest to repair and build to keep pace with growth and changing population and employment patterns, the consequences will be enormous.

We are already seeing intolerable congestion in our metropolitan cities. We are seeing longer commute times in our expanding outer suburban corridors.

We're experiencing a stifling of growth and economic development as local governments attempt to keep pace with increased demands for public water, sewers, schools, and transportation.

The failure to address these challenges, not only affects our economic growth, it negatively impacts the quality of life we've come to enjoy and cherish.

At the national level, the price tag to address the condition of our transportation infrastructure, power grids, water and waste water systems, was placed at $1.6 trillion in a report by the American Society of Civil Engineers.

The National Surface Transportation Policy and Revenue Study Commission report, released earlier this year, concluded that there was a need for an annual capital investment of three to four times what the Federal Government currently spends to address the investment gap.

The cause for this deterioration regarding our infrastructure, the backbone of our economic growth, is twofold: First, lack of money, but, second, the failure to recognize infrastructure investment as a public policy priority, essential to economic growth.

Those two factors have caused a significant backlog in the construction of new infrastructure projects, and resulted in many states only expending money for the very basic maintenance and repair of its systems.

In Maryland, the state went almost 16 years without a significant investment in transportation funding.

Last year, the six-year transportation plan included over 90 projects in the planning phase, with not a single dollar designated for construction of those projects.

The estimated total cost of the construction of those 90 projects, was well in excess of $40 billion.

Yet, just a few months ago, Maryland deferred $1.1 billion in transportation projects, in its current six-year plan, citing lagging revenues and uncertainty over federal funding, as the cause.

It's estimated that every billion dollars in federal transportation investment, supports approximately 35,000 jobs and $1.3 billion in employment income.

An investment in infrastructure at this time in our challenging economic state, would be significant. It would help buttress the struggling construction industry that's lost more than 600,000 jobs over the past two years, as a result of the declining housing market, and tightening credit markets.

It would stimulate investment in our weakening infrastructure and benefit small businesses and minority and women-owned businesses, that significantly rely on major construction projects to grow and expand their business capacities.

I thank you for the opportunity to address you on the importance of infrastructure investment and the vital role that it can and should play in your consideration of an economic stimulus package. Thank you.

[The prepared statement of Donald C. Fry appears in the Submissions for the Record on page 1116.]

Vice Chair Maloney. Mr. Haskins.

STATEMENT OF JOSEPH HASKINS, JR., CHAIRMAN, PRESIDENT, AND CEO, THE HARBOR BANK OF MARYLAND, BALTIMORE, MD

Mr. Haskins. Thank you very much, Vice Chairwoman Maloney, and I thank my Congressman, Elijah Cummings, for allowing me an opportunity to share thoughts from Main Street.

I am a Main Street banker. I manage a $300 million bank that has experiences that I think would be important for you to hear and for me to share. So this is a tremendous opportunity, and again I thank the Committee.

There are five points that I would like to make. I want to say first that I recognize that the government has taken very serious steps to address the crisis that is before us, the crisis that represents an erosion of the public confidence as well as an erosion in the confidence of the financial institutions.

But as I look back at the many steps that have been taken, what I quickly recognize—and many of my colleagues, and in this case I speak both as a community banker from Maryland, but also as a community banker representing many other community banks across this country—what we see is a program that has largely focused on the large financial institutions.

And while we recognize that there needed to be focus on the larger institutions, we also recognize and suggest to this Committee that we have got to give attention to Main Street, the street where we believe we have not seen any real measures taken.

My five points, and I quickly make them:

One, subprime. I am fortunate that my institution stopped doing subprime loans four years ago. The reason we stopped is not because we are smarter than my colleagues, it is simply because we recognized that there was too much fraud, too much misrepresentation, too much deception, and our due diligence process could not ferret out the magnitude of the problems such that it made sense for us to continue.

And so we say to you that those larger institutions that continued, they overlooked or did not pay attention the way that some of the small community banks did. And when you look at the problem you will find that many of my colleagues, as I, do not have heavy weighted portfolios of subprime.

Why am I raising this? I am raising this because as we looked at the increase that was made by the FDIC in terms of insurance coverage costs, we were increased along with everyone else. In many ways we see ourselves helping to bail out our larger, bigger brothers. And we questioned whether or not that is fair.

The second point that I would like to make: Many of these financial institutions have suffered losses in deposits as the larger institutions stumbled. The stumbling created a confidence scare, and therefore led to a run on deposits. Those deposits are our life blood. We loan those out to the small businesses. And so I lost initially about 10 percent of my deposit base.

Fortunately, with the changes made by the FDIC in coverage I was able to regain some of those, but not all of it, back.

The third point that I would make: With the increased problems that have plagued the economy, the credit crunch, what we have experienced is an increased number of delinquencies and defaults. I am running two-and-a-half times what I had previously experienced in my worst year. I am a 26-year-old institution, and a 37-year banker. So I am not talking about something that is new, something that is recent in terms of an observation, I am talking about something that is very real.

Our comment to you is that we at the community bank level need to see a stimulus package that helps us address those problems of securities, those problem loans to free us up to do the business that we need to handle.

Smaller banks, the fourth point, smaller banks need to have you consider having us purchase and sell to you some of our problem loans. It frees us up with our smaller staffs, our smaller operations. We are committing our time to work out rather than giving money to desperate leaders, or desperate businesses in our communities.

I know my time is up, but I've got to make one more point, and I'll leave my fifth one out. What I see every day, and what I am experiencing every day, are the small businesses that you won't hear from like the cleaners. The local cleaners are seeing less business because people are being laid off.

I finance about 15 different cleaners. And so when I talk to them, they say to me: Mr. Haskins, we're not getting the same business.

Restaurants, because larger companies don't like restaurants, we have been key in financing restaurants.

Restaurant business in Maryland is down 50 percent. I would suspect and suggest that it probably represents that kind of number across the country. I also say to you that many of the larger banks have approved loans to businesses, and I can give names if necessary but I won't because of confidentiality, but those same businesses originally had approved loans and later were called to say that they could not be financed, and they have come to me for that financing.

Ladies and gentlemen, in closing I say to you that there are hard times on Main Street. One of the fastest ways to get funds and money into the hands of these businesses that are vital to Main Street survival is by supporting the local community banks, those that know the community and deal with it every day.

Thank you, very much.

[The prepared statement of Joseph Haskins, Jr., appears in the Submissions for the Record on page 119.]

Vice Chair Maloney. I thank all the panelists for your testimony. It is important, and very relevant.

I would like to recognize my good friend Representative Cummings for the first questioning period and thank him again for helping me assemble this panel.

Representative Cummings. Thank you very much, Madam Chairwoman.

Mr. Haskins, many small businesses have had problems with lines of credit. I have had a number of businesses to tell me that the larger banks cut off their line of credit, and so they were placed in a position where they could not do business, literally could not do business.

You might want to address this, too, Mr. Fry, but how does that affect you? I mean, have you seen some of that? In other words, is that a problem in our area?

Mr. Haskins. It is a serious problem. I can tell you that we finance many of the small businesses, including law firms. For example, I have law firms that have had lines of credit with me for as long as five years that have never borrowed on those lines. They are now borrowing on those lines.

I have those who are in the construction business who are in the middle of projects, and because their lines have been reduced and cut off at other institutions have come to me for payroll. And I can tell you that my cell phone rings endlessly. Before coming into this meeting, I had an individual calling to make payroll tomorrow. I mean, my views and my comments are very real. They are individuals that we can talk about and we can look at.

There are people that you know that are calling me at this very moment seeking financing for projects that they are engaged in but they do not have the operating income to carry them forward.

Many of the larger institutions, because of the challenges that they are experiencing, have cut off lines to smaller businesses. That is very real. That is not something that is made up. I mean, there are names and individuals that we can point to that are reflective of that situation.

Where they turn is they turn to the community banks because they believe we understand and have a better and deeper appreciation for their need, and will find a way to try to get financial resources to them.

Representative Cummings. One of the things that in our research—I also sit on the Government Reform Committee where Ms. Maloney and I are doing investigations with regard to all of this—and one of the things that we discovered is that a lot of the larger banks seemed to be careless with some of their lending requirements because they knew that they could sell them off to others.

And as I listened to your comments about when you said that Harbor Bank stopped performing subprime loans four years ago, I am so glad you had the foresight. I assume you might not be in business today if you had stayed in there. Is that right?

Mr. Haskins. That is a fair and accurate comment. You know it is easy when—and again this was not to be critical—there was a greed factor, and this Committee and others must accept that there was a greed factor that motivated that. The brokers that largely put together many of these deals would present them to the smaller banks, or to the different community banks, and the banks tried to do initial due diligence. It became challenging to do the due diligence.

And because you were not holding that portfolio in your bank in your inventory, you packaged it, pooled it, sold it off to Wall Street to the Bear Stearns, and the Lehmans and so forth, and what they did is they reconfigured it and sold it around the world.

Many of us, you know, in business school—and I am both an economist and a finance-trained individual—some of the training we go through is if you diversify enough you can diversify away risk. We are kind of trained and taught that.

Well, you know, one could make a case arguing that there was diversity in it. Well we had geographical diversification because these pools were coming from across the country. There was income diversification. You had high income, low income. You had large house, small house. So you could argue that there was a lot of diversification.

But the underlying problem to those toxic securities was the fact that you had too much fraud that was in. I mean, we saw misrepresentation of employment history. We saw altered credit scores. We saw fraudulent incomes. That "stated income," any serious banker who has been around, "stated income" was a no-no.

When I bought my first house I worked five years to accumulate my 20 percent down. We had an old rule-of-thumb. We said you should never buy a house for more than two-and-a-half times your gross income.

Well we can look back and see that people were buying houses five, as much as ten times their income, because many times the income was stated at levels substantially higher than what they were actually earning. But there was no real due diligence done, and so for the problems to be resolved we have got to work that back through.

But to the economic stimulus package, the reason why Main Street banks and financial institutions are important is because many of these individuals are coming back to us. We didn't create the problem, but we can help be a part of the resolution.

Representative Cummings. Do you see much of a default rate with regard to your mortgages?

Mr. Haskins. We have defaults. We have increasing delinquencies, and what we are trying to do is work with individuals. Our biggest challenge is working with the commercial clients.

Many of the borrowers now are suffering, and we will see tremendous fatalities over the next six to twelve months if more financial resources are not moved into the direct hands of community bankers. It's too long for that money—it will take too long for the money to trickle down from the larger institutions.

For example, many of the largest institutions' credit score small business. It's hard to credit score a business. So if that small business doesn't meet a credit score that's acceptable, they don't get the business.

Well our experience reflects to us that there are extenuating situations, or there are different factors that you need to look at for making that loan other than just a credit score.

Representative Cummings. I see my time is up. Thank you.

Vice Chair Maloney. Mr. Brady.

Representative Brady. Well thank you to the panel, especially those who have Congressman Cummings as their Representative. He is one of the more respected Members of this body, and we appreciate his work on a wide range of issues. You have got a class act there.

Was that on TV? [Laughter.]

Representative Brady. No, I'm kidding you. I'm kidding you. [Laughter.]

Representative Brady. No, I mean I'm sincere about that.

I do think there is merit in rebuilding our crumbling infrastructure. It is really an embarrassment. And whether we do it through this economic stimulus or really come together, Republicans and Democrats, on fixing the Highway Trust Fund, energizing our Freight Rail infrastructure, our water infrastructure, we have got to act.

I do think there is a way we could bypass our federal middleman and inject dollars directly into bid-ready contracts back home. I actually think that that could create jobs at the local level, and fix just a looming problem we have, especially in fast-growth areas of the country, and then in the rural areas where they just don't have the resources to keep their roads and bridges safe at all.

On the banking side, you sound just like my community banks in southeast Texas. When I was looking at the bailout package, I didn't get on the phone to talk to people from Wall Street, I talked to our community bankers. I got them on the phone and started asking them questions, and they made the same points you did, which is:

One, you are scaring our depositors. You know, we don't have these problems. We didn't make these bad loans. We are running these things right. Stop scaring them. Which is why I think increasing the FDIC limit was helpful to reassure people, look at the community banks, the independent banks, they have got a very sound structure.

They also made the same point you did, which is give us a chance to buy some of these mortgage-backed securities and some of these things because we know how to work a loan out. We think there's value in loans, if you know who the people are, if you will work with them and try to find the terms that, if they can, keep them in their homes. Keep the property values up and the quality of life in that neighborhood. They said exactly the same thing you did.

My question is, Mr. Haskins, ought we not, as we go forward to try to prevent this from happening again, ought we not consider sort of back to the future? Going back to the basis of a down payment, even a minimal one, on home purchases? Have verifiable income so that you know there is an income stream?

Perhaps having lenders, whether it is the original lender or the first purchaser, either hold those for a period of time, or keep a stake in them so that their standards are going to be higher at the outset before you allow bad loans to become an infection throughout, as we know now, the world? You know, that there would actually be value in them before that occurs? Is there merit in us insisting that those nonbanking institutions have the same scrutiny, same capitalization rate, the same leveraging restraints that our local banks have?

Because it seems like to a layman these complicated financial instruments are way over many of our heads, and I am not sure if we can ever be smart enough to regulate the back end of all that. But it seems to me that if we set a good foundation early on in that whole asset-based financial structure, that we really limit the mischief later on.

Can you give me your thoughts?

Mr. Haskins. I think your comments are just so right on. Many of my colleagues in the banking worlds made the early statements that we were being sort of driven out of the origination market on residential mortgages because we were too conservative.

We were trying to hold folks to those standards. We got the development of an industry, the brokers, who did not make any money unless a transaction was consummated. A deal had to be done.

Then banks started getting very liberal—and I won't call names; you all have heard them and seen them—and banks started getting creative with the kind of products that steered away from that traditional kind of approach. And so we looked at teaser rates. We looked at adjustable rate mortgages. We looked at interest-only. We looked at stated income. And so we got creative because what we saw is an opportunity to make money.

And if you get too much into that money-chasing vein, you are going to start overlooking what you need to overlook. And if—and going to your recommendation—if we start moving back to a policy of requiring people to have money, first of all I think you should never have an unregulated body such as the brokers were. They ought to have some standards.

And I am not a big government kind of person, but you have got to have some standards and some regulation there. But we ought to require people—I mean, there is an old adage, and this I did not learn in business school, I learned this—if folks don't have some skin in the game, there is nothing to hold them to the table. And that's what you're talking about.

That person who had to work to get their down payment is much more likely to be a good payer of that mortgage. They just are. I mean history is replete with evidence and examples of that.

So I think while we talk about home ownership and say that it is the American dream, it shouldn't be the American dream if we are loaning somebody 100 percent of the mortgage and giving them the down payment. I mean, what do they really have at stake?

So I would be one that would argue that absolutely you ought to have a requirement for someone to have something from their personal financial resources that is verifiable, and you certainly ought to require verification of work status as well as income.

So I think you are right on. And if you are going to promote that, you can call me and I will be happy to come testify.

Representative Brady. Thank you, sir, I appreciate you being here today.

Vice Chair Maloney. Thank you for your testimony. And Congress did pass a Mortgage Reform bill that brings the broker/dealers under the same regulation as banks and community banks, and as we know the main problem was with the broker/dealers that had no regulation. Your points are very clear and important on going back to the future to standards of having skin in the game and higher standards going forward.

In your comments, Mr. Haskins, you said that your default rate and delinquency rates have increased. I would like to get a little more information on your bank's credit card accounts. Have they increased? Commercial real estate, what is the state of that? Residential real estate, auto loans, and other personal loans? If you could go through those categories and give us a sense of default or health that you're experiencing in your bank.

Mr. Haskins. I would tell you that in all of the categories that you mentioned, to be quick, and then I can get specific, to be quick about it, have increased in delinquency some 30 to 50 percent just automatically, I mean we saw increases.

Credit cards are at the highest levels. So you're not talking about people now who have any access to credit. You're talking about people who have exhausted their credit.

In the case of home equity lines, those lines are up to their max, so there's no place for them to go. And now they are delinquent on those. So we're seeing that piece.

When we talk about residential developers—and that's the area probably where I'm experiencing the most difficulty—the residential developers that we have financed are those who are doing somewhere between 5 to 50 units, and they're in the Baltimore Metropolitan Area.

These individuals are harder pressed for larger institutions to do. Now fortunately we have a lot of equity. We force our builders to put more of their money into the buildings. So while we don't have the same exposure, what we're seeing now with—and this is a bit of the challenge. See, many of the larger banks, as they get access to these resources, they then sell and turn over their products at substantially lower prices, which then drives down the price that we can get.

So you get this kind of conundrum going on here that is really interesting. So because X bank, not to call the name of one, X bank, we have the same financing in the same community, and so because they have gotten a nice award they can sell off their project for 50 percent of the value, where if they didn't have the award they would be like me negotiating to get 80 percent of my money.

But when they get 50 percent of the money, then the next person that comes along that I'm negotiating with will say, well, X bank sold it for 50 percent on a dollar, why are you trying to get 80 percent on the dollar? Which is the reason I am coming back to the importance of getting this stimulus package down to Main Street to community bankers, because we are dealing with that every day person. We are putting folks in houses. We are still doing product and projects that other banks have since turned their backs on.

So, yes, I am experiencing delinquencies. Fortunately, we have remained profitable through this. But when regulators come in, we are being asked to reserve for loans, by the way, which is very interesting, loans that are not delinquent but because they are in residential real estate we've got a reserve against those because the residential market is down.

So there are many challenges that we are experiencing. And one last point—

Vice Chair Maloney. Could you clarify when you say you have to reserve against those? Do they have a specific capital requirement, or what is the reserve that they make you put in for residential real estate?

Mr. Haskins. For example, if it's assumed that—and they will come up with several different indices to determine, so for example you take let's say a $100,000 loan. If no property has been sold, or if this project is in the middle of its development, they will come in and give an assessed value of the lot and an assessed value of the house at the end of its completion. And if they assess that the value of this is $80,000 and not $100,000, then that loan becomes what's known as "classified," and there are different states of classification.

Then we are required to set aside 20 percent, $20,000, in a reserve in anticipation of that loan not paying off or defaulting.

Vice Chair Maloney. Thank you.

Mr. Fry, I would like to focus really on a concern that we have heard repeatedly on the fiscal stimulus to support state infrastructure spending and other infrastructure spending in our country.

We know it is in dire straits. We know we have bridges crumbling. We have roads that need to be repaired. But many of our colleagues will say that this is not a good direction to go in because it's not immediate. We cannot spend those dollars immediately.

I know from my own City of New York we have many projects that have stopped because of lack of money. We could start those projects moving immediately, and I would like to specifically ask you: Are there projects that have been postponed only because of financing problems that could be started immediately in your state if there was a fiscal project directed towards its infrastructure?

Mr. Fry. I appreciate the concerns of those that are worried about the lag that may occur before a project moves forward, and that certainly could be true with respect to some projects that are in the planning mode, but even as recently as yesterday Maryland's transportation Secretary, John Porcari, before the House Transportation and Infrastructure Committee testified that he has identified as many as three dozen projects totalling about $150 million that could be obligated within about 120 days.

So I think that because of the deferral that has occurred recently because of the lagging gas tax revenues that have come in, and the lagging sales taxes that have come in from the sales of cars and registrations, that there are a number of projects that had to be deferred that could have some immediate impact if those monies were available.

I think you do have to pick and choose which projects are there, but I think the transportation secretaries of the states across the country could clearly identify those projects that could have that immediate impact.

Vice Chair Maloney. Thank you very much. My time has expired. Mr. Cummings.

Representative Cummings. Thank you very much, Madam Chairwoman.

Mr. DeMarco, let me just ask you this. I think there are a lot of Americans who are suffering, and I say that they are dying every day in large numbers because they cannot afford medicine, and sometimes cannot afford treatment.

I take it that these are the people you are concerned about, and your organization is concerned about. I live in the inner city in Baltimore and I have a fellow who showed me his medical bills for cancer. He had to have four chemotherapy treatments. The bill was $12,000 a treatment. He had insurance now. And he had to pay $1,172 of that.

He had to have something else called Nulastin after every treatment. Just for a little prick in the arm of Nulastin it cost him something like $6000 or $7000. He had to pay $500-and-some for that.

And that does not even include the MRIs and the PET scans and the CAT scans and all the other things. And then when we look at bankruptcies we see in the United States that a huge percentage of bankruptcies have to do with medical bills. People can't pay them.

And so in order to address that—and I say it's sort of a silent kind of problem because people suffer, and a lot of times they suffer but they don't talk about it to other people because it's so personal, but when I move around and I go throughout my District and I talk about this, I mean literally I see people sitting in the audience with tears running down their faces because they are going through it, or a family member is going through it.

You gave an example in your testimony, but do you see a lot of that? Do you all hear a lot of those kinds of cases where people just hit the end of the rope? And there is another thing that is happening, too, that my constituents tell me about, is like when people get a little older and they have to make difficult choices, and they see that medicine may cost them, it may be only $2000, $3000 a year, but that $2000 or $3000 when you do not have very much income is a lot of money, and so they will say: You know what? I don't want to burden my family. I am already a little older. So just let me die so that they will have a chance to live.

I mean, do you hear about those kinds of stories?

Mr. DeMarco. Yes, Congressman Cummings, we do. We have had public hearings across the State where we constantly hear people telling us of devastation caused to their families because they cannot afford health care.

You are right that some studies say that up to half of all bankruptcies are caused by health care bills that cannot be paid. Foreclosures happen a lot of times because people cannot pay their health care bills or have to put their money into staying alive so they cannot pay for their homes. There is a study by Families USA showing that. And it is just over and over again we see the devastation caused by people not having health care.

I told the story of Ms. Campbell's brother. There is another story of a gentleman who was the kind of person we all talk about who does the right thing. He works as hard as he could every day. He did not have a high-paying job and he could not get health care at his job, but he had to keep working. He could not stop working, and he just kept working and kept working and did odd jobs here and there to just feed his family, feed himself, but he could not pay for health care. So he had some health problems and he just could not deal with them. So, okay, he just kept working.

One day he was mowing somebody's lawn as part of his job and he had a heart attack and died. And if he had had health care coverage he could have dealt with these problems.

Now the thing, Mr. Congressman, that you know so well is that it is not just the uninsured who pay these costs. We all do because when someone is very ill, if they do not have health insurance and they put it off for years and they got sicker and sicker, we do not let them die in the street, unless of course they have a heart attack and die, but if they get ill and they go to the hospital we take care of them, and that costs lots and lots of money.

And somebody pays for it. Not the uninsured because they can't afford it. All of our insurance premiums go up to cover that. So there is a hidden health care tax that we all pay to keep people alive when, if we had had everybody covered with health care, they could have gotten their treatments and stayed alive. It would be much better for them and their families, and much better for all of us.

That is why this new Medicaid expansion is so important in Maryland that Governor O'Malley enacted. It is so important. Over the next couple of years we estimate that it will provide health care to over 100,000 uninsured people. I want to thank Don Fry and the Greater Baltimore Committee for being amongst the people who really pushed for that and understood how important it was.

We desperately need your stimulus package to include the FMAP money so that there is more money in the Medicaid Program to help us keep that program going.

These 16,000 people who just got covered—and there are going to be more—but these 16,000 people are people who desperately needed it. Let me tell you, Mr. Chairman, about the very first couple:

Alana and Adamontis Bollis, a couple whose kids were covered by the CHIP program for awhile but they could not get health care, and they had colon cancer issues, diabetes issues. They were not getting treated and they were getting sicker and sicker.

On July 7th of this year, Governor Martin O'Malley handed them the very first cards under our new Medicaid Expansion Program, and they now can get treatment.

Please help us keep that program going.

Representative Cummings. Just one last question, Madam Chair.

Mr. DeMarco, what would be the benefit of extending the Families and Small Business Health Care Coverage Act that we have in Maryland to the rest of the country? I am just curious.

Mr. DeMarco. Well, Representative Cummings, we want health care for all for the whole country. That is our goal that we are pushing for in Maryland but we want to work with you to have it nationally. But, we believe that until we reach that goal states should do as much as they can with your help to expand Medicaid coverage. And in addition to Medicaid in our program gives grants to small businesses to help them provide health care.

If in your stimulus package you included more Medicaid assistance for the states, other states would be able to do this, too, and we could help a lot of the people who just cannot afford private insurance and are out there getting sick like the Bollises. And again, let me emphasize this again, Congressman Cummings, it is not just the uninsured who suffer because of uninsurance. We all do.

Representative Cummings. I want to thank all of you for being here today. We really do appreciate what you have done.

Mr. Haskins, I have got to ask this because there has been a controversy here in the Congress with regard to these loans on mortgages and I want to ask you this question.

Some people bring lending to low-income households and CRA, the Community Reinvestment Act in particular, to the current financial crisis. As a lender who has received the highest performance rating for CRA, do you see differences in defaults or delinquencies from lower and middle-income households? And how has CRA impacted the Baltimore and Prince Georges County communities that you serve? Because a lot of people seem to want to push this on Fannie Mae and Freddie Mack, and I am just wondering how you see it? I just want to clear that up, from your perspective.

Mr. Haskins. This problem is across the board. When you start seeing the defaults that will begin to occur with some of the high-end properties you will know it is not CRA-based individuals who are a part of that problem, not at all.

I mean, this was across the board. The stated incomes are really more in the area of individuals who were privately employed, or upper income individuals. Many of the delinquencies and defaults we are seeing are at housing prices that are in the half-million dollar range and up. That is no low income. No, this cannot be passed off.

I served, by the way, three different terms on Fannie Mae's National Advisory Board and can speak very definitely to that program. Were there cases where those individuals were misrepresented or misrepresented? Absolutely. But I can tell you that more often than not what you will find with the lower income home buyers, they were more misled and duped than they were initiating.

Most do not understand. If you fill out a mortgage application, anyone here who has bought a home who has filled out a mortgage application, it is a pretty involved application. And I can tell you, having done endless seminars on how to go about buying a house, and buying a home, or looking at property, that most low-income folks are totally in the dark about that and they take a lot of direction, which is, Madam Vice Chair, why it was important to regulate broker/dealer individuals. Because they misled a lot of these individuals and were advising them that they, just by distorting this and distorting that, knowing what we look at for approving a loan, they could get over the hurdles.

So, no, you cannot put this on the back of just low-income individuals. In fact, as data will reveal and reflect over time, you are going to see more and more defaults at much, much higher home pricing points.

Representative Cummings. Thank you very much, Madam Chairlady, for your indulgence.

Vice Chair Maloney. Thank you.

One last question. Mr. Haskins, you testified that you did not invest and participate in these subprime loans. You saw fraud on the applications. So given that you did not engage in this risky behavior, what do you think about the financial rescue package for large banks?

Mr. Haskins. I can't tell you my first reaction. [Laughter.]

Mr. Haskins. That would not be printable or recordable. But I'll tell you this. Because of the importance of bringing confidence and stability back, those kinds of steps needed to and had to be taken. So for the greater good I have accepted it and said let's move forward.

I do believe, though, that you just cannot give money away without having some requirements. You just can't do that. I mean, I am in a business that we set very specific requirements for getting repaid.

So I agree that the actions taken by the Congress and the government in general needed to be taken, especially as it relates to Wall Street. However, I think there needs to be some requirements placed on that money, one; and two, I definitely think that you have got to have Main Street included in the proposition.

Vice Chair Maloney. Thank you. And finally I would like to ask all of the panelists, beginning with you, Mr. Haskins, Congress is considering a fiscal stimulus package that would include aid to the states and infrastructure investment.

How would such a fiscal stimulus package help consumers and businesses and individuals in your communities? Could you comment, all of you, Mr. Haskins, Mr. Fry, and Mr. DeMarco?

Mr. Haskins. First, you are going to get people in positions to earn a living. You are going to get jobs. Creating jobs. Jobs are vital.

As has been said by several of your colleagues, we have seen a reduction in the employment in our state, and especially in the City. The unemployment in Baltimore City, Congressman Cummings is quoting numbers that are official. The unofficial numbers are probably twice as high as his official numbers.

I am living on Main Street. I work with Main Street. I am in those communities. You know, I walk down the street yesterday past what was part of a restaurant row. Of the five restaurants that I passed—and Wednesdays used to be a good restaurant day—only three of the restaurants had people in those restaurants. And of the three that had people, only in that case were there three tables that were occupied.

I am just giving an example there. So this stimulus package is going to help create jobs where people can work and make a good living wage, and it is going to help those who are on the margin to be able to meet their obligations to pay the community bankers who are willing and ready to step forward to keep financial resources flowing into the community.

Vice Chair Maloney. Mr. Fry.

Mr. Fry. Madam Chair, I think that such a stimulus package that included aid to state governments and also investment in infrastructure would be a significant step forward for the State of Maryland and for the citizens there.

Right now looking at state governments, they are looking at tremendous deficits themselves. They are looking at programs being cut. They are looking at possible layoffs as time goes on, and trickling down even of course to the local governments as well. Everybody is on pins and needles, not unlike what Congressman Cummings and I experienced during the early 1990s when we served in the Maryland General Assembly together.

I think obviously what we see as significantly important would be that investment in infrastructure. The one thing that I think that provides a great opportunity, because transportation infrastructure in particular does not get a lot of attention, it does not move up that rank as far as political polls of something that is really critically important to the voters of the time or to the citizens, but transportation only becomes important when it becomes a crisis.

Unfortunately, once it becomes a crisis it takes too long for you to complete the projects that will even address that concern. By coming forth with a stimulus package that would include some investment for infrastructure, I think that would give a jump-start to projects that have not had a chance to move forward.

In Maryland over a year ago we were successful in getting the General Assembly to enact about $400 million in new revenue. We argued that we should have as much as $600 million in new revenue. Despite that influx of money, we've just seen a reduction of $1.1 billion over the six-year transportation plan. So this is something that is significantly needed. It will provide jobs not only to highway contractors and others, but to small businesses, to minority and women-owned companies who are also very dependent upon those major construction projects so that they can take part in those and also expand their capacity to grow.

Vice Chair Maloney. Mr. DeMarco.

Mr. DeMarco. Thank you, Madam Chair.

We urge you to include in your stimulus package an increase in the FMAP for the states. And if you do it at the level that was in

Senate Bill 2819, you would get a significant amount of new money into the State of Maryland, resulting in 1800 new jobs and a lot more money into the coffers of the State, which would be very important.

And in addition, very importantly, you would help us keep this tremendous new Governors Working Families and Small Business Health Care Coverage Act going, which is going to over the next couple of years provide health care to over 100,000 uninsured people, and deal with some of the major issues that Representative Cummings sees, and we all see in our community of people who cannot afford health care, whose lives are destroyed by it, and then we all pay the hidden health care tax.

It is a great two-for that you can include in the stimulus package which would help our society in Maryland a whole lot. Thank you, very much.

Vice Chair Maloney. Well thank you. And I would like to sincerely thank all the panelists and witnesses for their really meaningful testimony today.

The panel today, and indeed the hearings that Congress has conducted over the past month, have been sobering and should leave no doubt that we need a new stimulus package to get the economy back on track and provide relief to struggling American families.

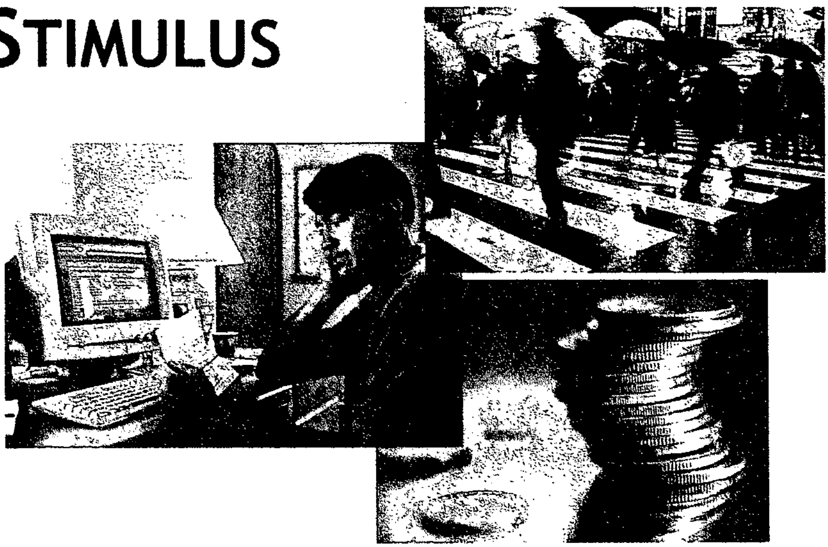
Congressman Cummings and Senator Schumer and I released this report yesterday, "Stemming The Current Economic Downturn Will Require More Stimulus." It can be seen on the Joint Economic Committee web site, and on my personal web site, and I would like unanimous consent to put it in the record.

Vice Chair Maloney. With that, the meeting is adjourned.

(Whereupon, at 12:35 p.m., Thursday, October 30, 2008, the meeting was adjourned.)

SUBMISSIONS FOR THE RECORD

STEMMING THE CURRENT ECONOMIC DOWNTURN WILL REQUIRE MORE STIMULUS



A Report By The Joint Economic Committee
Senator Charles E. Schumer, Chairman
Congresswoman Carolyn B. Maloney, Vice Chair
October 29, 2008

Executive Summary

The current economic downturn follows the weakest recovery on record, making prospects for a consumer-led recovery unlikely. Families are more financially constrained than at the beginning of any prior downturn as they face rising unemployment, high prices, dwindling assets, historically high debt, and real incomes that are lower than they were over eight years ago. The weakness of household finances means that absent aggressive government action, the current downturn could be particularly long-lasting and severe.

Consumer spending is already declining sharply. Falling household spending – which makes up nearly three-quarters of Gross Domestic Product – means businesses have limited incentives to invest. Declining consumer spending and business investment, combined with the decline in housing prices, will continue to drag down domestic demand for goods and services, leading to further job losses and still greater declines in family income and spending.

Families have not yet recovered from the previous recession and now the country faces a severe financial crisis that is spreading throughout the broader economy. The 10 indicators below demonstrate the weakness in the household sector:

1. Measured by wage gains and job growth, the 2000s economic recovery was the weakest in generations.
2. The 2000s economic recovery was the first since World War II where the typical family saw net income losses.
3. In the face of income losses, families sustained consumption through borrowing and the ratio of household debt to disposable income soared.
4. Families are now spending a historically high share of their income on debt payments.
5. As home prices fall, family net worth is plunging to its lowest levels in two decades.
6. Families have little or no savings "cushion" to maintain living standards in the face of unemployment or falling real income.
7. Families own a smaller share of their home than at any time since World War II, cutting off the opportunity to use home equity loans as a source of "income".
8. Women's earnings will not be able to cushion families as they have in prior recessions, because women's unemployment is already at recessionary levels.
9. Falling real wages and limited savings have already combined to drag down consumer spending.
10. Investment in residential housing usually boosts consumption after a recession, but given the record-high backlog of homes for sale and the continued credit squeeze, this is not likely to happen soon.

These indicators show that the combination of high debt loads, declining income, and rising unemployment will make it difficult for households to sustain consumer spending at current levels, let alone increase their spending enough to spur economic growth. This cycle, in which lower spending leads to business cutbacks and job losses, which then lowers spending further, is the textbook process, which drives prolonged economic recessions.

Increased business investment in response to export demand is also unlikely to spur economic growth in the near term. Export demand was high in recent quarters, but has still not been sufficient to avert slowing growth. As the economic slowdown spreads globally, such export demand may not continue. In addition, export success depends on a continued low valuation of the dollar.

In order to shorten the duration of a downturn and reduce its magnitude, it is important that government step in and break the current cycle with a temporary fiscal stimulus designed to support economic activity and household well-being while also laying the groundwork for further economic growth.

In January 2008, Congress passed and the President signed the Economic Stimulus Act, which injected over $150 billion dollars into the economy. In the spring of 2008, Congress extended benefits for the long-term unemployed. These policy actions have had their intended effect by temporarily boosting spending, but employment declines have continued and the financial crisis has spilled over into the broader economy.

Given current economic circumstances, infrastructure investment, aid to the states or other direct spending is likely to deliver far more effective stimulus than alternatives such as cuts in business taxes.[1] Over half of the states are projecting budget shortfalls for fiscal year 2009 and this will lead not only to cutbacks in necessary services, but likely higher unemployment as well. Rebuilding and modernizing America's aging infrastructure will strengthen our economy and help create good jobs at good wages.

Families are in a weak economic position and businesses can see clearly that consumers will not be able to increase their spending until their incomes recover. Lowering corporate taxes will not address the fundamental problem: businesses will not have an incentive to invest in products for the U.S. market until family economic circumstances improve. Lowering capital gains taxes will likely have no effect on investment since very few are seeing any gains right now.

The combination of pre-existing economic weakness and the current problems in the financial sector makes additional fiscal stimulus through government investment and support for families vital to keep the economy moving. As economic growth and business hiring slows due to the credit crunch, families have fewer financial resources than ever before to weather a downturn. This means prospects for a consumer-led recovery are bleak, and government stimulus will be important both in promoting economic recovery and sustaining living standards for the middle class.

Stemming the Current Economic Downturn Will Require More Stimulus

Introduction

While the nation's attention has been focused on the growing financial crisis, the broader economy has been showing signs of recession.[2] U.S. consumers largely make the economy grow, but families are responding to the current economic difficulties by curtailing their spending. Preliminary data show that real consumer spending declined or stagnated over the summer months: personal consumption fell by ¼ percent in June, ½ percent in July and no growth in August. Retail sales have also fallen sharply over the past few months, as export growth has stalled. Since consumer spending makes up over 71 percent of U.S. Gross Domestic Product, these data indicate that the third quarter GDP will likely will show faltering overall economic performance.

The combination of sustained job losses, falling home prices, and record levels of household debt mean that consumer spending – the largest single source of demand – is unlikely to sustain robust economic growth in the foreseeable future. In addition, state and local governments are feeling pressures to cut spending and businesses are unlikely to make major investments in the face of declining consumer demand and difficulty obtaining credit.

If consumption cannot rise because of the constraints faced by households, then there are three places to look to increase economic growth: increased business investment, increased exports, or more government spending. It appears unlikely that businesses will take up the slack. Demand drives business investment; so long as it remains weak, investment in housing, durable goods, or equipment is unlikely to respond strongly to lower interest rate or to business tax cuts – unless government takes up the slack by ordering more goods directly. In addition, the combined impact of the financial crisis and associated equity losses are likely to reduce the ability of businesses to raise investment capital – stock market declines have created over 6.2 trillion dollars in equity losses over the last year.

Exports have been the one recent bright spot in the economy, but they are also not likely to solve our growth problem in the months to come. While exports were up sharply in the second quarter of 2008, further export growth depends on a continued low valuation for the dollar and strong consumer demand in other nations. There is no guarantee that the dollar will remain low and, since other advanced economies are beginning to suffer economic slowdowns, export-led growth may not continue.

Economic research demonstrates that downturns coinciding with sharp house price declines or with problems in the banking sector tend to be significantly longer and deeper than other types of recessions.[3] During serious downturns, private sector investment and household consumption decline, leaving government spending as a crucial support for the economy. In addition, lengthy downturns greatly reduce the chance that government fiscal stimulus will be "mistimed", taking effect after the economy has begun to recover on its own.[4] There is a growing consensus that additional economic stimulus is necessary and many prominent economists have recently announced their support for a sizeable package.[5]

Consumption Drives the U.S. Economy

Consumption is by far the largest element of the U.S. economy, which is why the lack of resources available to U.S. households poses significant problems. U.S. consumer spending (consumption) makes up 71 percent of GDP. There are three other elements of GDP: U.S. businesses investment (14 percent), net U.S. government spending (20 percent), and the net difference between how much we export abroad compared to how much we import (-5 percent – meaning that we import more than we export).[6] If U.S. consumers are highly constrained – and especially if they are not willing or able to buy a new home, as they are now – then businesses, other countries (through buying our exports), or government must increase their spending to keep the economy moving. However, because these three elements make up a smaller share of the overall economy, they have to grow much more than usual to make up for weak consumer spending. For example, if, as was the case in July, U.S. consumers buy 0.4 percent less than they did the prior month, then to prevent GDP from falling, the three other components would have to rise by more than twice as much (at least 1 percent) just to make up for the decline in consumption.

Concerns have been voiced that the Bush administration's $700 billion financial rescue plan will constrain the government's ability to boost spending, but the rescue package should not constrain fiscal policy at this time. The rescue package Congress passed in September is aimed at unfreezing credit markets while insulating America's working families from the financial crisis by making investments that may eventually generate positive returns. For example, the Treasury now plans to invest $250 billion in U.S. banks in exchange for equity shares, so that taxpayers will see at least some return on their investment. As former Treasury Secretary Lawrence Summers wrote recently, "for the near term, government should do more, not less .... The case for fiscal stimulus – policy actions that increase short-term deficits – is stronger that any time in my professional lifetime."[7]

Today's economic difficulties are happening after the weakest economic recovery in the post-World War II period. Indeed, real family incomes are still lower than they were 8 years ago. As this economic downturn deepens, families have a limited ability to maintain their living standards in the face of falling wages or job losses because the weak recovery of the 2000s has left them with little to fall back on. Household incomes never recovered to their pre-recession peak, so families took on more debt to maintain their standard of living.

In the recession of the early 2000s, home prices were rising and households had easy access to credit so they responded to falling real incomes by taking out billions of dollars in home equity and credit card debt. This borrowing helped to keep the economy moving (although at a relatively low rate) and helped pull the economy out of recession. Falling home values and rising debt have driven family balance sheets to their worst condition in decades, and banks are now curtailing access to credit.

As the ten charts in this paper show, the deterioration of family economic circumstances makes a consumer-led recovery unlikely.

10 Reasons Why U.S. Households Will Not Be Able to Revive the Economy

1. **Measured by wage gains and job growth, the 2000s economic recovery was the weakest in generations** (Figure 1). The 2000s economic recovery created an average of 102,000 jobs each month, less than half as many as during the 1990s expansion, when the economy generated an average of 205,000 jobs each month, or the 1980s expansion, when the economy generated an average of 234,000 jobs each month.

Lackluster wage growth accompanied these limited employment gains. For women, the 2000s recovery brought weaker wage gains than the 1990s or 1980s economic recovery, while men experienced declining real wages over the 2000s recovery. Wage growth has been slow over the past seven years despite the fact that productivity—which should rise in tandem with wages—rose by over eight times as much as real wages, 2.5 percent per year.[8] The benefits from productivity growth were not shared with workers.

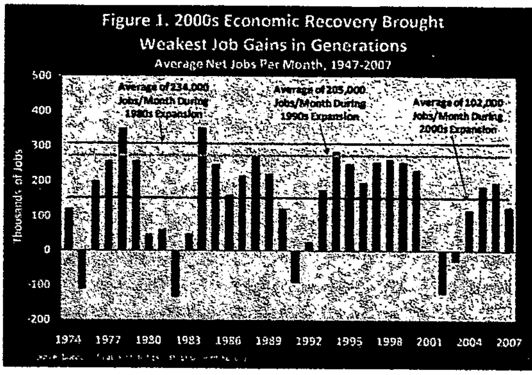


Figure 1. 2000s Economic Recovery Brought Weakest Job Gains in Generations

2. **The 2000s economic recovery was the first since World War II where the typical household saw a net loss of income** (Figure 2). Families are starting this downturn with less income than they would have if the 2000s recovery had provided them with real income gains. Real household incomes were $324 lower in 2007 (the last year for which we have data) than they were in 2000. For "working age" households (those headed by someone under 65), real household incomes fell by $2,178 between 2000 and 2007.[9] Given that wages have fallen sharply in 2008 and hours have stagnated, there is little indication that the data for 2008 will show any improvement in incomes. If the 2000s recovery ended in late 2007, this is the first recovery in decades where household income does not recover to its pre-recession peak.

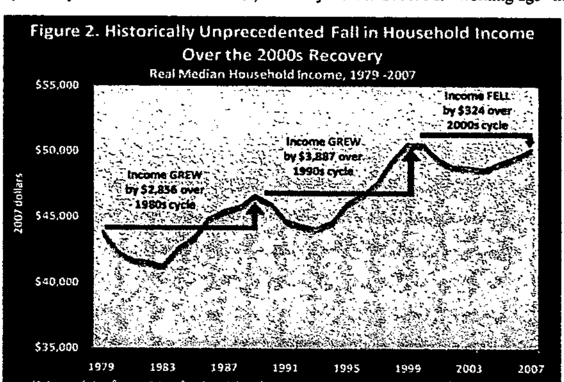
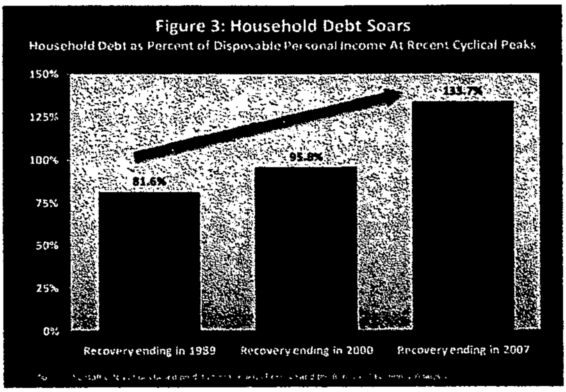
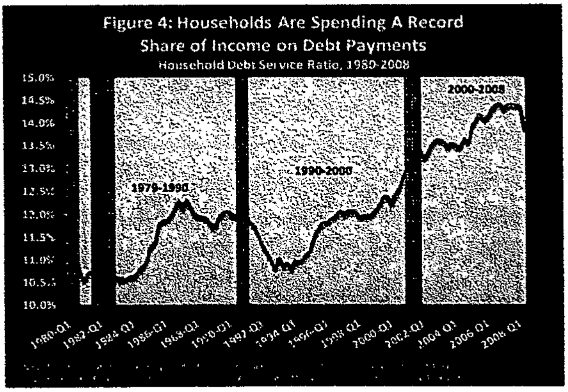


Figure 2. Historically Unprecedented Fall in Household Income Over the 2000s Recovery

3. **In the face of income losses, families maintained their living standards by borrowing and the ratio of household debt to disposable income soared** (Figure 3). The 2000s economic recovery saw significantly greater growth in household borrowing than previous economic cycles and this growth has accelerated in recent years. There are many theories on the causes of this growth;[10] however, the desire to maintain living standards in the face of declining income likely played a key role. The increase in borrowing has left households with considerably larger debt loads than in the past.[11] Today, U.S. household debt is over 1.3 times the total amount of disposable income households receive in a year.



4. **Families are now spending a historically high share of their income on debt payments** (Figure 4). Household debt service ratios have reached historic highs as a percentage of personal income, even though real interest rates reached record lows during the early part of this decade. The Federal Reserve estimates that a typical household pays over 2 percent more of its income in interest payments today than it did ten years ago. That increase represents $1,100 a year in additional interest payments for the typical U.S. household.[12]



5. **As home prices fall, household net worth is plunging** (Figure 5). Rising real estate prices peaked in July 2006. Since that time, housing prices have declined almost 20 percent and economists forecast them to fall further.[13] This house price decline has already caused a decline in household net worth and this is likely to fall even further as home values continue to decline. The Center for Economic and Policy Research has estimated household net worth for 2009 based on the declines in home values that have already happened and the conservative assumption is that housing prices fall by only an additional 10 percent between mid-2008 and mid 2009. Based on this conservative estimate of housing price declines, the study finds that by 2009, real median household net worth will drop to its lowest levels in twenty years.[14]

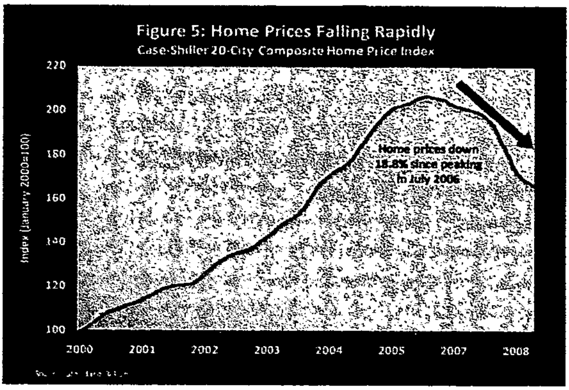


Figure 5: Home Prices Falling Rapidly

6. **Families have little or no savings "cushion" to maintain living standards in the face of unemployment or falling real income** (Figure 6). The national savings rate was near historic lows in 2007, at one-half of one percent.[15] Low savings means that many families will be unable to dip into reserve funds as incomes fall or they lose a job. The Center for American Progress has recently used Federal Reserve data to estimate the number of households who have a three-month "cushion" of savings to cover an unemployment spell or a medical emergency. They find that in 2007, less than 30 percent of families have such a reserve fund available, down from over 40 percent a decade ago.[16]

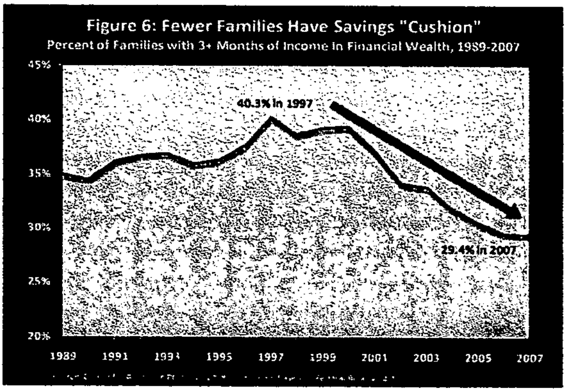


Figure 6: Fewer Families Have Savings "Cushion"

7. **Families own a smaller share of their home than at any time since World War II** (Figure 7): Current levels of homeowner's share of equity are the lowest ever recorded: the average homeowner owns less than half of his or her home. The decline in home equity is due to two factors: first, record levels of home equity loans taken out by families in the mid-2000s, and second, recent declines in housing values. The growth in housing prices during the early 2000s allowed families to significantly increase home equity withdrawals. The Federal Reserve estimates that by 2005 there were over $900 billion in home equity loans outstanding – a 124 percent increase since 2000. The same study found that the average annual level of home equity extraction increased by 350 percent in 2001-2005 as compared to the previous decade of 1991-2000, pumping an extra $160 billion annually into the economy.[17] As home values have fallen over the past two years, the share of their homes that homeowners actually own has plummeted. Many recent purchasers have no equity in their homes, or even negative equity – homes that are now worth less than the mortgage borrowed to purchase them.

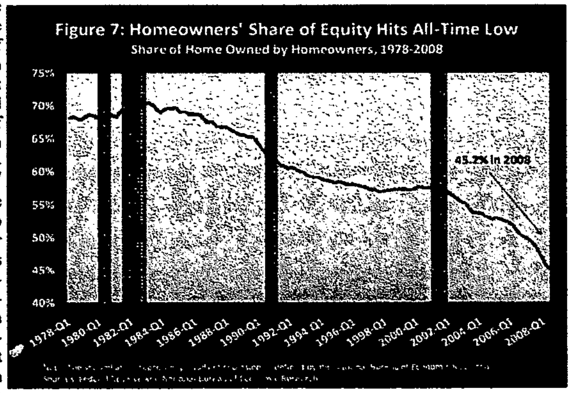


Figure 7: Homeowners' Share of Equity Hits All-Time Low
Share of Home Owned by Homeowners, 1978-2008

8. **Women's earnings will not be able to cushion families as they have in prior recessions** (Figure 8). In the 1970s, 1980s, and 1990s, family income growth was due in large part to the increase in women's labor force participation. Only families who have had a working wife have seen income growth since the early 1970s; families with a stay-at-home wife have seen no growth in their inflation-adjusted family income. However, in the 2000s, the share of women working stopped rising first, due to particularly devastating job losses suffered during the 2001 recession and then compounded by slow employment growth during the economic recovery thereafter.[18] Since women did not recover to their pre-recession employment levels, families may no longer be able to rely on women to help maintain their living standards in a downturn. This is looking more likely: in recent months, women's unemployment has hovered near its peak during the 2000s recession. This underscores that families are not going to be able to rely on women's employment to help buffer incomes during this downturn, as they had in prior downturns.

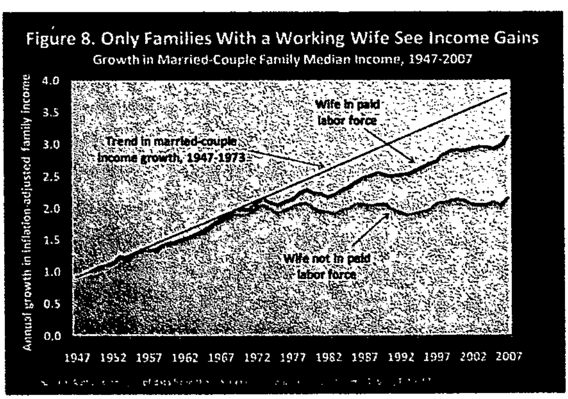


Figure 8. Only Families With a Working Wife See Income Gains
Growth in Married-Couple Family Median Income, 1947-2007

9. **Falling real wages, little or no savings, and the inability to borrow have already dragged down consumption** (Figure 9). Rising unemployment and falling real wages, combined with little savings to dip into and increased constraints on borrowing have pushed down consumption. Year over year growth in real personal consumption has fallen sharply in recent quarters and is already below where it was during the early 2000s recession. The trend is worsening, as preliminary data from the last two months shows actual declines in real consumption expenditures. Expenditures on durable goods such as cars and furniture – the easiest item for consumers to cut back on – have been particularly hard hit. In the second quarter of 2008, durable goods consumption dropped to 7.4 percent of GDP, the lowest level in 26 years.

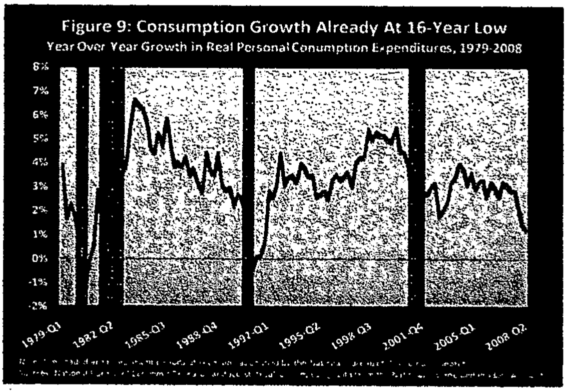


Figure 9: Consumption Growth Already At 16-Year Low
Year Over Year Growth in Real Personal Conumption Expenditures, 1979-2008

10. **Investment in residential housing is unlikely to boost consumption, given record home inventory** (Figure 10). Looking back on prior recessions, the cycle has typically been that home purchases fall during the recession, but that they help lead consumption as the economy moves out of the recession.[19] Typically, this has been because as the Federal Reserve lowers interest rates, mortgage rates fall so the price that consumers pay to buy a home falls. This, in turn, spurs businesses to invest in new homes and durable goods, since people tend to buy new appliances and furniture when they move into a new home. However, this is not likely to be the case this time around. The third quarter of 2008 saw a record-high backlog of new homes for sale –10.7 months – and it will be quite some time before that backlog is sold and there are incentives to invest in home construction. Already, residential investment is at lows typically only seen during recessions: in August 2008, residential construction hit a 17-year low.[20] Given the record-high backlog of homes for sale, it is likely to fall further before it recovers, dragging down economic growth.

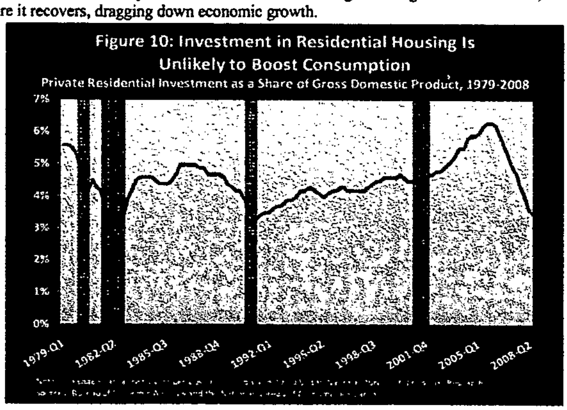


Figure 10: Investment in Residential Housing Is Unlikely to Boost Consumption
Private Residential Investment as a Share of Gross Domestic Product, 1979-2008

Stemming the Current Downturn Will Require More Economic Stimulus

The combination of sustained job losses, falling home prices, and record levels of household debt mean that consumer spending – the largest single source of demand – is unlikely to sustain robust economic growth in the foreseeable future. To the contrary, consumption weakness is likely to contribute to economic deterioration. In short, the prospects for a consumer-led recovery are not encouraging, making it crucial that Congress and the President take additional measures to shore up the economy.

As employers continue to shed jobs and real wages fall to a seven-year low[21], families are increasingly limited in their ability to draw down assets or rely on debt because of the credit squeeze and falling home values. During the early 1990s and early 2000s recessions, families who saw falling incomes or lost their jobs were able to borrow to maintain their consumption or dip into their savings. However, because family balance sheets are in their weakest position in decades, this will not be possible for millions of families this time around.

If unemployment continues to rise, family's resources are likely to continue to decline as higher unemployment leads to declining real wages and incomes. Researchers estimate that in a mild-to-moderate downturn, families could lose just over $2,000 per year by 2010, but in the case of a more severe recession, families could see income losses of $3,750 per year by 2011.[22] However, unlike during most downturns, this income hit will occur when family balance sheets are already in their weakest position in decades.

The weakness of household finances means that this recession could be particularly long lasting and severe, without swift government action to keep the economy moving: it is the fastest way to increase economic growth, promote job creation and support families in the short- to near-term.

Congress has already considered a new stimulus package. On September 26th, the House passed an economic stimulus package that included infrastructure investment, extended unemployment benefits for the long-term unemployed in high unemployment states, Food Stamp assistance, and funding for states to continue their Medicaid programs. On October 3, the House voted to extend unemployment benefits to unemployed workers in high unemployment states. These efforts have stalled because the President has threatened a veto and Senate Republicans have blocked them.

A temporary fiscal stimulus designed to support economic activity and household well-being, will lessen the severity of the downturn and shorten its duration, while laying the groundwork for future economic growth.

Endnotes

[1] See p. 7, p. 20 of Congressional Budget Office, "Options for Responding To Short-Term Economic Weakness", January, 2008, available at http://www.cbo.gov/ftpdocs/89xx/doc8916/01-15-Econ_Stimulus.pdf.
[2] In a speech given October 14, 2008, Janet Yellen, President of the Federal Reserve Bank of San Francisco said, "Indeed, the U.S. economy appears to be in a recession. This is not a controversial view, since the latest Blue Chip consensus projects that there will be three consecutive quarters of contraction in real GDP starting last quarter." http://www.frbsf.org/news/speeches/2008/1014.html. On October 15, 2008, the Federal Reserve's *Beige Book* begins with the statement, "Reports indicated that economic activity weakened in September across all twelve Federal Reserve Districts." http://www.federalreserve.gov/FOMC/BeigeBook/2008/20081015/default.htm.
[3] Claessens, Stijn, Ayhan Kose, and Marco Terrones, "What Happens During Recessions, Crunches, and Busts?" International Monetary Fund, 2008, available at http://www.aei.org/docLib/20080805_ClaessensKoseTerrones(2008).pdf.
[4] Congressional Budget Office, "Options for Responding to Short-Term Economic Weakness", January, 2008, available at http://www.cbo.gov/ftpdocs/89xx/doc8916/01-15-Econ_Stimulus.pdf.
[5] On October 15, 2008, Nobel Laureate Paul Krugman said on his blog, Conscience of a Liberal, "In addition to financial rescues, we need major stimulus programs."
[6] All percents are from the first quarter of 2008.
[7] Lawrence Summers, "Taxpayers Can Still Benefits From a Bail-Out," *Financial Times*, September 29, 2008.
[8] U.S. Department of Labor, Bureau of Labor Statistics, *Productivity and Costs*, available at www.bls.gov/lpc.
[9] JEC Analysis of U.S. Census Bureau data on median household income for households headed by someone under 65 from the Census Bureau's Current Population Survey, adjusted for inflation by the CPI-U-RS, as reported by the U.S. Department of Labor's Bureau of Labor Statistics.
[10] These theories range from low growth in household income, to lower interest rates, to changes in the willingness of financial institutions to lend to consumers, to changes in for borrowing preferences. See Karen E. Dynan and Donald L. Kohn, "The Rise in U.S. Household Indebtedness: Causes and Consequences," Washington, DC: Federal Reserve Board, 2007. Available at http://www.federalreserve.gov/pubs/feds/2007/200737/200737pap.pdf.
[11] Normally, recessionary periods cause a decline in debt, as the economic shakeout results in less lending by financial institutions and less willingness to take on risk by households. However, during the recession of the early 2000s household debt loads grew at unprecedented levels.
[12] Family income from Census Bureau, http://www.census.gov/prod/2007pubs/p60-233.pdf. Household debt service ratio from Federal Reserve Board, available at http://www.federalreserve.gov/releases/housedebt/.
[13] Case/Shiller 20-city composite index, available at http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic/indices_csmahp/0,0,0,0,0,0,0,0,0,2,1,0,0,0,0,0.html.
[14] Baker, Dean and David Rosnick, "The Impact of the Housing Crash on Family Wealth", Center For Economic and Policy Research, July, 2008. The cited figures use Scenario 2 in the paper, which assumes a ten percent drop in housing prices from March 2008 through 2009. This is the level forecast by housing futures markets, based on CME group September futures contracts for the Case and Fair Composite-20 index for mid-2009, as compared to historical index data for March, 2008. See http://www.cme.com/trading/prd/re/housing_FCS.html.
[15] The annual average savings rate for 2007 was 0.5 percent in 2007. The personal savings rate was 1.2 percent in July 2008, the most recent data available. U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts. See BEA's most recent release at http://www.bea.gov/newsreleases/national/pi/pinewsrelease.htm.
[16] Christian E. Weller and Amanda Logan, "America's Middle Class Still Losing Ground," Washington, DC: Center for American Progress, July 2008. Available at http://www.americanprogress.org/issues/2008/07/pdf/middleclasssqueeze.pdf. For methodology, see Christian E. Weller and Eli Staub, "Middle Class in Turmoil: Description of Methodology and Discussion of Findings", Washington, DC: Center for American Progress, September 2006. Available at http://www.americanprogress.org/issues/2006/09/MidClassMethReport.pdf.
[17] See http://www.federalreserve.gov/Pubs/feds/2007/200720/200720pap.pdf. Data on home equity loans outstanding in Table 2, line 45, data on average annual home equity extractions in Table 2, line 3.
[18] Joint Economic Committee, *Equality in Job Loss: Women Are Increasingly Vulnerable to Layoffs During Recessions*, July 22, 2008.
[19] Edward Leamer, Housing Is The Business Cycle, NBER Working Paper 13428, available at http://www.nber.org/papers/w13428.pdf.
[20] The Associated Press, "Housing Starts at 17-Year Low in August," *New York Times*, September 17, 2008.

[21] Except for 2005 Q3 immediately following Hurricane Katrina.
[22] John Schmitt and Dean Baker, "What We're In For: Projected Economic Impact of the Next Recession", Washington, DC: Center for Economic and Policy Research, January 2008. Available at: http://www.cepr.net/documents/publications/JSDB_08recession.pdf.

JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER, CHAIRMAN
REPRESENTATIVE CAROLYN B. MALONEY, VICE CHAIR

PREPARED STATEMENT OF CAROLYN MALONEY

Today's news is bleak. The gross domestic product, which is the broadest measure of our economy, fell by 0.3 percent and consumer spending fell by 3.1 percent in the third quarter. This news comes on the heels of this week's dismal report that the consumer confidence index plunged to an all-time low in October. All of this provides further confirmation that unless we act to bring real relief to Main Street, families will continue to suffer serious economic hardships.

These data indicate that Speaker Pelosi has been right in pressing for additional economic stimulus as the Congressional hearings this month have shown.

Over the past year, we have seen the sub-prime crisis turn into a full-blown financial crisis. Many economists now warn that we are the midst of a recession, quite possibly the worst in decades, and the impact on families may be devastating without government intervention.

This committee has been tracking the unfolding economic crisis for over a year. In our monthly hearings on the employment situation, we have seen how the private sector has shed nearly a million jobs in 2008 and U.S. workers have lost all of the wage gains that they had made during the 2000s recovery.

There is now a growing consensus that Congress should enact a second stimulus package and that it should be larger than the one we passed in January. During recent testimony in front of the House Budget Committee, Federal Reserve Chairman Ben Bernanke gave his support to another round of significant economic stimulus: "[W]ith the economy likely to be weak for several quarters, and with some risk of a protracted slowdown, consideration of a fiscal package by the Congress at this juncture seems appropriate."

As detailed in a Joint Economic Committee report released yesterday, the need for stimulus is urgent. A consumer- or export-led recovery is unlikely because this downturn follows the weakest recovery on record. Even as the economy expanded over the last eight years, household incomes never recovered from the last recession. Falling home values and rising debt have driven family balance sheets to their worst condition in decades, while at the same time banks have been curtailing access to credit. As consumers cut back on their spending, this drags down the economy further.

Economists are also encouraging Congress to recognize that during a potentially protracted and deep downturn, concerns about budget deficits must be secondary to the goal of getting the economy back on track. Former Treasury Secretary Lawrence Summers has said, "The idea seems to have taken hold in recent days that because of the unfortunate need to bail out the financial sector, the nation will have to scale back its aspirations in other areas such as healthcare, energy, education and tax relief. This is more wrong than right."

Congress has already taken numerous steps to help buffer families from the effects of the downturn. More than 130 million American households have received a Recovery Rebate and 3.5 million unemployed workers have received extended Unemployment Benefits. In July, Congress enacted a housing package aimed at stemming the tide of foreclosures.

As the financial crisis worsened this fall, Congress began a sweeping investigation to examine the root of the crisis and lay the foundation for action on common sense regulation of the financial and housing industries.

This is grim news today, but I expect this Congress will act with the current President and the next President to get the economy back on track and get Americans back to work. Clearly, we need a new direction on economic policy. American families need more help to weather this economic storm.

I want to thank our distinguished panel of witnesses for appearing before us today and thank Senator Schumer for calling this hearing. I look forward to today's testimony as we help to lay the groundwork for the next economic stimulus package.

NEWS RELEASE FROM CONGRESSMAN KEVIN BRADY

Eighth District, Texas

For Immediate Release
October 30, 2008

Contact: Tracee Evans
(936) 441-5700

Statement of Congressman Kevin Brady Before the Joint Economic Committee

"I join Vice Chairwoman Maloney in thanking the panel of witnesses before us today.

Congress and the Bush administration have taken extraordinary steps to address this once-in-a lifetime global financial crisis, unlock the credit market, restore investor confidence and work with other nations to prevent a worldwide financial meltdown. Given the resilience of the American economy, averting a sustained global recession will allow us to recover much more quickly.

Whether these actions are proven a success or a failure depends a great deal on how smartly and timely they are implemented. The question now is not how many more financial pills we can stuff down the market's throat, but how effectively they are administered and given time to work.

It would be wise, as well, for the financial institutions receiving this help to act responsibly. Hoarding these taxpayer dollars or simply using them to swallow smaller competitors does nothing to increase credit for the credit-worthy or address the crisis in confidence facing this nation. If these banks choose to use these dollars simply to further a competitive advantage rather than contribute to the recovery of our economy, I imagine there will be plenty of bipartisan scrutiny within Congress to those irresponsible actions.

As for the need for a second stimulus package, I seriously question its effectiveness. Already there is ample evidence that it will simply become a Christmas Tree of pet congressional projects, from Amtrak to Medicaid, adorned with financial handouts to local and state governments whose spending has outpaced even that of Congress – a remarkable feat given that this Congress is the Usain Bolt of spending.

Should there be help for the unemployed in struggling states? Of course.

Are there pro-growth tax measures that could help kick-start our economy? Yes. Especially lowering for one year the tax levee that prevents American companies from flowing back an estimated $350 billion in foreign profits from overseas and investing them in new jobs and research here at home.

Could we create jobs by injecting a boost of funding in our crumbling highway and bridge infrastructure? If done right, probably. But only if we bypass the federal Department of Transportation and inject those dollars directly into bid-ready construction projects that can churn in the next twelve months.

But in the end, there is reality. The last stimulus did not work, the dollars eaten up by high gas prices and, to their credit, taxpayers who chose to save their checks. The last time Congress provided financial aid to the governors in 2003, many states choose simply to pad their growing payrolls which has only made worse the financial crisis they face today.

And given the size of our $14 trillion economy, this stimulus package is likely too small to have any significant impact. To put it in real terms, if the American economy were the size of a football field, the stimulus package represents only one yard line. Or if it grows larger, as some propose, two yards. It is difficult to see how that impacts the economic game in any meaningful way.

Congress needs to do all it can to help this economy get back on its feet, but cannot forget the dire financial crisis of its own.

Republicans, to our discredit, did not control spending and left control of Congress with an annual deficit of $160 billion. Democrats in their first year of control tripled the federal deficit to over $400 billion – tripled, in just one year. Worse, at the end of the current fiscal year Democrats can boast the largest deficit in American history.

And in the good news – bad news scenario, that's what counts for the good. The bad is that it doesn't yet factor in the costs of the financial rescue plan or the nearly $60 trillion in unfunded liabilities in Social Security, Medicare and Medicaid.

Any stimulus package Congress considers should be debated in the context of both the current economy and the shaky financial foundation of the federal government.

Given that the growing American deficit and the looming entitlement crisis was a concern of world markets before the current financial crisis, perhaps one signal Congress could begin to send is that we too are going to begin to act financially responsible as well."

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STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM BEFORE THE HOUSE BUDGET COMMITTEE ON OCTOBER 20, 2008, SUBMITTED BY VICE CHAIR MALONEY

Chairman Spratt, Representative Ryan, and other members of the Committee, I appreciate this opportunity to discuss recent developments in financial markets, the near-term economic outlook, and issues surrounding the possibility of a second package of fiscal measures.

Financial Developments

As you know, financial markets in the United States and some other industrialized countries have been under severe stress for more than a year. The proximate cause of the financial turmoil was the steep increase and subsequent decline of house prices nationwide, which, together with poor lending practices, have led to large losses on mortgages and mortgage-related instruments by a wide range of institutions. More fundamentally, the turmoil is the aftermath of a credit boom characterized by underpricing of risk, excessive leverage, and an increasing reliance on complex and opaque financial instruments that have proved to be fragile under stress. A consequence of the unwinding of this boom and the resulting financial strains has been a broad-based tightening in credit conditions that has restrained economic growth.

The financial turmoil intensified in recent weeks, as investors' confidence in banks and other financial institutions eroded and risk aversion heightened. Conditions in the interbank lending market have worsened, with term funding essentially unavailable. Withdrawals from prime money market mutual funds, which are important suppliers of credit to the commercial paper market, severely disrupted that market; and short-term credit, when available, has become much more costly for virtually all firms. Households and state and local governments have also experienced a notable reduction in credit availability. Financial conditions deteriorated in other countries as well, putting severe pressure on both industrial and emerging-market economies. As confidence in the financial markets has declined and concerns about the U.S. and global economies have increased, equity prices have been volatile, falling sharply on net.

In collaboration with governments and central banks in other countries, the Treasury and the Federal Reserve have taken a range of actions to ameliorate these financial problems. To address ongoing pressures in interbank funding markets, the Federal Reserve significantly increased the quantity of term funds it auctions to banks and accommodated heightened demands for funding from banks and primary dealers. We have also greatly expanded our currency swap lines with foreign central banks. These swap lines allow the cooperating central banks to supply dollar liquidity in their own jurisdictions, helping to reduce strains in global money markets and, in turn, in our own markets. To address illiquidity and impaired functioning in the market for commercial paper, the Treasury implemented a temporary guarantee program for balances held in money market mutual funds, helping to stem the outflows from these funds. The Federal Reserve put in place a temporary lending facility that provides financing for banks to purchase high-quality asset-backed commercial paper from money market funds, thus providing some relief for money market funds that have needed to sell their holdings to meet redemptions. Moreover, we soon will be implementing a new Commercial Paper Funding Facility that will provide a backstop to commercial paper markets by purchasing highly rated commercial paper from issuers at a term of three months.

The recently enacted Emergency Economic Stabilization Act provided critically important new tools to address the dysfunction in financial markets and thus reduce the accompanying risks to the economy. The Troubled Asset Relief Program (TARP) authorized by the legislation will allow the Treasury to undertake two highly complementary activities. First, the Treasury will use TARP funds to provide capital to financial institutions. Indeed, last week, nine of the nation's largest financial institutions indicated their willingness to accept capital from the program, and many other institutions, large and small, are expected to follow suit in coming weeks. Second, the Treasury will purchase or guarantee troubled mortgage-related and possibly other assets held by banks and other financial institutions. Taken together, these measures should help rebuild confidence in the financial system, increase the liquidity of financial markets, and improve the ability of financial institutions to raise capital from private sources.

As another measure to improve confidence, the act also temporarily raised the limit on the deposit insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration from $100,000 to $250,000 per account, effective immediately. Unfortunately, the loss of confidence in financial institutions became so severe in recent weeks that additional steps in this direction proved necessary. The FDIC, the Federal Reserve Board, and the Secretary of the Treasury in consultation with the President determined that significant risks to the stability of the financial system were present. With this determination, the FDIC was able to use its authority to provide, for a specified period, unlimited insurance coverage of funds held in non-interest-bearing transactions accounts, such as payroll accounts. In addition, the FDIC announced that it would guarantee the senior unsecured debt of FDIC-insured depository institutions and their associated holding companies. In taking the dramatic steps of providing capital to the banking system and expanding guarantees, the United States consulted with other countries, many of whom have announced similar actions. Given the global nature of the financial system, international consultation and cooperation on actions to address the crisis are important for restoring confidence and stability.

These measures were announced less than a week ago, and, although there have been some encouraging signs, it is too early to assess their full effects. However, I am confident that these initiatives, together with other actions by the Treasury, the Federal Reserve, and other regulators, will help restore trust in our financial system and allow the resumption of more-normal flows of credit to households and firms. I would like to reiterate the critical importance of the recent legislation passed by the Congress; without that action, tools essential for stabilizing the financial system and thereby containing the damage to the broader economy would not have been available. That said, the stabilization of the financial system, though an essential first step, will not quickly eliminate the challenges still faced by the broader economy.

Economic Outlook

Even before the recent intensification of the financial crisis, economic activity had shown considerable signs of weakening. In the labor market, private employers shed 168,000 jobs in September, bringing the total job loss in the private sector since January to nearly 900,000. Meanwhile, the unemployment rate, at 6.1 percent in September, has risen 1.2 percentage points since January. Incoming data on consumer spending, housing, and business investment have all showed significant slowing over the past few months, and some key determinants of spending have worsened: Equity and house prices have fallen, foreign economic growth has slowed, and credit conditions have tightened. One brighter note is that the declines in the prices of oil and other commodities will have favorable implications for the purchasing power of households. Nonetheless, the pace of economic activity is likely to be below that of its longer-run potential for several quarters.

As I noted, the slowing in spending and activity spans most major sectors. Real personal consumption expenditures for goods and services declined over the summer and apparently fell further in September. Although the weakness in household spending has been widespread, the drop-off in purchases of motor vehicles recently has been particularly sharp. Increased difficulty in obtaining auto loans appears to have contributed to the decline in auto sales. Consumer sentiment has been quite low, reflecting concerns about jobs, gasoline prices, the state of the housing market, and stock prices.

In the business sector, orders and shipments for nondefense capital goods have generally slowed, and forward-looking indicators suggest further declines in business investment in coming months. Outlays for construction of nonresidential buildings, which had posted robust gains over the first half of the year, also appear to have decelerated in the third quarter. Although the less favorable outlook for sales has undoubtedly played a role, the softening in business investment also appears to reflect reduced credit availability from banks and other lenders.

As has been the case for some time, the housing market remains depressed, with sales and construction of new homes continuing to decline. Indeed, single-family housing starts fell 12 percent in September, and permit issuance also dropped sharply. With demand for new homes remaining at a low level and the backlog of unsold homes still sizable, residential construction is likely to continue to contract into next year.

International trade provided considerable support for the U.S. economy over the first half of the year. Domestic output was buoyed by strong foreign demand for a wide range of U.S. exports, including agricultural products, capital goods, and industrial supplies. Although trade should continue to be a positive factor for the U.S. economy, its contribution to U.S. growth is likely to be less dramatic as global growth slows.

The prices of the goods and services purchased by consumers rose rapidly earlier this year, as steep increases in the prices of oil and other commodities led to higher retail prices for fuel and food, and as firms were able to pass through a portion of their higher costs of production. These effects are now reversing in the wake of the substantial declines in commodity prices since the summer. Moreover, the prices of imports now appear to be decelerating, and consumer surveys and yields on inflation-indexed Treasury securities suggest that expected inflation has held steady or eased. If not reversed, these developments, together with the likelihood that economic activity will fall short of potential for a time, should bring inflation down to levels consistent with price stability.

Over time, a number of factors are likely to promote the return of solid gains in economic activity and employment in the context of low and stable inflation. Among those factors are the stimulus provided by monetary policy, the eventual stabilization in housing markets that will occur as the correction runs its course, improvements in our credit markets as the new programs take effect and market participants work through remaining problems, and the underlying strengths and recuperative powers of our economy. The time needed for economic recovery, however, will depend greatly on the pace at which financial and credit markets return to more normal functioning. Because the time that will be needed for financial normalization and the effects of ongoing credit problems on the broader economy are difficult to judge, the uncertainty currently surrounding the economic outlook is unusually large.

Fiscal Policy

I understand that the Congress is evaluating the desirability of a second fiscal package. Any fiscal action inevitably involves tradeoffs, not only among current needs and objectives but also—because commitments of resources today can burden future generations and constrain future policy options—between the present and the future. Such tradeoffs inevitably involve value judgments that can properly be made only by our elected officials. Moreover, with the outlook exceptionally uncertain, the optimal timing, scale, and composition of any fiscal package are unclear. All that being said, with the economy likely to be weak for several quarters, and with some risk of a protracted slowdown, consideration of a fiscal package by the Congress at this juncture seems appropriate.

Should the Congress choose to undertake fiscal action, certain design principles may be helpful. To best achieve its goals, any fiscal package should be structured so that its peak effects on aggregate spending and economic activity are felt when they are most needed, namely, during the period in which economic activity would otherwise be expected to be weak. Any fiscal package should be well-targeted, in the sense of attempting to maximize the beneficial effects on spending and activity per dollar of increased federal expenditure or lost revenue; at the same time, it should go without saying that the Congress must be vigilant in ensuring that any allocated funds are used effectively and responsibly. Any program should be designed, to the extent possible, to limit longer-term effects on the federal government's structural budget deficit.

Finally, in the ideal case, a fiscal package would not only boost overall spending and economic activity but would also be aimed at redressing specific factors that have the potential to extend or deepen the economic slowdown. As I discussed earlier, the extraordinary tightening in credit conditions has played a central role in the slowdown thus far and could be an important factor delaying the recovery. If the Congress proceeds with a fiscal package, it should consider including measures to help improve access to credit by consumers, homebuyers, businesses, and other borrowers. Such actions might be particularly effective at promoting economic growth and job creation.

Thank you. I would be pleased to take your questions.

Majority of economists in USA TODAY survey back 2nd stimulus

By Barbara Hagenbaugh, USA TODAY

WASHINGTON — Congress should pass a second economic stimulus bill that could include tax cuts, an extension of unemployment benefits, or funds for roads and bridges, say a majority of economists polled recently by USA TODAY.

The advice to lawmakers comes as many of those economists say the USA is in a recession that is likely to resemble the 1990-1991 downturn, which featured sharp drops in consumer and business spending and lasted eight months.

Thirty-two of the 43 economists (74%) who answered the question last week in a survey by USA TODAY said lawmakers should pass a stimulus bill to soften the blow. "It won't keep us from going into recession," PMI Group chief economist David Berson says. "But it may make the difference in preventing a worse recession."

USA TODAY SURVEY: Fed rate cut expected this week

Congress enacted a $168 billion stimulus bill earlier this year that included federal income tax rebate checks of as much as $600 per person. Without recommending an amount, Federal Reserve Chairman Ben Bernanke last week supported a second stimulus bill. Congress could return for a lame-duck session after next Tuesday's election to consider it.

Nearly one-third of the economists, who come from businesses, trade groups and universities, said the most effective way to stimulate the economy would be through tax cuts. Other ideas include extending unemployment benefits and boosting food stamps, which would provide money that would likely be spent immediately; funding job-creating infrastructure projects; and giving home buyers a tax credit to try to stop the slide in the housing market.

Mission Residential chief economist Richard Moody and a few others suggested the federal government give money to state and local governments, whose budgets are suffering from less tax revenue as homes lose value and people lose their jobs.

"It would help them keep providing basic services and help keep people on their payrolls," Moody says.

Asked which of the prior recessions the current downturn will most resemble, 40% of the economists, a plurality, cited the 1990-91 period. The unemployment rate in that downturn continued to rise after the recession was over in March 1991, eventually reaching 7.8% more than a year later. The rate was 6.1% last month.

Approximately a fifth of the economists said they expect the recession to look more like the 1981-82 downturn, which lasted for 16 months, one of the longest for the USA.

Contributing: Barbara Hansen

PREPARED STATEMENT OF DR. J. STEVEN LANDEFELD, DIRECTOR, BUREAU OF ECONOMIC ANALYSIS

Mr. Chairman and Members of the Committee:

Thank you for inviting me to discuss the gross domestic product (GDP) accounts, including the data we released this morning. I will present highlights from this morning's release to the Committee, Mr. Chairman. I ask that the GDP release be included as part of my statement for the record.

In the third quarter of 2008, real GDP decreased 0.3 percent at an annual rate. By comparison, in the second quarter real GDP increased 2.8 percent. The decrease in third-quarter GDP reflected declines in consumer spending, residential investment, and business nonresidential fixed investment (which consists of investment in durable equipment, software, and structures). In contrast, government spending, net exports, and business inventory investment increased. The price index for gross domestic purchases, which measures the prices paid by U.S. residents, increased 4.8 percent, following an increase of 4.2 percent in the second quarter.

Consumer spending decreased 3.1 percent in the third quarter, following an increase of 1.2 percent in the second. The third-quarter decline in consumer spending was the largest decline since the second quarter of 1980. Consumer spending on durable goods fell 14.1 percent, with motor vehicles accounting for most of the decline. Consumer spending on nondurable goods fell 6.4 percent. In contrast, spending on services grew 0.6 percent.

Spending on residential investment fell 19.1 percent in the third quarter, compared with a decline of 13.3 percent in the second. This was the eleventh consecutive quarter in which residential investment has declined. Since its peak in the fourth quarter of 2005, residential investment has fallen 42.2 percent.

Business nonresidential fixed investment fell 1.0 percent in the third quarter, compared with an increase of 2.5 percent in the second. Third-quarter business spending on durable equipment and software fell 5.5 percent, whereas spending on nonresidential structures increased 7.9 percent.

Business inventory investment contributed +0.56 percentage point to the change in real GDP, compared to -1.50 percentage points in the second quarter.

Exports of goods and services increased 5.9 percent in the third quarter, compared with an increase of 12.3 percent in the second. Exports have now increased for twenty-one consecutive quarters. Imports of goods and services decreased 1.9 percent in the third quarter, compared with a decrease of 7.3 percent in the second.

Spending on goods and services by the federal government increased 13.8 percent in the third quarter, compared with an increase of 6.6 percent in the second. Most of the increase was in defense spending. Spending by state and local governments increased 1.4 percent in the third quarter, compared with 2.5 percent in the second.

During the third quarter, hurricanes Gustav and Ike struck the Gulf Coast region, especially impacting coastal Texas and Louisiana. Because the effects of these storms are not separately identified in our source data, it is not possible to estimate their overall effect on GDP, but their impact is included in the GDP estimates. In particular, disruptions to oil and gas extraction and to petroleum and petrochemical producers are reflected in BEA's estimates for inventory change in the nondurable manufacturing and wholesale trade industries.

As I mentioned earlier, the price index for gross domestic purchases increased 4.8 percent in the third quarter, after increasing 4.2 percent in the second. Excluding food and energy prices, the price index for gross domestic purchases increased 3.1 percent in the third quarter, after increasing 2.2 percent in the second. The personal consumption expenditures price index increased 5.4 percent in the third quarter, after increasing 4.3 percent in the second. Excluding food and energy prices, the personal consumption expenditures price index increased 2.9 percent in the third quarter, after increasing 2.2 percent in the second.

Turning to the household sector, real disposable personal income fell 8.7 percent in the third quarter, after increasing 11.9 percent in the second. The third quarter personal saving rate was 1.3 percent, compared with 2.7 percent in the second quarter and 0.2 percent in the first. The second-quarter increase in real disposable personal income was boosted by tax rebate payments to individuals as authorized by the Economic Stimulus Act of 2008. Excluding these payments, real disposable income increased 0.3 percent in the third quarter after decreasing 0.4 percent in the second.

My colleagues and I now would be glad to answer your questions.

BEA
BUREAU OF ECONOMIC ANALYSIS
U.S. DEPARTMENT OF COMMERCE

NEWS RELEASE

EMBARGOED UNTIL RELEASE AT 8:30 A.M. EDT, THURSDAY, OCTOBER 30, 2008

Lisa S. Mataloni: (202) 606-5304
Recorded message: (202) 606-5306

BEA 08-48

GROSS DOMESTIC PRODUCT: THIRD QUARTER 2008 (ADVANCE)

Real gross domestic product -- the output of goods and services produced by labor and property located in the United States -- decreased at an annual rate of 0.3 percent in the third quarter of 2008, (that is, from the second quarter to the third quarter), according to advance estimates released by the Bureau of Economic Analysis. In the second quarter, real GDP increased 2.8 percent.

The Bureau emphasized that the third-quarter "advance" estimates are based on source data that are incomplete or subject to further revision by the source agency (see the box on page 3). The third-quarter "preliminary" estimates, based on more comprehensive data, will be released on November 25, 2008.

The decrease in real GDP in the third quarter primarily reflected negative contributions from personal consumption expenditures (PCE), residential fixed investment, and equipment and software that were largely offset by positive contributions from federal government spending, exports, private inventory investment, nonresidential structures, and state and local government spending. Imports, which are a subtraction in the calculation of GDP, decreased.

Most of the major components contributed to the downturn in real GDP growth in the third quarter. The largest contributors were a sharp downturn in PCE for nondurable goods, a smaller decrease in imports, a larger decrease in PCE for durable goods, and a deceleration in exports. Notable offsets were an upturn in inventory investment and an acceleration in federal government spending.

Final sales of computers contributed 0.06 percentage point to the third-quarter change in real GDP after contributing 0.17 percentage point to the second-quarter change. Motor vehicle output contributed 0.09 percentage point to the third-quarter change in real GDP after subtracting 1.01 percentage points from the second-quarter change.

NOTE.--Quarterly estimates are expressed at seasonally adjusted annual rates, unless otherwise specified. Quarter-to-quarter dollar changes are differences between these published estimates. Percent changes are calculated from unrounded data and are annualized. "Real" estimates are in chained (2000) dollars. Price indexes are chain-type measures.

This news release is available on BEA's Web site along with the Technical Note and Highlights related to this release.

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The price index for gross domestic purchases, which measures prices paid by U.S. residents, increased 4.8 percent in the third quarter, compared with an increase of 4.2 percent in the second. Excluding food and energy prices, the price index for gross domestic purchases increased 3.1 percent in the third quarter, compared with an increase of 2.2 percent in the second.

Real personal consumption expenditures decreased 3.1 percent in the third quarter, in contrast to an increase of 1.2 percent in the second. Durable goods decreased 14.1 percent, compared with a decrease of 2.8 percent. Nondurable goods decreased 6.4 percent, in contrast to an increase of 3.9 percent. Services expenditures increased 0.6 percent, compared with an increase of 0.7 percent.

Real nonresidential fixed investment decreased 1.0 percent in the third quarter, in contrast to an increase of 2.5 percent in the second. Nonresidential structures increased 7.9 percent, compared with an increase of 18.5 percent. Equipment and software decreased 5.5 percent, compared with a decrease of 5.0 percent. Real residential fixed investment decreased 19.1 percent, compared with a decrease of 13.3 percent.

Real exports of goods and services increased 5.9 percent in the third quarter, compared with an increase of 12.3 percent in the second. Real imports of goods and services decreased 1.9 percent, compared with a decrease of 7.3 percent.

Real federal government consumption expenditures and gross investment increased 13.8 percent in the third quarter, compared with an increase of 6.6 percent in the second. National defense increased 18.1 percent, compared with an increase of 7.3 percent. Nondefense increased 4.8 percent, compared with an increase of 5.0 percent. Real state and local government consumption expenditures and gross investment increased 1.4 percent, compared with an increase of 2.5 percent.

The real change in private inventories added 0.56 percentage point to the third-quarter change in real GDP after subtracting 1.50 percentage points from the second-quarter change. Private businesses decreased inventories $38.5 billion in the third quarter, following a decrease of $50.6 billion in the second quarter and a decrease of $10.2 billion in the first.

Real final sales of domestic product -- GDP less the change in private inventories -- decreased 0.8 percent in the third quarter, in contrast to an increase of 4.4 percent in the second.

Gross domestic purchases

Real gross domestic purchases -- purchases by U.S. residents of goods and services wherever produced -- decreased 1.3 percent in the third quarter, compared with a decrease of 0.1 percent in the second.

Disposition of personal income

Current-dollar personal income increased $31.0 billion (1.0 percent) in the third quarter, compared with an increase of $228.4 billion (7.9 percent) in the second. The deceleration primarily reflected a downturn in personal current transfer receipts due to the effects of the second-quarter rebates to individuals who pay no income taxes (or for whom the rebate exceeded the amount of taxes they pay) from the Economic Stimulus Act of 2008.

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Personal current taxes increased $133.4 billion in the third quarter, in contrast to a decrease of $180.9 billion in the second. The sharp upturn reflected the second-quarter rebates to individuals with tax liabilities, which were treated as an offset to taxes.

Disposable personal income decreased $102.4 billion (3.7 percent) in the third quarter, in contrast to an increase of $409.3 billion (16.7 percent) in the second. Real disposable personal income decreased 8.7 percent, in contrast to an increase of 11.9 percent.

Personal outlays increased $54.5 billion (2.1 percent) in the third quarter, compared with an increase of $133.3 billion (5.2 percent) in the second. Personal saving -- disposable personal income less personal outlays -- was $139.7 billion in the third quarter, compared with $296.6 billion in the second. The personal saving rate -- saving as a percentage of disposable personal income -- was 1.3 percent in the third quarter, compared with 2.7 percent in the second. Saving from current income may be near zero or negative when outlays are financed by borrowing (including borrowing financed through credit cards or home equity loans), by selling investments or other assets, or by using savings from previous periods. For more information, see the FAQs on "Personal Saving" on BEA's Web site. For a comparison of personal saving in BEA's national income and product accounts with personal saving in the Federal Reserve Board's flow of funds accounts and data on changes in net worth (which helps finance negative saving), go to http://www.bea.gov/bea/dn/nipaweb/Nipa-Frb.asp.

Current-dollar GDP

Current-dollar GDP -- the market value of the nation's output of goods and services -- increased 3.8 percent, or $134.7 billion, in the third quarter to a level of $14,429.2 billion. In the second quarter, current-dollar GDP increased 4.1 percent, or $143.7 billion.

Information on the assumptions used for unavailable source data is provided in a technical note that is posted with the news release on BEA's Web site. Within a few days after the release, a detailed "Key Source Data and Assumptions" file is posted on the Web site. In the middle of each month, an analysis of the current quarterly estimates of GDP and related series is made available on the Web site; click on *Survey of Current Business*, "GDP and the Economy."

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BEA's national, international, regional, and industry estimates; the *Survey of Current Business*; and BEA news releases are available without charge on BEA's Web site at www.bea.gov. By visiting the site, you can also subscribe to receive free e-mail summaries of BEA releases and announcements.

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Next release -- November 25, 2008, at 8:30 A.M. EST for:
Gross Domestic Product: Third Quarter 2008 (Preliminary)
Corporate Profits: Third Quarter 2008 (Preliminary)

Comparisons of Revisions to GDP

Quarterly estimates of GDP are released on the following schedule: "Advance" estimates, based on source data that are incomplete or subject to further revision by the source agency, are released near the end of the first month after the end of the quarter; as more detailed and more comprehensive data become available, "preliminary" and "final" estimates are released near the end of the second and third months, respectively. The "latest" estimates reflect the results of both annual and comprehensive revisions.

Annual revisions, which cover the quarters of the 3 most recent calendar years, are usually carried out each summer and incorporate newly available major annual source data. Comprehensive (or benchmark) revisions are carried out at about 5-year intervals and incorporate major periodic source data, as well as improvements in concepts and methods that update the accounts to portray more accurately the evolving U.S. economy.

The table below shows comparisons of the revisions between quarterly percent changes of current-dollar and real GDP for the different vintages of the estimates. From the advance estimate to the preliminary estimate (one month later), the average revision to real GDP without regard to sign is 0.5 percentage point, while from the advance estimate to the final estimate (two months later), it is 0.6 percentage point. From the advance estimate to the latest estimate, the average revision without regard to sign is 1.2 percentage points. The average revision (with regard to sign) from the advance estimate to the latest estimate is 0.3 percentage point, which is larger than the average revisions from the advance estimate to the preliminary or to the final estimates. The larger average revisions to the latest estimate reflect the fact that comprehensive revisions include major improvements, such as the introduction of chain indexes and the capitalization of software. The quarterly estimates correctly indicate the direction of change of real GDP 98 percent of the time, correctly indicate whether GDP is accelerating or decelerating 74 percent of the time, and correctly indicate whether real GDP growth is above, near, or below trend growth more than three-fifths of the time.

Revisions Between Quarterly Percent Changes of GDP: Vintage Comparisons
[Annual rates]

Vintages compared	Average	Average without regard to sign	Standard deviation of revisions without regard to sign
	Current-dollar GDP		
Advance to preliminary.....	0.2	0.5	0.4
Advance to final...............	.2	.7	.4
Preliminary to final..........	.0	.3	.2
Advance to latest..............	.4	1.1	.9
	Real GDP		
Advance to preliminary.....	0.1	0.5	0.4
Advance to final...............	.1	.6	.4
Preliminary to final..........	.0	.3	.2
Advance to latest..............	.3	1.2	1.0

NOTE.--These comparisons are based on the period from 1983 through 2005.

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Table 1. Real Gross Domestic Product and Related Measures: Percent Change From Preceding Period

	2005	2006	2007	Seasonally adjusted at annual rates															
				2004	2005				2006				2007				2008		
				IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
Gross domestic product (GDP)	2.9	2.8	2.0	2.5	3.0	2.6	3.8	1.3	4.8	2.7	0.8	1.5	0.1	4.8	4.8	−0.2	0.9	2.8	−0.3
Personal consumption expenditures	3.0	3.0	2.8	4.2	1.7	3.6	3.7	1.4	4.3	2.8	2.2	3.7	3.9	2.0	2.0	1.0	0.9	1.2	−3.1
Durable goods	4.6	4.5	4.8	7.0	0.6	12.1	5.4	−11.7	18.9	1.8	3.5	4.2	9.2	5.0	2.3	0.4	−4.3	−2.8	−14.1
Nondurable goods	3.4	3.7	2.5	4.9	2.4	4.2	3.0	4.7	4.4	3.1	2.3	3.1	3.5	1.9	1.2	0.3	−0.4	3.9	−6.4
Services	2.6	2.5	2.6	3.4	1.7	1.7	3.8	2.5	1.6	2.8	2.0	3.9	3.1	1.4	2.4	1.4	2.4	0.7	0.6
Gross private domestic investment	5.8	2.1	−5.4	6.4	8.1	−5.1	4.8	12.2	8.2	−0.4	−5.3	−15.8	−8.6	6.2	3.5	−11.9	−5.8	−11.5	−1.9
Fixed investment	6.8	1.9	−3.1	7.3	5.3	7.6	5.3	2.3	8.3	−2.5	−4.8	−7.6	−3.4	3.0	−0.9	−6.2	−5.6	−1.7	−5.6
Nonresidential	7.2	7.5	4.9	10.3	3.7	6.3	8.1	3.7	15.9	6.4	5.3	−1.0	3.4	10.3	8.7	3.4	2.4	2.5	−1.0
Structures	1.3	8.2	12.7	−0.2	7.5	−1.3	−9.2	1.9	15.6	19.7	14.3	2.5	11.2	18.3	20.5	8.5	8.6	18.5	7.9
Equipment and software	9.3	7.2	1.7	14.3	2.3	9.2	12.2	4.4	16.3	1.7	2.0	−2.4	0.0	6.9	3.6	1.0	−0.6	−5.0	−5.5
Residential	6.3	−7.1	−17.9	2.4	8.1	9.7	4.0	0.2	−3.6	−16.6	−21.4	−19.5	−16.2	−11.5	−20.6	−27.0	−25.1	−13.3	−19.1
Change in private inventories	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......
Net exports of goods and services	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......
Exports	7.0	9.1	8.4	10.0	8.1	8.8	0.4	10.9	16.7	5.5	3.5	15.6	0.8	8.8	23.0	4.4	5.1	12.3	5.9
Goods	7.7	9.9	7.5	7.2	7.1	14.5	−0.8	13.2	18.1	8.7	3.6	10.4	2.1	6.9	21.8	5.1	4.5	16.3	7.5
Services	5.6	7.2	10.5	16.8	10.2	−2.8	3.2	5.7	13.4	2.7	3.2	28.6	−2.7	13.3	25.9	2.7	6.4	3.8	2.3
Imports	5.9	6.0	2.2	13.8	3.2	0.8	0.8	15.3	10.3	0.1	3.1	2.0	7.7	−3.7	3.0	−2.3	−0.8	−7.3	−1.9
Goods	6.8	6.0	1.7	14.5	5.0	0.7	1.1	17.0	9.0	0.5	3.8	−0.8	8.4	−4.0	2.4	−2.6	−2.0	−7.1	−2.8
Services	1.4	6.0	4.4	10.5	−6.7	0.0	−1.0	8.8	17.7	−2.0	−0.3	18.4	4.2	−2.0	6.3	−0.9	5.5	−8.0	3.5
Government consumption expenditures and gross investment	0.4	1.7	2.1	−1.8	−0.2	0.9	3.4	−1.7	3.9	1.2	1.7	1.8	0.9	3.9	3.8	0.8	1.9	3.9	5.8
Federal	1.2	2.3	1.6	−4.6	1.1	1.1	9.7	−7.2	10.0	−1.5	1.9	1.8	−3.6	6.7	7.2	−0.5	5.8	6.6	13.8
National defense	1.5	1.6	2.5	−9.7	3.1	4.0	12.3	−14.2	8.8	1.9	−0.9	7.0	−6.9	8.5	10.2	−0.9	7.3	7.3	18.1
Nondefense	0.6	3.6	−0.2	6.5	−2.7	−4.5	4.4	8.9	12.4	−8.1	7.7	−8.1	1.2	3.1	1.2	0.4	2.9	5.0	4.8
State and local	−0.1	1.3	2.3	−0.1	−1.0	0.8	−0.1	1.6	0.5	2.9	1.6	1.5	3.8	2.4	1.9	1.6	−0.3	2.5	1.4
Addenda:																			
Final sales of domestic product	3.1	2.8	2.4	2.7	2.3	4.8	4.1	−0.3	5.1	2.3	0.9	2.9	1.1	4.3	4.0	0.8	0.9	4.4	−0.8
Gross domestic purchases	3.0	2.6	1.4	3.4	2.5	1.7	3.7	2.5	4.5	2.0	0.9	0.2	1.2	2.9	2.6	−1.0	0.1	−0.1	−1.3
Final sales to domestic purchasers	3.1	2.6	1.8	3.6	1.9	3.7	3.9	1.0	4.8	1.6	1.0	1.5	2.2	2.5	1.9	−0.1	0.1	1.3	−1.8
Gross national product (GNP)	3.0	2.6	2.2	1.5	4.7	2.2	4.1	0.4	4.9	2.8	0.2	2.0	−0.3	4.4	6.3	1.3	0.1	2.1	......
Disposable personal income	1.4	3.5	2.8	7.5	−4.7	2.5	−1.3	7.5	5.1	1.3	2.3	5.8	4.4	−0.6	3.1	0.6	−0.7	11.9	−8.7
Current-dollar measures:																			
GDP	6.3	6.1	4.8	5.9	7.1	4.8	8.1	5.1	8.6	5.5	3.6	3.7	4.3	6.9	6.3	2.3	3.5	4.1	3.8
Final sales of domestic product	6.5	6.1	5.2	8.0	6.5	7.0	8.4	3.5	8.8	5.1	3.7	5.2	5.3	6.4	5.6	3.6	3.6	5.6	3.4
Gross domestic purchases	6.8	6.1	4.2	7.2	6.3	4.8	9.1	6.5	7.5	5.7	3.8	0.7	5.0	6.4	4.9	2.6	3.5	4.3	3.3
Final sales to domestic purchasers	6.9	6.1	4.6	7.3	5.7	6.9	9.4	5.0	7.8	5.3	3.9	2.1	5.9	5.9	4.2	3.9	3.7	5.7	2.9
GNP	6.4	5.9	4.9	4.8	8.8	4.4	8.4	4.2	8.7	5.6	3.0	4.1	4.0	6.4	7.9	3.9	2.6	3.4	......
Disposable personal income	4.4	6.4	5.5	10.8	−2.4	5.1	3.4	11.1	6.9	4.6	5.4	5.3	7.9	3.0	5.7	4.9	2.9	16.7	−3.7

See "Explanatory Note" at the end of the tables

Table 2. Contributions to Percent Change in Real Gross Domestic Product

	2005	2006	2007	Seasonally adjusted at annual rates															
				2004	2005				2006				2007				2008		
				IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
Percent change at annual rate:																			
Gross domestic product	2.9	2.8	2.0	2.5	3.0	2.6	3.8	1.3	4.8	2.7	0.8	1.5	0.1	4.8	4.8	−0.2	0.9	2.8	−0.3
Percentage points at annual rates:																			
Personal consumption expenditures	2.13	2.13	1.95	2.93	1.25	2.50	2.59	0.94	2.86	1.88	1.52	2.55	2.71	1.42	1.44	0.67	0.61	0.87	−2.25
Durable goods	0.38	0.36	0.38	0.57	0.04	0.95	0.44	−1.02	1.37	0.14	0.27	0.33	0.71	0.40	0.19	0.03	−0.33	−0.21	−1.10
Motor vehicles and parts	−0.01	−0.09	0.07	0.23	−0.32	0.53	0.15	−1.59	0.53	0.06	0.06	0.01	0.30	0.05	−0.22	−0.03	−0.35	−0.64	−0.80
Furniture and household equipment	0.30	0.35	0.24	0.25	0.26	0.29	0.37	0.41	0.55	0.15	0.20	0.23	0.34	0.17	0.26	0.11	0.05	0.39	−0.23
Other	0.08	0.10	0.08	0.09	0.11	0.13	−0.08	0.17	0.29	−0.06	0.00	0.09	0.07	0.17	0.15	−0.06	−0.04	0.04	−0.07
Nondurable goods	0.69	0.74	0.50	0.97	0.49	0.83	0.59	0.93	0.85	0.62	0.46	0.62	0.71	0.40	0.25	0.05	−0.08	0.80	−1.41
Food	0.36	0.38	0.18	0.60	0.32	0.29	0.45	0.37	0.50	0.43	0.10	0.20	0.12	0.27	0.03	0.27	0.13	0.40	−0.89
Clothing and shoes	0.17	0.16	0.13	0.23	0.15	0.27	0.00	0.35	0.18	0.02	0.14	0.12	0.25	0.08	0.12	−0.09	0.08	0.28	−0.31
Gasoline, fuel oil, and other energy goods	−0.01	−0.05	0.02	0.00	−0.09	0.09	0.02	−0.04	−0.17	−0.11	0.03	0.03	0.13	−0.07	−0.01	−0.05	−0.18	−0.20	−0.23
Other	0.17	0.25	0.17	0.14	0.12	0.17	0.11	0.25	0.33	0.27	0.19	0.26	0.22	0.12	0.11	−0.08	−0.10	0.33	0.02
Services	1.06	1.02	1.07	1.39	0.72	0.72	1.55	1.02	0.64	1.12	0.79	1.61	1.29	0.62	1.00	0.59	1.02	0.28	0.26
Housing	0.33	0.34	0.16	0.31	0.34	0.36	0.39	0.35	0.37	0.31	0.25	0.22	0.12	0.09	0.08	0.12	0.05	0.18	0.08
Household operation	0.06	−0.02	0.07	0.15	0.01	0.02	0.15	−0.01	−0.42	0.26	0.10	0.03	0.08	0.02	0.06	0.09	0.07	−0.17	−0.18
Electricity and gas	0.04	−0.05	0.03	0.15	0.03	0.00	0.12	−0.04	−0.42	0.20	0.05	−0.01	0.07	−0.04	0.02	0.01	0.11	−0.19	−0.23
Other household operation	0.03	0.03	0.04	0.01	−0.02	0.01	0.04	0.03	0.01	0.06	0.05	0.04	0.00	0.06	0.04	0.08	−0.05	0.02	0.05
Transportation	0.03	0.05	0.05	0.06	0.02	0.02	0.02	0.01	0.08	0.08	0.03	0.10	0.03	0.04	0.06	−0.02	0.04	−0.08	−0.04
Medical care	0.40	0.31	0.35	0.40	0.31	0.37	0.48	0.39	0.37	0.15	0.07	0.35	0.63	0.13	0.45	0.48	0.59	0.35	0.35
Recreation	0.06	0.09	0.13	0.03	0.08	0.02	0.04	0.04	0.08	0.04	0.18	0.36	0.06	0.08	0.07	−0.01	−0.14	0.04	−0.02
Other	0.18	0.24	0.31	0.44	−0.03	−0.08	0.46	0.24	0.16	0.27	0.15	0.55	0.37	0.27	0.28	−0.08	0.40	−0.03	0.07
Gross private domestic investment	0.95	0.35	−0.90	1.04	1.48	−0.86	0.89	1.98	1.15	−0.02	−0.92	−2.68	−1.63	0.94	0.54	−1.93	−0.89	−1.74	−0.27
Fixed investment	1.08	0.32	−0.50	1.14	0.85	1.21	0.88	0.41	1.39	−0.40	−0.81	−1.27	−0.57	0.47	−0.15	−0.97	−0.86	−0.25	−0.83
Nonresidential	0.71	0.77	0.52	1.00	0.37	0.64	0.64	0.40	1.62	0.71	0.59	−0.09	0.33	1.07	0.91	0.36	0.26	−0.27	−0.11
Structures	0.03	0.23	0.40	0.00	0.19	−0.04	−0.26	0.05	0.42	0.54	0.42	0.08	0.35	0.57	0.65	0.29	0.30	0.64	0.30
Equipment and software	0.67	0.54	0.13	1.01	0.18	0.68	0.90	0.35	1.20	0.16	0.17	−0.18	−0.02	0.50	0.26	0.07	−0.04	−0.37	−0.40
Information processing equipment and software	0.29	0.32	0.34	0.41	0.23	0.31	0.36	0.33	0.61	0.15	0.34	0.04	0.57	0.41	0.31	0.37	0.27	0.30	0.10
Computers and peripheral equipment	0.10	0.15	0.11	0.24	−0.06	0.12	0.09	0.22	0.16	0.17	0.13	0.02	0.17	0.09	0.12	0.12	0.10	0.08	−0.08
Software	0.11	0.06	0.15	0.17	0.07	0.16	0.04	0.10	0.03	0.02	0.07	0.14	0.21	0.22	0.10	0.16	0.16	0.04	0.06
Other	0.08	0.11	0.08	0.00	0.22	0.03	0.23	0.02	0.41	−0.04	0.14	−0.11	0.19	0.09	0.09	0.10	0.00	0.18	0.12
Industrial equipment	0.10	0.07	0.02	0.06	0.12	−0.04	0.19	0.19	−0.07	0.25	−0.12	−0.02	−0.10	0.34	−0.04	−0.20	0.01	−0.05	−0.14
Transportation equipment	0.17	0.09	−0.17	0.40	−0.20	0.24	0.31	−0.24	0.52	−0.25	0.06	−0.15	−0.21	−0.32	−0.07	−0.18	−0.16	−0.58	−0.55
Other equipment	0.11	0.05	−0.07	0.13	0.04	0.17	0.04	0.07	0.15	0.02	−0.12	−0.05	−0.28	0.07	0.06	0.08	−0.18	−0.04	0.20
Residential	0.37	−0.45	−1.02	0.14	0.48	0.57	0.25	0.01	−0.23	−1.11	−1.40	−1.18	−0.91	−0.60	−1.06	−1.33	−1.12	−0.52	−0.72
Change in private inventories	−0.13	0.03	−0.40	−0.11	0.63	−2.07	−0.19	1.58	−0.24	0.38	−0.11	−1.41	−1.06	0.47	0.69	−0.96	−0.02	−1.50	0.56
Farm	−0.06	−0.03	0.04	−0.14	−0.22	0.14	0.19	−0.15	0.02	−0.24	0.00	0.12	−0.07	0.14	−0.08	0.47	−0.17	−0.14	−0.09
Nonfarm	−0.07	0.06	−0.44	0.03	0.85	−2.20	−0.39	1.71	−0.26	0.62	−0.12	−1.52	−0.99	0.33	0.77	−1.43	0.15	−1.36	0.65
Net exports of goods and services	−0.21	−0.02	0.58	−1.07	0.28	0.79	−0.07	−1.26	0.09	0.59	−0.12	1.33	−1.20	1.66	2.03	0.94	0.77	2.93	1.13
Exports	0.71	0.96	0.95	0.97	0.80	0.89	0.04	1.09	1.70	0.58	0.39	1.66	0.06	1.01	2.54	0.53	0.63	1.54	0.78
Goods	0.54	0.73	0.59	0.49	0.49	0.98	−0.06	0.91	1.27	0.49	0.28	0.78	0.15	0.55	1.66	0.43	0.39	1.39	0.68
Services	0.17	0.23	0.36	0.49	0.31	−0.09	0.10	0.18	0.42	0.09	0.11	0.87	−0.09	0.46	0.88	0.10	0.24	0.15	0.09
Imports	−0.93	−0.98	−0.37	−2.04	−0.52	−0.10	−0.11	−2.35	−1.61	0.01	−0.51	−0.33	−1.25	0.65	−0.51	0.40	0.14	1.39	0.35
Goods	−0.89	−0.82	−0.25	−1.78	−0.67	−0.10	−0.14	−2.18	−1.18	−0.04	−0.51	0.13	−1.14	0.59	−0.34	0.38	0.29	1.14	0.45
Services	−0.04	−0.16	−0.12	−0.26	0.15	0.00	0.03	−0.17	−0.43	0.05	0.01	−0.46	−0.11	0.06	−0.17	0.02	−0.15	0.25	−0.10
Government consumption expenditures and gross investment	0.07	0.32	0.40	−0.35	−0.04	0.17	0.85	−0.34	0.72	0.23	0.32	0.30	0.17	0.77	0.75	0.16	0.38	0.78	1.15
Federal	0.09	0.16	0.11	−0.33	0.08	0.08	0.66	−0.53	0.66	−0.11	0.13	0.12	−0.26	0.47	0.51	−0.04	0.41	0.47	0.97
National defense	0.07	0.08	0.12	−0.48	0.14	0.18	0.56	−0.73	0.39	0.09	−0.04	0.32	−0.29	0.40	0.48	−0.04	0.34	0.36	0.86
Consumption expenditures	0.04	0.04	0.11	−0.45	0.22	0.06	0.45	−0.70	0.40	−0.02	0.00	0.14	−0.08	0.28	0.45	−0.06	0.31	0.15	0.72
Gross investment	0.03	0.04	0.01	−0.04	−0.08	0.12	0.11	−0.02	−0.01	0.11	−0.05	0.18	−0.21	0.12	0.03	0.02	0.04	0.21	0.14
Nondefense	0.01	0.08	0.00	0.15	−0.07	−0.11	0.10	0.20	0.27	−0.20	0.17	−0.20	0.03	0.07	0.03	0.01	0.06	0.11	0.11
Consumption expenditures	0.00	0.05	0.00	0.12	−0.03	−0.12	0.03	0.10	0.22	−0.14	0.15	−0.20	0.08	0.02	0.03	−0.02	0.06	0.08	0.11
Gross investment	0.01	0.03	0.00	0.03	−0.03	0.01	0.07	0.10	0.06	−0.07	0.03	0.01	−0.04	0.05	−0.01	0.02	0.01	0.03	0.00
State and local	−0.01	0.16	0.28	−0.01	−0.12	0.10	−0.01	0.19	0.06	0.34	0.19	0.18	0.43	0.30	0.24	0.19	−0.03	0.31	0.18
Consumption expenditures	0.01	0.16	0.20	0.11	−0.13	0.02	0.06	0.09	0.23	0.16	0.24	0.23	0.20	0.17	0.15	0.15	0.14	0.12	0.15
Gross investment	−0.03	0.00	0.09	−0.12	0.01	0.08	−0.07	0.10	−0.18	0.18	−0.05	−0.06	0.24	0.13	0.09	0.04	−0.18	0.19	0.03
Addenda:																			
Goods	1.35	1.67	0.97	1.18	1.12	1.49	1.68	0.65	3.40	1.84	0.51	0.42	−0.80	3.08	2.71	0.01	0.29	1.49	−1.14
Services	1.25	1.35	1.61	1.41	1.24	0.59	2.23	0.52	1.48	1.26	1.29	2.19	1.26	1.81	2.35	0.79	1.62	1.02	1.22
Structures	0.34	−0.24	−0.55	−0.03	0.62	0.54	−0.06	0.15	−0.07	−0.42	−1.00	−1.10	−0.41	0.09	−0.30	−0.97	−1.03	0.32	−0.33
Motor vehicle output	0.13	−0.03	−0.03	−0.34	0.15	0.24	0.76	−1.22	0.59	−0.34	0.40	−0.65	0.10	0.13	0.47	−0.86	−0.41	−1.01	0.09
Final sales of computers	0.15	0.15	0.13	0.29	0.06	0.22	0.07	0.21	0.18	0.15	0.04	0.20	−0.03	0.21	0.28	0.14	0.05	0.17	0.06

See "Explanatory Note" at the end of the tables.

Table 3. Gross Domestic Product and Related Measures: Level and Change From Preceding Period

	Billions of current dollars						Billions of chained (2000) dollars								
	2007	Seasonally adjusted at annual rates					2007	Seasonally adjusted at annual rates					Change from preceding period		
		2007		2008				2007		2008			2007	2008	
		III	IV	I	II	III		III	IV	I	II	III		II	III
Gross domestic product	13,807.5	13,950.6	14,031.2	14,150.8	14,294.5	14,429.2	11,523.9	11,625.7	11,620.7	11,646.0	11,727.4	11,720.0	229.1	81.4	-7.4
Personal consumption expenditures	9,710.2	9,765.6	9,892.7	10,002.3	10,138.0	10,190.7	8,252.8	8,278.5	8,296.2	8,316.1	8,341.3	8,275.2	223.8	25.2	-66.1
Durable goods	1,082.8	1,086.2	1,083.0	1,071.0	1,059.3	1,018.3	1,242.4	1,249.4	1,250.6	1,237.0	1,228.3	1,182.5	57.3	-8.7	-45.8
Motor vehicles and parts	440.4	437.9	437.6	424.7	400.6	371.9	446.7	443.5	442.6	430.2	407.2	378.2	8.8	-23.0	-29.0
Furniture and household equipment	415.3	417.2	415.3	415.1	423.0	412.0	594.0	600.8	606.6	609.3	629.6	617.3	43.8	20.3	-12.3
Other	227.0	231.1	229.9	231.3	235.7	234.4	228.3	232.9	230.8	229.4	230.8	228.2	10.3	1.4	-2.6
Nondurable goods	2,633.0	2,848.6	2,908.2	2,950.7	3,028.2	3,050.4	2,392.6	2,398.6	2,400.2	2,397.9	2,420.7	2,380.7	57.3	22.8	-40.0
Food	1,329.1	1,337.9	1,359.8	1,380.5	1,418.3	1,413.2	1,110.5	1,110.9	1,118.7	1,122.4	1,133.6	1,108.3	20.4	11.2	-25.3
Clothing and shoes	374.0	375.4	373.2	375.5	382.4	376.8	412.9	416.6	413.2	416.3	427.2	414.9	18.5	10.9	-12.3
Gasoline, fuel oil, and other energy goods	366.9	367.1	405.3	423.7	441.6	471.8	196.1	197.9	197.0	194.0	190.8	187.4	1.6	-3.2	-3.4
Other	762.9	766.1	767.9	771.1	785.7	788.5	687.3	690.5	687.9	684.8	695.1	695.8	21.2	10.3	0.7
Services	5,794.4	5,832.8	5,903.5	5,980.6	6,052.5	6,122.0	4,648.2	4,659.8	4,678.1	4,704.3	4,712.1	4,719.2	116.3	7.8	7.1
Housing	1,460.9	1,468.9	1,482.7	1,495.1	1,508.8	1,520.9	1,171.7	1,172.5	1,175.9	1,177.3	1,182.3	1,184.4	17.1	5.0	2.1
Household operation	525.7	526.9	534.3	541.7	554.5	561.4	421.2	421.5	424.0	425.9	421.3	416.5	7.7	-4.6	-4.8
Electricity and gas	218.8	218.3	221.1	228.1	236.3	237.2	151.1	151.0	151.2	154.0	149.6	144.4	2.8	-4.4	-5.2
Other household operation	306.9	308.6	313.2	313.6	318.1	324.1	270.9	271.3	273.9	272.5	273.2	274.8	4.8	0.7	1.6
Transportation	357.0	360.4	362.9	368.8	372.9	377.4	299.2	300.5	299.9	301.2	298.9	297.7	5.5	-2.3	-1.2
Medical care	1,681.1	1,690.2	1,721.9	1,748.6	1,769.3	1,795.6	1,327.8	1,331.4	1,344.5	1,360.8	1,370.3	1,380.1	37.6	9.5	9.8
Recreation	403.4	405.9	409.7	408.2	412.3	416.5	335.0	336.6	336.3	332.3	333.4	332.7	14.3	1.1	-0.7
Other	1,366.3	1,382.5	1,392.0	1,420.2	1,434.6	1,450.2	1,089.9	1,096.0	1,093.9	1,105.0	1,104.0	1,106.0	34.0	-1.0	2.0
Gross private domestic investment	2,130.4	2,164.0	2,092.3	2,058.1	2,000.9	1,999.4	1,809.7	1,838.7	1,781.3	1,754.7	1,702.0	1,693.7	-102.8	-52.7	-8.3
Fixed investment	2,134.0	2,141.0	2,113.4	2,081.7	2,077.0	2,061.7	1,808.5	1,817.0	1,788.2	1,762.4	1,754.9	1,729.8	-57.0	-7.5	-25.1
Nonresidential	1,503.8	1,522.9	1,542.1	1,553.6	1,571.9	1,584.1	1,382.9	1,402.9	1,414.7	1,423.1	1,431.8	1,428.3	64.7	8.7	-3.5
Structures	480.3	492.9	508.7	522.7	549.8	570.2	304.6	313.2	318.7	326.4	340.5	347.0	34.3	14.1	6.5
Equipment and software	1,023.5	1,030.0	1,033.4	1,030.9	1,022.1	1,013.9	1,078.9	1,087.5	1,090.1	1,088.6	1,074.7	1,059.6	17.9	-13.9	-15.1
Information processing equipment and software	517.7	521.1	532.5	539.6	550.9	563.7	653.9	660.9	677.6	689.6	702.9	707.3	57.3	13.3	4.4
Computers and peripheral equipment	93.7	93.7	95.7	95.8	96.8	91.8	....	....	....	....	....	....	....	....	....
Software	227.3	229.5	235.6	241.8	244.6	247.2	237.0	239.4	245.1	251.0	252.3	254.3	21.5	1.3	2.0
Other	196.8	197.9	201.2	202.0	209.5	214.6	218.0	219.6	223.5	223.6	230.6	235.3	11.3	7.0	4.7
Industrial equipment	180.6	185.2	179.9	182.0	183.2	181.4	155.7	159.1	153.1	153.4	152.0	147.8	2.2	-1.4	-4.2
Transportation equipment	157.2	154.6	148.4	142.1	121.4	102.4	139.4	137.4	131.9	127.0	108.6	90.9	-20.1	-18.4	-17.7
Other equipment	168.0	169.2	172.6	167.3	166.5	176.5	148.4	149.2	151.5	146.5	145.3	151.5	-8.1	-1.2	6.2
Residential	630.2	618.1	571.3	528.1	505.0	477.6	453.8	445.3	411.6	383.0	369.6	350.5	-99.1	-13.4	-19.1
Change in private inventories	-3.6	23.0	-21.1	-25.6	-76.0	-62.3	-2.5	16.0	-8.1	-10.2	-50.6	-38.5	-44.8	-40.4	12.1
Farm	1.6	-0.2	5.7	0.2	-4.1	-8.7	1.0	-2.5	10.5	6.0	2.4	-0.6	4.2	-3.6	-3.0
Nonfarm	-5.2	23.2	-26.7	-25.8	-71.9	-53.7	-3.7	19.2	-20.6	-17.9	-55.1	-38.6	-50.0	-37.2	16.5
Net exports of goods and services	-707.8	-682.8	-698.7	-705.7	-718.2	-708.7	-646.5	-611.8	-484.5	-462.0	-381.3	-350.0	69.2	80.7	31.3
Exports	1,662.4	1,714.9	1,758.7	1,820.8	1,923.2	1,981.1	1,425.9	1,468.2	1,482.1	1,500.6	1,544.7	1,567.0	111.1	44.1	22.3
Goods	1,149.2	1,181.2	1,213.7	1,256.9	1,343.7	1,385.2	998.7	1,024.1	1,037.0	1,048.6	1,088.9	1,108.7	70.0	40.3	19.8
Services	513.2	533.8	546.0	563.9	579.5	595.9	426.9	441.8	444.7	451.7	455.8	458.4	40.6	4.1	2.6
Imports	2,370.2	2,397.5	2,456.5	2,526.5	2,641.4	2,687.8	1,972.4	1,978.0	1,966.5	1,962.6	1,926.0	1,916.9	41.9	-36.6	-8.1
Goods	1,985.2	2,005.4	2,060.9	2,118.0	2,225.5	2,262.1	1,677.7	1,681.1	1,670.2	1,662.0	1,631.6	1,619.8	28.7	-30.4	-11.8
Services	385.1	392.1	395.6	408.5	415.9	425.8	298.4	298.4	297.8	301.8	295.5	298.1	12.7	-6.3	2.6
Government consumption expenditures and gross investment	2,674.8	2,703.5	2,742.9	2,798.1	2,873.7	2,945.8	2,012.1	2,025.3	2,029.4	2,039.1	2,058.9	2,088.3	40.9	19.8	29.4
Federal	979.3	994.0	998.3	1,026.5	1,056.1	1,097.8	752.9	762.7	761.7	772.8	785.0	810.8	11.9	12.4	25.8
National defense	662.2	675.6	679.3	699.9	723.3	759.5	502.1	511.0	509.9	518.9	528.1	550.6	12.1	9.2	22.5
Consumption expenditures	580.1	591.9	594.7	613.8	629.0	659.6	425.8	433.5	431.9	439.7	443.4	461.6	10.8	3.7	18.2
Gross investment	82.1	83.7	84.6	86.1	94.3	99.9	78.0	79.3	79.9	81.0	87.9	92.6	1.3	6.9	4.7
Nondefense	317.1	318.3	319.0	326.6	332.9	338.3	250.4	251.2	251.5	253.2	256.3	259.4	-0.4	3.1	3.1
Consumption expenditures	276.0	277.2	276.9	284.2	289.2	294.4	211.7	212.4	212.0	213.5	215.6	218.5	-0.5	2.1	2.9
Gross investment	41.1	41.2	42.1	42.4	43.7	43.9	39.3	39.4	40.2	40.5	41.6	41.7	0.0	1.1	0.1
State and local	1,695.5	1,709.5	1,744.6	1,771.6	1,817.6	1,848.0	1,259.0	1,262.6	1,267.5	1,266.7	1,274.4	1,278.9	28.8	7.7	4.5
Consumption expenditures	1,355.9	1,365.3	1,395.2	1,426.3	1,462.7	1,486.4	1,008.0	1,010.0	1,013.9	1,017.6	1,020.6	1,024.3	19.8	3.0	3.7
Gross investment	339.6	344.2	349.4	345.3	354.9	361.6	250.9	252.5	253.4	249.0	253.7	254.5	9.1	4.7	0.8
Residual	....	....	....	....	....	....	-152.7	-158.2	-171.9	-178.7	-191.6	-168.9	....	....	....
Addenda:															
Final sales of domestic product	13,811.2	13,927.6	14,052.3	14,176.4	14,370.5	14,491.5	11,523.4	11,605.0	11,628.0	11,653.7	11,778.8	11,755.2	274.1	125.1	-23.6
Gross domestic purchases	14,515.3	14,633.1	14,728.0	14,856.6	15,012.7	15,135.6	12,066.8	12,135.1	12,103.2	12,105.8	12,102.6	12,083.0	182.7	-3.2	-39.6
Final sales to domestic purchasers	14,519.0	14,610.1	14,749.0	14,882.2	15,088.7	15,198.2	12,068.0	12,114.1	12,109.8	12,113.3	12,153.0	12,097.5	207.5	39.7	-56.5
Gross domestic product	13,807.5	13,950.6	14,031.2	14,150.8	14,294.5	14,429.2	11,523.9	11,625.7	11,620.7	11,646.0	11,727.4	11,720.0	229.1	81.4	-7.4
Plus: Income receipts from the rest of the world	861.7	896.5	907.4	843.2	822.8	....	719.9	749.3	749.9	690.9	667.2	....	97.7	-23.7	....
Less: Income payments to the rest of the world	759.3	786.3	742.0	705.1	708.9	....	633.3	654.1	611.7	575.2	571.6	....	79.2	-3.6	....
Equals: Gross national product	13,910.0	14,062.8	14,196.6	14,289.9	14,408.3	....	11,609.8	11,719.9	11,758.3	11,760.9	11,822.2	....	247.5	61.3	....
Net domestic product	12,087.1	12,218.6	12,272.6	12,372.9	12,491.3	12,528.9	10,025.9	10,120.3	10,098.1	10,093.2	10,151.2	10,069.1	178.3	58.0	-82.1

NOTE. Users are cautioned that particularly for components that exhibit rapid change in prices relative to other prices in the economy, the chained-dollar estimates should not be used to measure the component's relative importance or its contribution to the growth rate of more aggregate series. For accurate estimates of the contributions to percent changes in real gross domestic product, use table 2.

See "Explanatory Note" at the end of the tables.

Table 4. Price Indexes for Gross Domestic Product and Related Measures: Percent Change From Preceding Period

				Seasonally adjusted at annual rates															
	2005	2006	2007	2004	2005				2006				2007				2008		
				IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
Gross domestic product (GDP)	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.7	3.5	2.7	2.8	2.2	4.1	2.0	1.5	2.8	2.6	1.1	4.2
Personal consumption expenditures	2.9	2.8	2.6	3.0	2.5	2.5	4.7	3.3	1.8	3.3	3.1	-0.5	3.4	3.6	2.5	4.3	3.6	4.3	5.4
Durable goods	-0.8	-1.3	-1.8	0.2	0.4	-0.9	-3.1	-0.9	-0.9	-0.8	-1.3	-2.7	-1.8	-1.6	-1.9	-1.6	-0.1	-1.6	-0.6
Nondurable goods	3.7	3.0	3.0	4.7	1.5	2.0	11.2	2.3	0.3	4.9	4.4	-6.2	5.1	6.4	2.9	8.4	6.7	6.5	10.3
Services	3.3	3.5	3.3	2.8	3.3	3.5	3.3	4.7	3.0	3.3	3.3	2.8	3.6	3.3	3.1	3.5	2.8	4.2	4.0
Gross private domestic investment	4.4	4.2	1.4	3.9	4.7	4.0	5.0	5.4	5.2	3.5	1.6	3.3	1.6	-0.3	-0.3	1.3	-0.5	0.4	2.3
Fixed investment	4.5	4.2	1.4	3.9	4.7	4.2	5.3	5.7	5.0	3.4	1.5	3.2	1.6	-0.2	-0.4	1.2	-0.2	0.8	2.9
Nonresidential	2.9	3.3	1.4	2.5	4.4	2.7	2.0	4.4	4.3	3.3	1.7	2.9	1.3	0.3	-0.6	1.7	0.6	2.3	4.2
Structures	11.8	12.3	3.8	12.0	11.9	10.1	14.8	17.0	14.1	12.0	4.6	6.7	3.4	0.7	0.5	4.5	2.7	3.3	7.2
Equipment and software	-0.1	0.1	0.3	-0.6	1.8	0.1	-2.3	0.2	0.7	-0.1	0.5	1.2	0.4	0.1	-1.2	0.4	-0.4	1.7	2.5
Residential	7.2	5.9	1.5	6.2	5.2	6.8	11.0	7.8	6.4	3.7	1.2	3.9	2.2	-1.3	0.3	0.0	-2.6	-3.5	-1.2
Change in private inventories	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......
Net exports of goods and services	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......
Exports	3.6	3.5	3.5	4.2	4.6	3.5	2.5	3.2	2.9	5.8	4.7	-0.8	3.6	5.3	3.5	6.2	9.1	10.8	6.4
Goods	3.1	3.3	3.5	3.6	4.3	3.0	1.3	2.2	3.0	6.2	5.2	0.0	3.3	5.1	2.6	6.0	10.0	12.3	5.1
Services	4.9	3.8	3.5	5.5	5.2	4.6	5.3	5.5	2.7	4.9	3.7	-2.6	4.3	5.9	5.2	6.6	6.9	7.5	9.4
Imports	6.3	4.3	3.7	6.9	2.3	9.7	10.3	4.5	-1.1	10.3	5.0	-9.1	0.9	12.8	7.4	12.8	12.8	28.8	9.3
Goods	6.5	4.2	3.6	7.0	2.1	10.0	10.8	5.0	-2.0	10.4	5.4	-10.1	0.8	13.0	7.7	14.5	13.6	31.2	9.9
Services	5.7	4.8	3.7	6.0	3.5	7.9	7.8	2.0	4.1	9.9	3.2	-3.8	1.1	11.7	6.1	4.5	7.6	16.6	6.1
Government consumption expenditures and gross investment	5.9	4.7	4.5	5.7	7.7	4.1	7.0	4.8	4.9	4.9	3.3	2.3	8.4	5.2	3.4	5.1	6.2	7.0	4.3
Federal	4.8	4.1	3.4	2.6	11.8	1.7	3.1	0.6	10.2	4.1	1.2	0.9	7.6	3.7	0.9	2.3	5.6	5.1	2.6
National defense	5.2	4.5	3.5	3.1	12.6	1.8	3.2	1.3	10.9	4.4	1.5	0.7	7.0	4.3	1.6	3.1	5.1	6.3	2.9
Nondefense	4.0	3.4	3.1	1.7	10.2	1.6	3.0	-0.1	8.9	3.5	0.5	1.2	8.8	2.6	-0.5	0.5	6.8	2.8	1.7
State and local	6.5	5.1	5.1	7.6	5.3	5.6	9.4	7.3	2.0	5.4	4.6	3.2	5.7	6.1	4.9	6.8	6.6	8.1	5.4
Addenda:																			
Final sales of domestic product	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.8	3.5	2.7	2.7	2.2	4.1	2.0	1.5	2.8	2.7	1.2	4.2
Gross domestic purchases	3.7	3.4	2.8	3.6	3.7	3.1	5.2	3.9	2.9	3.6	2.9	0.6	3.6	3.3	2.2	4.0	3.5	4.2	4.8
Final sales to domestic purchasers	3.7	3.4	2.8	3.6	3.7	3.1	5.2	4.0	2.8	3.6	2.9	0.6	3.7	3.3	2.2	4.0	3.5	4.3	4.8
Gross national product (GNP)	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.7	3.5	2.7	2.8	2.2	4.1	2.0	1.5	2.8	2.8	1.1	......
Implicit price deflators:																			
GDP	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.8	3.6	2.7	2.7	2.2	4.2	2.0	1.5	2.5	2.6	1.3	4.1
Gross domestic purchases	3.7	3.4	2.8	3.7	3.7	3.1	5.2	4.0	2.9	3.6	2.9	0.6	3.7	3.3	2.2	3.7	3.4	4.4	4.7
GNP	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.8	3.6	2.7	2.6	2.1	4.2	2.0	1.5	2.5	2.5	1.3	......

See "Explanatory Note" at the end of the tables.

Table 5. Real Gross Domestic Product, Quantity Indexes

[Index numbers, 2000=100]

	2005	2006	2007	Seasonally adjusted				
				2007		2008		
				III	IV	I	II	III
Gross domestic product	111.944	115.054	117.388	118.425	118.374	118.631	119.460	119.385
Personal consumption expenditures	115.615	119.135	122.456	122.838	123.130	123.395	123.770	122.789
Durable goods	131.397	137.274	143.908	144.720	144.856	143.284	142.273	136.974
Nondurable goods	115.687	119.930	122.872	123.182	123.261	123.147	124.317	122.263
Services	112.525	115.298	118.259	118.605	119.020	119.739	119.937	120.118
Gross private domestic investment	107.853	110.200	104.278	105.950	102.639	101.110	98.071	97.595
Fixed investment	108.984	111.109	107.717	108.218	106.503	104.969	104.522	103.028
Nonresidential	99.520	106.987	112.244	113.863	114.819	115.504	116.212	115.930
Structures	79.747	86.318	97.264	100.005	102.076	104.206	108.716	110.804
Equipment and software	107.695	115.467	117.412	118.348	118.636	118.470	118.961	115.308
Residential	133.226	123.728	101.534	99.644	92.110	85.698	82.692	78.436
Change in private inventories	....	....	....	....	....	....	....	....
Exports of goods and services	109.942	119.937	130.068	133.747	135.189	138.880	140.908	142.934
Imports of goods and services	123.453	130.815	133.654	134.033	133.254	132.991	130.509	129.895
Government consumption expenditures and gross investment	112.626	114.497	116.871	117.642	117.879	118.443	119.594	121.301
Federal	125.181	128.019	130.078	131.772	131.610	133.488	135.628	140.080
State and local	106.256	107.642	110.167	110.484	110.914	110.844	111.517	111.910
Addenda:								
Final sales of domestic product	112.159	115.254	118.062	118.898	119.133	119.397	120.679	120.437
Gross domestic purchases	113.744	116.748	118.343	119.013	118.700	118.726	118.894	118.306
Final sales to domestic purchasers	113.959	116.948	118.995	119.469	119.427	119.461	119.853	119.305
Gross national product	112.340	115.284	117.795	118.913	119.302	119.329	119.950	....

See "Explanatory Note" at the end of the tables.

Table 6. Price Indexes for Gross Domestic Product

[Index numbers, 2000=100]

	2005	2006	2007	Seasonally adjusted				
				2007		2008		
				III	IV	I	II	III
Gross domestic product	113.039	116.676	119.819	119.984	120.826	121.613	121.951	123.203
Personal consumption expenditures (PCE)	111.581	114.675	117.659	117.969	119.221	120.283	121.544	123.152
Durable goods	89.984	88.772	87.154	86.938	86.598	86.581	86.237	86.110
Nondurable goods	111.606	114.984	118.407	118.682	121.092	123.059	125.021	128.134
Services	116.700	120.752	124.712	125.179	126.253	127.133	128.450	129.731
Gross private domestic investment	111.381	116.102	117.735	117.566	117.960	117.815	117.926	118.593
Fixed investment	111.638	116.380	117.995	117.836	118.189	118.117	118.353	119.188
Nonresidential	103.829	107.277	108.739	108.558	109.015	109.177	109.788	110.911
Structures	135.177	151.822	157.662	157.402	159.138	160.182	161.496	164.325
Equipment and software	94.534	94.594	94.870	94.712	94.798	94.700	95.101	95.696
Residential	129.268	136.897	138.884	138.820	138.803	137.900	136.687	136.264
Change in private inventories	....	....	....	....	....	....	....	....
Exports of goods and services	106.814	112.618	116.586	117.018	118.794	121.397	124.560	128.495
Imports of goods and services	111.154	115.932	120.168	121.200	124.907	128.722	137.136	140.205
Government consumption expenditures and gross investment	121.470	127.239	132.941	133.497	135.174	137.237	139.588	141.074
Federal	120.834	125.806	130.076	130.342	131.070	132.879	134.553	135.411
State and local	121.862	128.109	134.671	135.400	137.649	139.866	142.632	144.509
Addenda:								
PCE excluding food and energy	109.644	112.129	114.548	114.797	115.512	116.158	116.782	117.612
Market-based PCE [1]	110.316	113.167	115.893	116.118	117.371	118.452	119.719	121.365
Market-based PCE excluding food and energy [1]	107.657	109.715	111.700	111.831	112.439	113.021	113.522	114.244
Final sales of domestic product	113.074	116.710	119.853	120.020	120.856	121.653	122.008	123.284
Gross domestic purchases	113.263	117.066	120.294	120.571	121.766	122.821	124.103	125.557
Final sales to domestic purchasers	113.299	117.101	120.329	120.609	121.798	122.863	124.160	125.636
Gross national product	113.036	116.673	119.815	119.978	120.822	121.601	121.938	....
Implicit price deflators:								
Gross domestic product	113.034	116.676	119.816	119.997	120.743	121.508	121.890	123.116
Final sales of domestic product	113.074	116.709	119.853	120.013	120.849	121.647	122.002	123.277
Gross domestic purchases	113.258	117.066	120.292	120.585	121.687	122.722	124.045	125.473
Final sales to domestic purchasers	113.299	117.101	120.329	120.604	121.794	122.858	124.156	125.631
Gross national product	113.031	116.672	119.813	119.990	120.737	121.495	121.876	....

1. This index is a supplemental measure that is based on household expenditures for which there are observable price measures. It excludes most implicit prices (for example, the services furnished without payment by financial intermediaries) and the expenses of nonprofit institutions. Percentage changes for these series are included in the addenda to table 8 and appendix table A.

See "Explanatory Note" at the end of the tables.

Table 7. Real Gross Domestic Product: Percent Change From Preceding Year

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Gross domestic product (GDP)	3.3	2.7	4.0	2.5	3.7	4.5	4.2	4.5	3.7	0.8	1.6	2.5	3.6	2.9	2.8	2.0
Personal consumption expenditures	3.3	3.3	3.7	2.7	3.4	3.8	5.0	5.1	4.7	2.5	2.7	2.8	3.6	3.0	3.0	2.8
Durable goods	5.9	7.8	8.4	4.4	7.8	8.6	11.3	11.7	7.3	4.3	7.1	5.8	6.3	4.6	4.5	4.8
Nondurable goods	2.0	2.7	3.5	2.2	2.6	2.7	4.0	4.6	3.8	2.0	2.5	3.2	3.5	3.4	3.7	2.5
Services	3.5	2.8	2.8	2.6	2.9	3.3	4.2	4.0	4.5	2.4	1.9	1.9	3.2	2.6	2.5	2.6
Gross private domestic investment	8.1	8.9	13.6	3.1	8.9	12.4	9.8	7.8	5.7	-7.9	-2.8	3.6	9.7	5.8	2.1	-5.4
Fixed investment	5.9	8.8	9.3	6.5	9.0	9.2	10.2	8.3	6.5	-3.0	-5.2	3.4	7.3	6.8	1.9	-3.1
Nonresidential	3.2	8.7	9.2	10.5	9.3	12.1	11.1	9.2	8.7	-4.2	-9.2	1.0	5.8	7.2	7.5	4.9
Structures	-6.0	-0.7	1.8	6.4	5.6	7.3	5.1	-0.4	6.8	-2.3	-17.1	-4.1	1.3	1.3	8.2	12.7
Equipment and software	7.3	12.5	11.9	12.0	10.6	13.8	13.3	12.7	9.4	-4.9	-6.2	2.8	7.4	9.3	7.2	1.7
Residential	13.8	8.2	9.6	-3.2	8.0	1.9	7.6	6.0	0.8	0.4	4.8	8.4	10.0	6.3	-7.1	-17.9
Change in private inventories	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Net exports of goods and services	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Exports	6.9	3.2	8.7	10.1	8.4	11.9	2.4	4.3	8.7	-5.4	-2.3	1.3	9.7	7.0	9.1	8.4
Goods	7.5	3.3	9.7	11.7	8.8	14.3	2.2	3.8	11.2	-6.1	-4.0	1.8	9.0	7.7	9.9	7.5
Services	5.5	3.2	6.3	6.3	7.2	5.9	2.9	5.6	2.9	-3.7	1.9	0.0	11.5	5.6	7.2	10.5
Imports	7.0	8.8	11.9	8.0	8.7	13.6	11.6	11.5	13.1	-2.7	3.4	4.1	11.3	5.9	6.0	2.2
Goods	9.3	10.1	13.3	9.0	9.3	14.4	11.7	12.4	13.5	-3.2	3.7	4.9	11.3	6.8	6.0	1.7
Services	-2.6	2.9	5.7	3.3	5.5	9.4	11.4	6.9	11.1	-0.3	2.1	0.0	11.5	1.4	6.0	4.4
Government consumption expenditures and gross investment	0.5	-0.9	0.0	0.5	1.0	1.9	1.9	3.9	2.1	3.4	4.4	2.5	1.4	0.4	1.7	2.1
Federal	-1.7	-4.2	-3.7	-2.7	-1.2	-1.0	-1.1	2.2	0.9	3.9	7.0	6.8	4.2	1.2	2.3	1.6
National defense	-5.0	-6.6	-4.9	-3.8	-1.4	-2.8	-2.1	1.9	-0.5	3.9	7.4	8.7	5.8	1.5	1.6	2.5
Nondefense	6.9	-0.7	-1.2	-0.4	-0.7	2.8	0.7	2.8	3.5	3.9	6.3	3.4	1.1	0.6	3.6	-0.2
State and local	2.2	1.4	2.6	2.6	2.3	3.6	3.6	4.7	2.7	3.2	3.1	0.2	-0.2	-0.1	1.3	2.3
Addenda:																
Final sales of domestic product	3.0	2.6	3.4	3.0	3.7	4.0	4.2	4.5	3.8	1.6	1.2	2.5	3.3	3.1	2.8	2.4
Gross domestic purchases	3.3	3.2	4.4	2.4	3.8	4.8	5.3	5.3	4.4	0.9	2.2	2.8	4.1	3.0	2.6	1.4
Final sales to domestic purchasers	3.1	3.2	3.8	2.8	3.8	4.3	5.3	5.4	4.5	1.8	1.8	2.8	3.8	3.1	2.6	1.8
Gross national product	3.3	2.7	3.9	2.6	3.7	4.4	4.0	4.6	3.7	0.8	1.5	2.7	3.8	3.0	2.6	2.2
Real disposable personal income	3.4	1.0	2.7	2.8	3.0	3.5	5.8	3.0	4.8	1.9	3.1	2.2	3.6	1.4	3.5	2.8
Price indexes:																
Gross domestic purchases	2.3	2.2	2.1	2.1	1.8	1.4	0.6	1.6	2.5	2.0	1.6	2.3	3.1	3.7	3.4	2.8
Gross domestic purchases excluding food and energy	2.6	2.3	2.2	2.2	1.5	1.3	1.0	1.4	1.9	1.9	1.9	1.9	2.7	3.1	3.1	2.4
GDP	2.3	2.3	2.1	2.0	1.9	1.7	1.1	1.4	2.2	2.4	1.7	2.1	2.9	3.3	3.2	2.7
GDP excluding food and energy	2.5	2.4	2.2	2.1	1.7	1.7	1.2	1.5	2.0	2.1	2.1	1.9	2.7	3.2	3.2	2.5
Personal consumption expenditures	2.9	2.3	2.1	2.1	2.2	1.7	0.9	1.7	2.5	2.1	1.4	2.0	2.6	2.9	2.8	2.6

Table 8. Real Gross Domestic Product: Percent Change From Quarter One Year Ago

	2004	2005				2006				2007				2008		
	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
Gross domestic product (GDP)	3.1	3.2	2.9	3.0	2.7	3.1	3.2	2.4	2.4	1.3	1.8	2.8	2.3	2.5	2.1	0.8
Personal consumption expenditures (PCE)	3.7	3.0	3.3	3.3	2.6	3.2	3.0	2.7	3.2	3.1	2.9	2.9	2.2	1.5	1.3	0.0
Durable goods	5.6	4.3	6.8	6.2	1.2	5.5	3.0	2.5	6.9	4.6	5.4	5.1	4.2	0.8	-1.1	-5.4
Nondurable goods	3.5	3.0	3.6	3.6	3.6	4.1	3.8	3.6	3.2	3.0	2.7	2.4	1.7	0.7	1.2	-0.7
Services	3.3	2.7	2.4	2.6	2.4	2.4	2.7	2.2	2.8	2.9	2.6	2.7	2.1	1.9	1.7	1.3
Gross private domestic investment	9.1	10.9	4.4	3.5	4.8	4.1	5.4	3.0	-3.9	-7.7	-6.2	-4.1	-3.3	-2.3	-6.8	-7.9
Fixed investment	7.2	8.7	7.3	6.4	5.1	5.8	3.3	0.7	-1.8	-4.6	-3.3	-2.3	-1.9	-2.5	-3.6	-4.8
Nonresidential	7.5	9.2	8.1	6.6	4.9	7.9	7.9	7.7	6.5	3.5	4.4	5.3	6.4	6.2	4.2	1.8
Structures	2.3	4.2	2.3	-1.0	-0.5	1.4	6.4	12.7	12.8	11.7	11.4	12.9	14.5	13.9	13.9	10.8
Equipment and software	9.4	11.0	10.2	9.4	7.0	10.5	8.5	5.9	4.2	0.3	1.6	2.0	2.8	2.7	-0.3	-2.6
Residential	6.7	7.7	6.1	6.0	5.4	2.5	-4.3	-10.6	-15.5	-18.5	-17.3	-17.0	-19.0	-21.3	-21.7	-21.3
Change in private inventories	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Net exports of goods and services	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Exports	7.4	6.9	7.5	6.8	7.0	9.0	8.2	9.0	10.1	6.1	7.0	11.7	8.9	10.1	11.0	6.9
Goods	7.0	6.9	8.7	6.8	8.3	11.0	9.0	10.2	9.5	5.6	5.7	10.0	8.7	9.4	11.7	8.3
Services	8.3	6.9	4.8	6.6	4.0	4.7	8.2	6.2	11.5	7.3	10.0	15.6	9.3	11.7	9.3	3.8
Imports	11.5	9.1	5.5	4.5	4.8	6.6	6.5	7.1	3.8	3.2	2.2	2.2	1.1	-1.0	-1.9	-3.1
Goods	11.9	10.2	6.3	5.2	5.8	6.8	6.7	7.4	3.1	2.9	1.7	1.4	0.9	-1.6	-2.4	-3.6
Services	9.3	3.7	1.5	0.8	-0.1	5.6	5.1	5.3	8.0	4.8	4.8	6.5	1.8	2.2	0.6	-0.1
Government consumption expenditures and gross investment	0.7	0.2	0.1	0.6	0.6	1.6	1.7	1.3	2.1	1.4	2.0	2.8	2.4	2.6	2.6	3.1
Federal	2.4	1.2	0.9	1.7	1.0	3.1	2.5	0.6	2.9	-0.4	1.6	2.9	2.3	4.8	4.7	6.3
National defense	2.5	1.3	1.8	2.1	0.8	2.2	1.7	-1.5	4.1	0.4	2.0	4.7	2.7	6.2	5.9	7.7
Nondefense	2.3	1.0	-0.9	0.8	1.4	5.1	4.1	4.9	0.5	-2.1	0.8	-0.8	1.5	1.9	2.3	3.2
State and local	-0.4	-0.4	-0.3	-0.1	0.3	0.7	1.2	1.7	1.6	2.4	2.3	2.3	2.4	1.4	1.4	1.3
Addenda:																
Final sales of domestic product	2.8	2.8	3.4	3.5	2.7	3.4	2.8	2.0	2.8	1.8	2.3	3.1	2.5	2.5	2.5	1.3
Gross domestic purchases	3.9	3.6	2.9	2.8	2.6	3.1	3.2	2.4	1.9	1.1	1.3	1.7	1.4	1.1	0.4	-0.6
Final sales to domestic purchasers	3.6	3.3	3.3	3.3	2.6	3.4	2.8	2.1	2.2	1.6	1.8	2.0	1.6	1.1	0.8	-0.1
Gross national product	2.9	3.2	3.1	3.1	2.8	2.9	3.1	2.1	2.5	1.2	1.6	3.1	2.9	3.0	2.4	—
Real disposable personal income	4.1	1.9	1.9	0.9	0.9	3.4	3.1	4.0	3.6	3.4	2.9	3.1	1.8	0.6	3.6	0.5
Price indexes:																
Gross domestic purchases	3.7	3.6	3.3	3.9	4.0	3.8	3.9	3.3	2.5	2.7	2.6	2.4	3.3	3.3	3.5	4.1
Gross domestic purchases excluding food and energy	3.1	3.2	3.0	3.1	3.2	3.0	3.2	3.1	2.9	2.8	2.4	2.3	2.3	2.1	2.2	2.5
GDP	3.2	3.3	2.9	3.4	3.5	3.4	3.5	3.2	2.8	2.9	2.8	2.5	2.6	2.3	2.0	2.7
GDP excluding food and energy	3.2	3.3	3.1	3.2	3.3	3.2	3.4	3.2	3.0	2.9	2.5	2.3	2.3	2.0	1.9	2.3
PCE	3.1	2.8	2.5	3.2	3.3	3.1	3.3	2.9	1.9	2.3	2.4	2.2	3.5	3.5	3.7	4.4
PCE excluding food and energy	2.2	2.3	2.1	2.1	2.2	2.1	2.3	2.5	2.3	2.3	2.1	2.0	2.2	2.2	2.3	2.5
Market-based PCE [1]	2.8	2.5	2.2	3.1	3.1	2.9	3.1	2.7	1.8	2.1	2.2	2.0	3.3	3.4	3.6	4.5
Market-based PCE excluding food and energy [1]	1.6	1.7	1.7	1.7	1.7	1.6	1.9	2.1	2.0	2.1	1.8	1.6	1.8	1.7	1.9	2.2

1. This index is a supplemental measure that is based on household expenditures for which there are observable price measures. It excludes most implicit prices (for example, the services furnished without payment by financial intermediaries) and the expenses of nonprofit institutions.

Table 9. Relation of Gross Domestic Product, Gross National Product, and National Income

[Billions of dollars]

	2005	2006	2007	Seasonally adjusted at annual rates				
				2007		2008		
				III	IV	I	II	III
Gross domestic product	12,421.9	13,178.4	13,807.5	13,950.6	14,031.2	14,150.8	14,294.5	14,429.2
Plus: Income receipts from the rest of the world	573.5	725.4	861.7	898.5	907.4	843.2	822.8	....
Less: Income payments to the rest of the world	480.5	647.1	759.3	786.3	742.0	705.1	708.9	....
Equals: Gross national product	12,514.9	13,256.6	13,910.0	14,062.8	14,196.6	14,289.0	14,408.3	....
Less: Consumption of fixed capital	1,612.0	1,623.9	1,720.5	1,731.9	1,758.6	1,778.0	1,803.1	1,900.2
Less: Statistical discrepancy	–71.2	–163.0	–81.4	–7.8	13.9	63.4	98.4	....
Equals: National income	10,974.0	11,795.7	12,270.9	12,338.6	12,424.1	12,447.6	12,506.9	....
Compensation of employees	7,030.8	7,433.8	7,812.3	7,839.3	7,941.0	8,009.7	8,071.8	8,135.6
Wage and salary accruals	5,676.7	6,028.5	6,355.7	6,377.7	6,465.5	6,518.0	6,568.6	6,623.2
Supplements to wages and salaries	1,354.1	1,405.3	1,456.6	1,461.6	1,475.5	1,491.7	1,503.1	1,512.4
Proprietors' income with inventory valuation and capital consumption adjustments	959.8	1,014.7	1,056.2	1,063.8	1,073.8	1,071.7	1,076.9	1,080.0
Rental income of persons with capital consumption adjustment	40.9	44.3	40.0	41.8	38.6	39.1	58.6	64.3
Corporate profits with inventory valuation and capital consumption adjustments	1,447.9	1,668.5	1,642.4	1,668.3	1,611.1	1,593.5	1,533.3	....
Net interest and miscellaneous payments	569.1	631.2	664.4	663.0	688.1	662.3	683.4	666.1
Taxes on production and imports less subsidies	868.9	926.4	963.2	965.7	975.3	975.1	988.5	987.6
Business current transfer payments	70.0	85.4	100.2	102.2	103.1	103.2	102.1	92.8
Current surplus of government enterprises	–13.4	–8.6	–7.9	–5.5	–6.7	–7.1	–7.7	–8.0
Addendum:								
Gross domestic income	12,493.0	13,341.4	13,889.0	13,958.4	14,017.4	14,087.4	14,196.1	....

Table 10. Personal Income and Its Disposition

[Billions of dollars]

	2005	2006	2007	Seasonally adjusted at annual rates				
				2007		2008		
				III	IV	I	II	III
Personal income [1]	10,269.8	10,993.9	11,663.2	11,730.4	11,872.1	11,960.5	12,188.9	12,219.9
Compensation of employees, received	7,025.8	7,432.6	7,818.6	7,839.3	7,941.0	8,009.7	8,071.8	8,135.6
Wage and salary disbursements	5,671.7	6,027.2	6,362.0	6,377.7	6,465.5	6,518.0	6,568.6	6,623.2
Supplements to wages and salaries	1,354.1	1,405.3	1,456.6	1,461.6	1,475.5	1,491.7	1,503.1	1,512.4
Proprietors' income with inventory valuation and capital consumption adjustments	959.8	1,014.7	1,056.2	1,063.8	1,073.8	1,071.7	1,076.9	1,080.0
Farm	34.1	16.2	44.0	47.4	47.1	41.6	38.0	31.2
Nonfarm	925.7	998.6	1,012.2	1,016.4	1,026.7	1,030.1	1,039.0	1,048.8
Rental income of persons with capital consumption adjustment	40.9	44.3	40.0	41.8	38.6	39.1	58.6	64.3
Personal income receipts on assets	1,596.9	1,824.8	2,000.1	2,030.9	2,056.2	2,054.1	2,052.3	2,070.6
Personal interest income	1,022.0	1,125.4	1,214.3	1,238.2	1,242.7	1,224.6	1,208.7	1,232.3
Personal dividend income	574.9	699.4	785.8	794.7	813.5	829.5	843.6	838.3
Personal current transfer receipts	1,520.7	1,603.0	1,713.3	1,720.6	1,737.8	1,778.1	1,926.3	1,871.6
Less: Contributions for government social insurance	874.3	925.5	965.1	966.0	975.3	992.2	997.0	1,002.2
Less: Personal current taxes	1,207.8	1,353.2	1,492.8	1,501.6	1,520.5	1,535.0	1,354.1	1,487.5
Equals: Disposable personal income	9,062.0	9,640.7	10,170.5	10,228.8	10,351.5	10,425.5	10,834.8	10,732.4
Less: Personal outlays	9,029.5	9,570.0	10,113.1	10,182.0	10,309.2	10,404.9	10,538.2	10,592.7
Equals: Personal saving	32.5	70.7	57.4	46.8	42.4	20.6	296.6	139.7
Personal saving as a percentage of disposable personal income	0.4	0.7	0.6	0.5	0.4	0.2	2.7	1.3
Addendum:								
Disposable personal income, billions of chained (2000) dollars [2]	8,121.4	8,407.0	8,644.0	8,671.1	8,683.1	8,667.9	8,914.6	8,715.1

1. Personal income is also equal to national income less corporate profits with inventory valuation and capital consumption adjustments, taxes on production and imports less subsidies, contributions for government social insurance, net interest and miscellaneous payments, business current transfer payments, current surplus of government enterprises, and wage accruals less disbursements, plus personal income receipts on assets, and personal current transfer receipts.
2. Equals disposable personal income deflated by the implicit price deflator for personal consumption expenditures.

Appendix Table A. Real Gross Domestic Product and Related Aggregates and Price Indexes: Percent Change From Preceding Period

	2005	2006	2007	Seasonally adjusted at annual rates															
				2004	2005				2006				2007				2008		
				IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III
Gross domestic product (GDP) and related aggregates:																			
GDP	2.9	2.8	2.0	2.5	3.0	2.8	3.8	1.3	4.8	2.7	0.8	1.5	0.1	4.8	4.8	-0.2	0.9	2.8	-0.3
Goods	4.3	5.4	3.1	3.7	3.6	4.7	5.3	2.0	11.1	5.9	1.5	1.3	-2.5	10.3	9.0	0.0	0.9	4.9	-3.7
Services	2.2	2.3	2.8	2.4	2.1	1.0	3.9	0.9	2.8	2.3	2.3	3.8	2.1	2.7	4.0	1.3	2.7	1.7	2.0
Structures	3.2	-2.2	-6.0	-0.3	6.0	5.1	-0.6	1.3	-0.8	-3.8	-8.8	-9.8	-3.9	0.8	-2.9	-9.3	-10.1	3.3	-3.5
Motor vehicle output	3.8	-0.9	-1.1	-9.6	4.6	7.1	24.6	-31.0	20.2	-10.1	13.7	-19.0	3.8	4.6	17.3	-25.7	-14.2	-33.8	4.1
GDP excluding motor vehicle output	2.9	2.9	2.1	3.0	2.9	2.5	3.2	2.6	4.3	3.1	0.4	2.2	-0.1	4.8	4.4	0.7	1.3	4.0	-0.3
Final sales of computers [1]	23.4	25.0	21.3	50.1	8.5	38.5	11.5	37.2	27.8	25.2	7.0	34.2	-5.0	37.2	52.6	23.7	8.2	28.4	10.2
GDP excluding final sales of computers	2.8	2.6	1.9	2.3	2.9	2.4	3.8	1.1	4.7	2.5	0.8	1.3	0.1	4.6	4.5	-0.3	0.8	2.7	-0.3
Farm gross value added [2]	9.1	-6.9	9.7	40.8	-1.8	27.7	3.1	-28.8	-22.3	3.1	6.9	30.4	12.5	-6.1	8.6	8.2	-15.5	-10.7	8.6
Nonfarm business gross value added [3]	3.4	3.2	2.0	2.6	3.7	2.9	4.8	1.3	6.0	2.9	0.3	1.4	-0.9	5.8	5.5	-0.7	0.9	2.8	-1.7
Price indexes:																			
GDP	3.3	3.2	2.7	3.2	4.0	2.1	4.1	3.7	3.5	2.7	2.8	2.2	4.1	2.0	1.5	2.8	2.6	1.1	4.2
GDP excluding food and energy	3.2	3.2	2.5	3.1	3.9	2.7	3.2	3.5	3.8	3.2	2.6	2.6	3.2	1.7	1.8	2.4	2.0	1.5	3.4
GDP excluding final sales of computers	3.4	3.4	2.8	3.4	4.2	2.3	4.2	3.9	3.7	2.9	2.9	2.3	4.2	2.1	1.7	3.0	2.7	1.2	4.3
Gross domestic purchases	3.7	3.4	2.8	3.6	3.7	3.1	5.2	3.9	2.9	3.6	2.9	0.6	3.6	3.3	2.2	4.0	3.5	4.2	4.8
Gross domestic purchases excluding food and energy	3.1	3.1	2.4	2.8	3.9	2.7	2.8	3.2	3.4	3.2	2.5	2.5	2.9	1.8	1.9	2.4	2.2	2.2	3.1
Gross domestic purchases excluding final sales of computers to domestic purchasers	3.9	3.6	2.9	3.9	3.9	3.3	5.4	4.1	3.0	3.8	3.1	0.7	3.8	3.5	2.4	4.2	3.7	4.4	4.9
Personal consumption expenditures (PCE)	2.9	2.8	2.8	3.0	2.5	2.5	4.7	3.3	1.8	3.3	3.1	-0.5	3.4	3.6	2.5	4.3	3.6	4.3	5.4
PCE excluding food and energy	2.1	2.3	2.2	2.1	2.5	2.1	1.6	2.4	2.1	3.0	2.3	1.8	2.4	1.8	2.1	2.5	2.3	2.2	2.9
Market-based PCE [4]	2.7	2.6	2.4	2.9	2.2	2.2	4.9	3.2	1.4	3.1	3.1	-1.1	3.5	3.5	2.0	4.4	3.7	4.3	5.6
Market-based PCE excluding food and energy [4]	1.7	1.9	1.8	1.8	2.2	1.6	1.2	2.0	1.8	2.6	2.1	1.5	2.3	1.2	1.4	2.2	2.1	1.8	2.6

1. For some components of final sales of computers, includes computer parts.
2. Farm output less intermediate goods and services purchased.
3. Consists of GDP less gross value added of farm, of households and institutions, and of general government.
4. This index is a supplemental measure that is based on household expenditures for which there are observable price measures. It excludes most implicit prices (for example, the services furnished without payment by financial intermediaries) and the expenses of nonprofit institutions.

See "Explanatory Note" at the end of the tables.

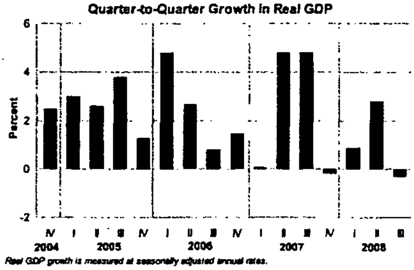
THURSDAY October 30, 2008

BEA
BUREAU OF ECONOMIC ANALYSIS
U.S. DEPARTMENT OF COMMERCE

GDP DECLINES 0.3 PERCENT IN THIRD QUARTER

"Advance" Estimate of GDP

Real gross domestic product (GDP) decreased 0.3 percent in the third quarter of 2008 after increasing 2.8 percent in the second quarter of 2008, according to estimates released today by the Bureau of Economic Analysis.



Real GDP declined in the third quarter mainly because of weak consumer spending, which fell 3.1 percent after modest growth over the previous 3 quarters. Spending on food, clothing, and shoes turned down.

Also:

- Net exports continued to contribute to growth but at a reduced rate.
- Business investment turned down.
- Housing continued to act as a drag on growth.

In contrast, inventories and federal government spending added more to growth this quarter than last.

Prices

Prices of goods and services purchased by U.S. residents rose 4.8 percent after rising 4.2 percent in the second quarter. Food prices picked up, while energy prices decelerated. Excluding food and energy, prices rose 3.1 percent after rising 2.2 percent.

Personal Income

Real disposable personal income (DPI)—income adjusted for inflation and taxes—decreased 8.7 percent, in contrast to an 11.9 percent increase in the second quarter. In the second quarter, it was boosted by the tax rebates from the Economic Stimulus Act of 2008. Excluding these payments, real DPI rose 0.3 percent after decreasing 0.4 percent.

BEA data—including GDP, personal income, the balance of payments, foreign direct investment, the input-output accounts, and economic data for states, local areas, and industries—are available on the BEA Web site: www.bea.gov. E-mail alerts are also available.

NOTE: The "preliminary" estimates of GDP and corporate profits for the third quarter of 2008 will be released on November 25, 2008.

Contact: Ralph Stewart or Thomas Dail (202) 606-2649

Bureau of Economic Analysis, U.S. Department of Commerce

BEA
BUREAU OF ECONOMIC ANALYSIS

U.S. Department of Commerce
Economics and Statistics Administration

Frequently Asked Questions

How do federal financial interventions, such as the Emergency Economic Stabilization Act of 2008, affect the GDP accounts?

During 2008, the federal government has intervened several times in financial markets to restore confidence, to provide liquidity or capital, or to avoid the collapse of a bankrupt or nearly bankrupt corporation or other entity. Typically, a financial intervention involves transactions between an entity and the Department of the Treasury, the Federal Reserve, or another government agency. The federal assistance may involve direct payments, loans, loan guarantees, or the purchase of financial securities.

Direct payments: In the GDP accounts, a direct payment from a federal agency to a business to support current production or operations is classified as a subsidy, while a payment associated with the acquisition or disposal of an asset is classified as a capital transfer. Direct payments made to local governments are classified as grants or capital transfers.

Loans and purchases of financial securities: Loans and purchases of financial securities are not recorded in the GDP accounts, but are recorded in the Federal Reserve Board's flow of funds accounts. (If the transactions involve foreign residents, they also appear in BEA's international transactions accounts.) These financial transactions are not directly counted in GDP because they involve the exchange of financial claims and liabilities rather than current income and production. Financial transactions, however, may lead to subsequent income flows that are recorded in the GDP accounts. For example, the holding of financial securities may result in the federal government receiving interest and dividends, which would increase federal current receipts. Any associated capital gains or losses, however, are excluded from the GDP accounts because they represent a change in the value of an existing asset rather than income from current production.

Administrative costs: Administrative costs incurred by general government agencies associated with implementing financial interventions are included in GDP and are classified as federal consumption expenditures.

Where do Government Sponsored Enterprises (GSEs), like Fannie Mae and Freddie Mac, appear in the GDP accounts?

Government-sponsored enterprises (GSEs) are private companies that were established and chartered by the federal government. (GSEs are different from government enterprises, such as the U.S. Postal Service and local transit agencies, which are businesses owned and operated by government.) In the GDP accounts, government-sponsored enterprises are treated as financial corporations in the business sector. Their value added is recorded in the business sector, and their profits (or losses) are included in corporate profits. Government-sponsored enterprises include the following companies: the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Home Loan banks, Federal Farm Credit banks, and the Federal Agricultural Mortgage Corporation (Farmer Mac).

Conservatorship

On September 7, 2008, the Federal Housing Finance Agency (an agency of the federal government) placed Fannie Mae and Freddie Mac under its conservatorship and the U.S. Treasury acquired preferred stock in each company. At present, however, the GDP accounts continue to classify these two government-sponsored enterprises as private financial corporations.

1441 L Street NW · Washington, DC 20230 · p. 202.606.9900 · www.bea.gov

Explanatory Note: NIPA Measures of Quantities and Prices

Current-dollar GDP is a measure of the market value of goods, services, and structures produced in the economy in a particular period. Changes in current-dollar GDP can be decomposed into quantity and price components. Quantities, or "real" measures, and prices are expressed as index numbers with the reference year -- at present, the year 2000 -- equal to 100.

Annual changes in quantities and prices are calculated using a Fisher formula that incorporates weights from two adjacent years. (Quarterly changes in quantities and prices are calculated using a Fisher formula that incorporates weights from two adjacent quarters; quarterly indexes are adjusted for consistency to the annual indexes before percent changes are calculated.) For example, the 2006-07 annual percent change in real GDP uses prices for 2006 and 2007 as weights, and the 2006-07 annual percent change in GDP prices uses quantities for 2006 and 2007 as weights. These annual changes are "chained" (multiplied) together to form time series of quantity and price indexes. Percent changes in Fisher indexes are not affected by the choice of reference year. (BEA also publishes a measure of the price level known as the implicit price deflator (IPD), which is calculated as the ratio of the current-dollar value to the corresponding chained-dollar value, multiplied by 100. The values of the IPD are very close to the values of the corresponding "chain-type" price index.)

Index numbers of quantity and price indexes for GDP and its major components are presented in this release in tables 5 and 6. Percent changes from the preceding period are presented in tables 1, 4, 7, 8, and Appendix Table A. Contributions by major components to changes in real GDP are presented in table 2.

Measures of real GDP and its major components are also presented in dollar-denominated form, designated "chained (2000) dollar estimates." For most series, these estimates, which are presented in table 3, are computed by multiplying the current-dollar value in 2000 by a corresponding quantity index number and then dividing by 100. For example, if a current-dollar GDP component equaled $100 in 2000 and if real output for this component increased 10 percent in 2001, then the chained (2000) dollar value of this component in 2001 would be $110 (= $100 x 110 / 100). Percent changes calculated from chained-dollar estimates and from chain-type quantity indexes are the same; any differences will be small and due to rounding.

Chained-dollar values for the detailed GDP components will not necessarily sum to the chained-dollar estimate of GDP (or to any intermediate aggregate). This is because the relative prices used as weights for any period other than the reference year differ from those of the reference year. A measure of the extent of such differences is provided by a "residual" line, which indicates the difference between GDP (or other major aggregate) and the sum of the most detailed components in the table. For periods close to the reference year, when there usually has not been much change in the relative prices that are used as weights, the residuals tend to be small, and the chained-dollar estimates can be used to approximate the contributions to growth and to aggregate the detailed estimates. For periods further from the reference year, the residuals tend to be larger, and the chained-dollar estimates are less useful for analyses of contributions to growth. Thus, the contributions to percent change shown in table 2 provide a better measure of the composition of GDP growth. In particular, for components for which relative prices are changing rapidly, calculation of contributions using chained-dollar estimates may be misleading even just a few years from the reference year.

Reference: "Chained-Dollar Indexes: Issues, Tips on Their Use, and Upcoming Changes," November 2003 *Survey*, pp. 8-16.

PREPARED STATEMENT OF DR. NOURIEL ROUBINI, PROFESSOR OF ECONOMICS, STERN SCHOOL OF BUSINESS, NEW YORK UNIVERSITY AND CHAIRMAN OF ROUBINI GLOBAL ECONOMICS, LLC

The U.S. Will Experience a Severe Recession; thus a Large Fiscal Policy Stimulus is Necessary to Dampen the Severity of this Economic Contraction

The U.S. is currently in a severe recession that will be deeper, longer and more protracted than previous U.S. recessions. The last two economic recessions—in 1990–91 and 2001—lasted each 8 months and the cumulative fall in GDP from peak through the trough was only 1.3% in the 1990–91 contraction and 0.4% in the 2001 contraction. In a typical U.S. recession in the post-WWII period GDP falls by an average of 2% and the recession lasts 10 months. The current economic contraction—that my analysis dates as having started in the first quarter of 2008 will last through the fourth quarter of 2009 with a cumulative fall in GDP of the order of about 4% that is even larger than the worst post-WWII recession (the one in 1957–68 when the GDP fall was 3.7%).

Since most components of private aggregate demand are sharply falling right now (private consumption, residential investment, non-residential investment in structures, capex spending by the corporate sector on software and machinery) a major additional fiscal stimulus is necessary to reduce the depth and length of the current economic contraction. And since direct tax incentives have not been effective in boosting consumption and capex spending (as worried households and firm are retrenching their spending) the new round of fiscal stimulus will have to take the form of direct government spending on goods and services (preferably productive investment in infrastructures) and provision to income to those agents in the economy more likely to spend it (block grants to state and local governments, increased unemployment benefits to unemployed workers, etc.).

Given the size of the expected contraction in private aggregate demand (likely to be about $450 billion in 2009 relative to 2008) a fiscal stimulus of the order of $300 billion minimum (and possibly as large as $400 billion) will be necessary to partially compensate for the sharp fall in private aggregate demand.

This fiscal stimulus should be voted on and spent as soon as possible as delay will make the economic contraction even more severe. A stimulus package legislated only February or March of next year when the new Congress comes back will be too late as the contraction of private aggregate demand will be extremely sharp in the next few months. Such policy action should be legislated right away—in a "lame duck" session right after the election—to ensure that the actual spending is undertaken rapidly in the next few months.

Financial Turmoil and Crisis

The rich world's financial system is in significant and persistent turmoil. This is the worst financial crisis that the U.S. and other advanced economies have experienced since the Great Depression. Stock markets have been falling most days, money markets and credit markets have shut down as their interest-rate spreads skyrocket, and it is still too early to tell whether the raft of measures adopted by the US and Europe will stem the financial bleeding on a sustained basis.

A generalized run on the banking system has been a source of fear for the first time in seven decades, while the shadow banking system—broker-dealers, non-bank mortgage lenders, structured investment vehicles and conduits, hedge funds, money market funds and private equity firms—are at risk of a run on their short-term liabilities. On the real economic side, all the advanced economies—representing over 60% percent of global GDP—entered a recession even before the massive financial shocks that started in late summer. So we now have recession, a severe financial crisis and a severe banking crisis in the advanced economies.

Emerging markets were initially tied to this distress only when foreign investors began pulling out their money. Then panic spread to credit markets, money markets and currency markets, highlighting the vulnerabilities of many developing countries' financial systems and corporate sectors, which had experienced credit booms and had borrowed short and in foreign currencies. Countries with large current-account deficits and/or large fiscal deficits and with large short-term foreign currency liabilities have been the most fragile. But even the better-performing ones—like Brazil, Russia, India and China—are now at risk of a hard landing. Many emerging markets are now at risk of a severe financial crisis.

The crisis was caused by the largest leveraged asset bubble and credit bubble in history. Leveraging and bubbles were not limited to the US housing market, but also characterized housing markets in other countries. Moreover, beyond the housing market, excessive borrowing by financial institutions and some segments of the corporate and public sectors occurred in many economies. As a result, a housing bubble, a mortgage bubble, an equity bubble, a bond bubble, a credit bubble, a commodity bubble, a private equity bubble and a hedge funds bubble are all now bursting simultaneously.

The hope that economic contraction in the US and other advanced economies would be short and shallow—a V-shaped six-month recession—has been replaced by certainty that this will be a long and protracted U-shaped recession, possibly lasting at least two years in the US and close to two years in most of the rest of the world. And, given the rising risk of a global systemic financial meltdown, the prospect of a decade-long L-shaped recession—like the one experienced by Japan after the collapse of its real estate and equity bubble—cannot be ruled out.

Indeed, the growing disconnect between increasingly aggressive policy actions and strains in the financial market is scary. When Bear Stearns' creditors were bailed out to the tune of US$30 billion in March, the rally in equity, money and credit markets lasted eight weeks. When the US Treasury announced a bailout of mortgage giants Fannie Mae and Freddie Mac in July, the rally lasted just four weeks. When the US$200 billion rescue of these firms was undertaken and their US$6 trillion in liabilities taken over by the US government, the rally lasted one day.

Until the recent US and European measures were announced, there were no rallies at all. When AIG was bailed out to the tune of US$85 billion, the market fell 5 percent. Then, when the US$700 billion US rescue package was approved, markets fell another 7 percent in two days. As authorities in the US and abroad took ever more radical policy steps in the last few weeks, stock, credit and money markets fell further, day after day for most days. Even the rally following the G7 statement and radical policy actions taken to back stop the financial system lasted only one day and was followed by two weeks of sharply falling equity prices and rising CDS and credit spreads. Policy authorities seem to have lost their credibility in financial markets as—until recently—their actions were step by step, ad hoc and without a comprehensive crisis resolution plan.

Do the recent measures go far enough? When policy actions don't provide real relief to market participants, it is clear that you are one step away from a systemic stress on the financial and corporate sector. A vicious circle of de-leveraging, plummeting asset prices and margin calls is underway.

Recent Policy Actions and Further Necessary Policy Actions to Stem the Crisis

As we have seen in recent weeks, it will take a big change in economic policy and very radical, coordinated action among all advanced and emerging-market economies to avoid an even more severe economic and financial crisis. This includes:

- Another rapid round of interest-rate cuts of at least 150 basis points on average globally;
- A temporary blanket guarantee of all.deposits while insolvent financial institutions that must be shut down are distinguished from distressed but solvent institutions that must be partially nationalized and given injections of public capital;
- A rapid reduction of insolvent households' debt burden, preceded by a temporary freeze on all foreclosures;
- Massive and unlimited provision of liquidity to solvent financial institutions;
- Public provision of credit to the solvent parts of the corporate sector in order to avoid a short-term debt refinancing crisis for solvent but illiquid corporations and small businesses;
- A massive direct government fiscal stimulus that includes public works, infrastructure spending, unemployment benefits, tax rebates to lower-income households and provision of grants to cash-strapped local governments;
- An agreement between creditor countries running current-account surpluses and debtor countries running current-account deficits to maintain an orderly financing of deficits and a recycling of creditors' surpluses to avoid disorderly adjustment of such imbalances.

After the early October crash in stock markets and financial markets (and it was indeed a crash as during the week before the G7/IMF meetings equity prices fell as much as the two day crash of 1929) policy makers finally realized the risk of a systemic financial meltdown, they peered into the systemic collapse abyss a few steps in front of them and finally got religion and started announcing radical policy actions (the G7 statement, the EU leaders agreement to bailout European banks, the British plan to rescue—and partially nationalize—its banks, the European countries plans along the same lines, and the Treasury plan to ditch the initial TARP that was aimed only at buying toxic assets in favor of plan to recapitalize—i.e., partially nationalize—US banks and broker dealers. The main policy actions that will be undertaken are:

- Preventing systemically important banks and broker dealers from going bust (i.e., the U.S. made a mistake letting Lehman fail; so Morgan Stanley and other systemically important financial institutions will be rescued) ("Take decisive action and use all available tools to support systemically important financial institutions and prevent their failure" as in the G7 statement)
- Recapitalization of banks and broker dealers via public injections of capital via preferred shares (i.e., partial nationalization of financial institutions as it is already occurring in the UK, Belgium, Netherlands, Germany, Iceland and, soon enough the U.S.) matched by private equity injections ("Ensure that our banks and other major financial intermediaries, as needed, can raise capital from public as well as private sources, in sufficient amounts to re-establish confidence and permit them to continue lending to households and businesses")
- Temporary guarantee of bank liabilities: certainly all deposits, possibly interbank lines along the lines of the British approach, likely other new debts incurred by the banking system ("Ensure that our respective national deposit insurance and guarantee programs are robust and consistent so that our retail depositors will continue to have confidence in the safety of their deposits")
- Unlimited provision of liquidity to the banking system and to some parts of the shadow banking system to restore interbank lending and lending to the real economy ("Ensure that our banks and other major financial intermediaries, as needed, can raise capital from public as well as private sources, in sufficient amounts to re-establish confidence and permit them to continue lending to households and businesses")
- Provision of credit to the corporate sector via purchases of commercial paper (certainly in the US, possibly in Europe)
- Purchase of toxic assets to restore liquidity in the mortgage backed securities market (U.S.) ("Take action, where appropriate, to restart the secondary markets for mortgages and other securitized assets. Accurate valuation and transparent disclosure of assets and consistent implementation of high quality accounting standards are necessary.")
- Implicit triage between distressed that are solvent given liquidity support and capital injection and non-systemically important and insolvent banks that will need to be closed down/merged/resolved/etc.
- Use of the IMF and other international financial institutions to provide lending to many emerging market economies—and some advanced ones such as Iceland—that are now at risk of a severe financial crisis.
- Use of any other tools that are available and necessary to avoid a systemic meltdown (including implicitly more monetary policy easing as well as possibly fiscal policy stimulus "We will use macroeconomic policy tools as necessary and appropriate.").

At this stage central banks that are usually supposed to be the "lenders of last resort" need to become the "lenders of first and only resort" as, under conditions of panic and total loss of confidence, no one in the private sector is lending to anyone else since counterparty risk is extreme. Only over time private lending will recover.

While most of the economic and financial damage is already done and the global economy will not be able to avoid a painful recession, financial and banking crisis (i.e., the V-shaped short and shallow 6-month recession is now out of the window and we will experience a severe and more protracted 18 to 24 months U-shaped recession) the rapid and consistent implementation of these and other action will prevent the US, European and global economies from experiencing a systemic financial meltdown and entering in a more severe L-shaped decade long stagnation like the one experienced by Japan after the bursting of its real estate and equity bubble.

Are we close to the bottom of this financial crisis? Not really as financial markets are and will remain volatile with significant downside risks to markets remaining over the next few weeks and months as:

- Details of the policy plans are still very fuzzy and ambiguous and with uncertain effects on various assets classes (common shares, preferred shares, unsecured debt of financial institutions, etc.);
- Macroeconomic news will surprise on the downside as the economies sharply weaken and contract while fiscal policy stimulus is lagging. Indeed such macro news flow was worse than awful in the last couple of weeks: free fall in retail sales confirming a consumption recession that started in June; terrible news about housing (starts, permits, prices, homebuilders' sentiment); consumer confidence collapsing; awful leading indicators of supply from the regional Fed re-

ports (Empire State and Philly); continued high initial claims; free fall in industrial production (only in part driven by temporary factors); fall in durable goods orders ex-transportation.

- Earnings news for financial and non financial firms will sharply surprise on the downside;
- The damage done to confidence and to levered investment is already severe and the process of deleveraging of the shadow financial system will continue;
- Major sources of future stress in the financial system remain; these systemic financial risks include: a major surge in corporate defaults rates and fall in recovery rates as the recession becomes severe thus leading to a further widening of credit spreads; the risk of a CDS market blowout as corporate defaults start to spike; the collapse of hundreds of hedge funds that, while being small individually, will have systemic effects as hundreds of small funds make the size of a few LTCMs in terms of their common deleveraging and selling assets in illiquid markets; the rising troubles of many insurance companies; a slow motion refinancing and insolvency crisis for many toxic LBOs once covenant-lite clauses and PIK toggles effects fizzle out; the risk that other systemically important financial institutions are insolvent and in need of expensive rescue programs while the $250 bn of recap of banks is way insufficient to deal with their needs; the ongoing process of deleveraging in illiquid financial markets that will continue the vicious circle of falling asset prices, margin calls, further deleveraging and further sales in illiquid markets that continues the cascading fall in asset prices; further downside risks to housing and to home prices pushing over 20 million households into negative equity by 2009; the risk that some significant emerging market economies and some advanced ones too (Iceland) will experience a severe financial crisis.

The last factor is a crucially important one: there are now about a dozen of emerging market economies that are in serious financial trouble: they include Estonia, Latvia, Hungary, Bulgaria, Turkey, Pakistan, Korea, Indonesia, a few other ones in Central-South Europe and several Central American ones. There is now a significant and rising risk that several of them will experience a true financial crisis. Even a small tiny country of 300,000 souls like Iceland is now having systemic effects on global financial markets: since the country was like a huge hedge fund with banks having liabilities that were 12 times the GDP of the country the collapse of these banks may now lead to a disorderly sale of their assets in already illiquid markets. Now the risk of a financial crisis in a number of twenty countries in the region that goes from the Baltics to Turkey is rising as they all have very large current account deficits and other macro and financial vulnerabilities.

Need for Fiscal Policy Stimulus to Dampen the Contraction in Private Demand

More aggressive and consistent and rapid implementation of the policy plans will increase the likelihood that risky asset prices will bottom out sooner rather than later and then start recovering. A key policy tool—that is currently missing in the G7 and EU plans is to use fiscal policy to boost aggregate demand. Indeed, given the current collapse of private aggregate demand (consumption is falling, residential investment is falling, non-residential investment in structures is falling, capex spending by the corporate sector was falling already before the latest financial and confidence shock and will now be plunging at an even faster rate) it is urgent to provide a boost to aggregate demand to ensure that an unavoidable two-year recession does not become a decade long stagnation. Since the private sector is not spending and since the first fiscal stimulus plan (tax rebates for households and tax incentives to firms) miserably failed as households and firms are saving rather than spending and investing it is necessary now to boost directly public consumption of goods and services via a massive spending program (a $300 to $400 bn fiscal stimulus): the federal government should have a plan to immediately spend in infrastructures and in new green technologies; also unemployment benefits should be sharply increased together with targeted tax rebates only for lower income households at risk; and federal block grants should be given to state and local government to boost their infrastructure spending (roads, sewer systems, etc.). If the private sector does not spend and/or cannot spend old fashioned traditional Keynesian spending by the government is necessary. It is true that we are already having large and growing budget deficits; but $300-400 bn of public works is more effective and productive than just spending $700 bn to buy toxic assets and/or recapitalizing financial institutions. If such fiscal stimulus plan is not rapidly implemented any improvement in the financial conditions of financial institution that the rescue plans will provide will be undermined—in a matter of six months—with an even sharper drop of aggregate demand that will make an already severe recession even more severe. So a fiscal stimulus plan is essential to restore—on a sustained basis—the viability and solvency of many impaired financial institutions. If Main Street goes bust in the next six months rescuing in the short run Wall Street will still lead Wall Street to go bust again as the real economy implodes further.

Moreover, the US government will need to implement a clear plan to reduce the face value of mortgages for distressed home owners and avoid a tsunami of foreclosures (as in the Great Depression HOLC and in my HOME proposal). Households in the US have too much debt (subprime, near prime, prime mortgages, home equity loans, credit cards, auto loans and student loans) while their assets (values of their homes and stocks) are plunging leading to a sharp fall in their net worth. And households are getting buried under this mountain of mounting debt and rising debt servicing burdens. Thus, a fraction of the household sector—as well as a fraction of the financial sector and a fraction of the corporate sector and of the local government sector—is insolvent and needs debt relief. When a country (say Russia, Ecuador or Argentina) has too much debt and is insolvent it defaults and gets debt reduction and is then able to resume fast growth; when a firm is distressed with excessive debt it goes into bankruptcy court and gets debt relief that allows it to resume investment, production and growth; when a household is financially distressed it also needs debt relief to be able to have more discretionary income to spend. So any unsustainable debt problem requires debt reduction. The lack of debt relief to the distressed households is the reason why this financial crisis is becoming more severe and the economic recession—with a sharp fall now in real consumption spending—now worsening. The fiscal actions taken so far (income relief to households via tax rebates) do not resolve the fundamental debt problem because you cannot grow yourself out of a debt problem: when debt to disposable income is too high increasing the denominator with tax rebates is ineffective and only temporary; i.e., you need to reduce the nominator (the debt). During the Great Depression the Home Owners' Loan Corporation was created to buy mortgages from bank at a discount price, reduce further the face value of such mortgages and refinance distressed homeowners into new mortgages with lower face value and lower fixed rate mortgage rates. This massive program allowed millions of households to avoid losing their homes and ending up in foreclosure. The HOLC bought mortgages for two years and managed such assets for 18 years at a relatively low fiscal cost (as the assets were bought at a discount and reducing the face value of the mortgages allowed home owners to avoid defaulting on the refinanced mortgages). A new HOLC will be the macro equivalent of creating a large "bad bank" where the bad assets of financial institutions are taken off their balance sheets and restructured/reduced.

A large fiscal stimulus plan and a plan to reduce the debt overhang of distressed home owners will also ease the political economy of the financial bailout: as the debate in Congress showed, the US public is mad about a system where gains and profits are privatized while losses are socialized, a welfare system for the rich, the well connected and Wall Street. Bernanke and Paulson and the US administration did a lousy job in explaining why partially bailing Wall Street is necessary to avoid severe collateral damage to Main Street in the form of a most severe recession and a risk of an even more severe economic stagnation. At least the redesign of the TARP into a program that will recapitalize banks with public capital (and thus provide the US government and the taxpayer with some upside potential) makes this bailout more socially fair and acceptable.

But the current collapse of private aggregate demand makes it fair, necessary and efficient to directly help Main Street with a direct fiscal stimulus program and with a plan to reduce the debt burden of distressed home owners. Those two additional policy actions are necessary and fundamental—together with the rescue and recapitalization of financial institutions—to minimize the damage to the real economy and to the financial system.

The Risks of a Global Stag-Deflation (Stagnation/Recession and Deflation)

Another important risk that the economy faces—and that suggests the need for a large fiscal stimulus is the risk of a recession associated with price deflation. Last January—at a time when the economic consensus was starting to worry about rising global inflation—I wrote a piece titled Will the U.S. Recession be Associated with Deflation or Inflation (i.e., Stagflation)? On the Risks of "Stag-deflation" rather than "Stagflation" where I argued that the US and other economies would soon have to worry about price deflation rather than price inflation.

As I put it at that time last January:

The S-word (stagflation that implies growth recession cum high and rising inflation) has recently returned in the markets and analysts' debate as inflation has been rising in many advanced and emerging markets economies. This rise in inflation to-

gether with the now unavoidable US recession, the risk of a recession in a number of other economies (especially in Europe) and the likelihood of a sharp global economic slowdown has led to concerns that the risks of stagflation may be rising.

Should we thus worry about US and global stagflation? This note will argue that such worries are not warranted as a US hard landing followed by a global economic slowdown represents a negative global demand shock that will lead to lower global growth and lower global inflation. To get stagflation one needs a large negative global supply-side shock that, as argued below, is not likely to occur in the near future. Thus the coming US recession and global economic slowdown will be accompanied by a reduction—rather than an increase—in inflationary pressures. As in 2001–2003 inflation may become the last of the worries of the Fed and one may actually start hearing again concerns about global deflation rather than inflation.

Let me elaborate next why . . .

. . . unlike a true negative supply side shock—that reduces growth while increasing inflation—a US recession followed by a global economic slowdown is a negative demand shock that has the effect of reducing US and global growth while at the same time reducing US and global inflationary pressures. Specifically such a negative demand shock will reduce inflation and across the world because of a variety of channels.

First, a US hard landing will lead to a reduction in aggregate demand relative to the aggregate supply as a glut of housing, consumer durables, autos and, soon enough, other goods and service takes places. Such reduction in aggregate demand tends to reduce inflationary pressures as firms lose pricing power and then cut prices to stave off the fall in demand and the rising stock of inventories of unsold goods. These deflationary pressures are already clear in housing where prices are falling and in the auto sector where the glut of automobiles is leading to price discounts and other price incentives. Obviously, inflation tends to fall in recession led by a fall in aggregate demand.

Second, during US recessions you observe a significant slack in labor markets: job losses and the rise in the unemployment rate lead to a slowdown in nominal wage growth that reduces labor costs and unit labor cost, thus reducing wage and price inflationary pressures in the economy.

Third, the same slack of aggregate demand and slack in labor markets will occur around the world as long as the negative US demand shock is transmitted—through trade, financial, exchange rate and confidence channels—to other countries leading to a slowdown in growth in other countries (the recoupling rather than decoupling phenomenon). The reduction in global aggregate demand—relative to the global supply of goods and service—will lead to a reduction in inflationary pressures.

Fourth, during any US hard landing and global economic slowdown driven by a negative demand shock the US and global demand for oil, gas, energy and other commodities tends to fall leading to a sharp fall in the price of all commodities. A US hard landing followed by a European, Chinese and Asian slowdown will lead to a much lower demand for commodities, pushing down their price. The fall in prices tends to be sharp because—in the short run—the supply of commodities tends to be inelastic; thus any fall in demand leads to a greater fall in price—given an inelastic supply curve—to clear the commodity prices. And indeed in recent weeks the rising probability of a US hard landing has already led to a fall in such prices: for example oil prices that had flirted with a $100 a barrel level are now down to a price closer to $90; or the Baltic Dry Freight index—that measures the cost of shipping dry commodities across the globe and that had spiked for most of 2007 given the high demand and the limited supply of such ships—is now sharply down by over 20% relative to its peak in the fall of 2007. Similar downward pressure in prices is now starting to show up in other commodities.

Note that a cyclical drop in commodity prices—led by a US hard landing and global economic slowdown—does not mean that commodity prices will remain depressed over the middle term once this global growth slowdown is past. If in the medium term the supply response to high prices is modest while the medium-long term demand for commodities remains high once the US and global economy return to their potential growth rates commodity prices could indeed resume their upward trend. But in a cyclical horizon of 12 to 18 months a US hard landing and global economic slowdown would lead to a sharp fall in commodity prices. Note that even in the case of oil that is the commodity with the weakest supply response to prices—as the investments in new production in a bunch of unstable petro-states (Nigeria, Venezuela, Iran, Iraq and even Russia) are limited—a cyclical global slowdown could lead to a very sharp fall in oil prices. Indeed while oil today is closer to the $90-100 range in the last 12 months oil prices drifted downward at some point close to a $50–60 range even before a US hard landing and global slowdown had occurred.

Thus, one cannot rule out that in such a hard landing scenario oil prices could drift to a price close to $60.

The four factors discussed above suggest that—conditional on the negative global demand shock (US hard landing and global economic slowdown) materializing even the risks of stagflation-lite are exaggerated; rather US and global inflationary force would sharply diminish in this scenario and, if anything, concerns about deflation may reemerge again.

This is not a far fetched scenario as one looks back at what happened in the 2000–2003 cycle. Until 2000 the Fed was worried about the economy overheating and rising inflation risk. But once the economy spinned into a recession in 2001 US and global inflationary pressures diminished and by 2002 the great scare became one of US and global deflation rather than inflation. Indeed the Fed aggressively cut the Fed Funds rate all the way to 1% and Ben Bernanke—then only a Fed governor—wrote speeches about using heterodox policy instruments to fight the risk of deflation once and if the Fed Funds rate were to reach its nominal floor of zero percent.

Today, following a US hard landing and a global economic slowdown, the risks of outright deflation would be lower than in the 2001–2003 episode because of various factors: US inflation starts higher than in 2001; the Fed needs to worry about a disorderly fall of the US dollar that may increase inflationary pressures; the rise and persistence of growth rates in Chindia and other emerging market economies implies that—even if such economies likely recouple to the US hard landing—a global growth slowdown will not turn into an outright global recession that would be truly deflationary. Still, while the scenario outlined here—US recession and global slowdown—may not lead to outright deflationary pressures it would certainly lead to a slowdown of US and global inflation.

The fact that the most likely scenario in the global economy in 2008 is one of a negative global demand shock is the one that is priced by bond markets: if investors were really worried about a rise in US and global inflation—or about true stagflationary shocks—the yield on long term government bonds would have not fallen as sharply as it has since last summer. With US 10 year Treasury yield now well below 4% and sharply falling in the last few weeks it is hard to see a bond market that is worried about global inflation or global stagflation. And while until recently commodity prices pointed to the other directions, recent weakness in oil prices, the cost of shipping commodities and the price of some other commodities also signals that commodity markets are now pricing the risk of a US recession and the risk that—with a lag—a US recession will lead to a broader global economic slowdown.

So in conclusion "stag-deflation" (i.e., low growth or recession with falling inflation rates and possible deflationary pressures) is more likely than "stagflation" (low growth or recession with rising inflation rates) if a US hard landing materializes and leads—as likely—to a slowdown in global demand and growth.

So last January I argued that four major forces would lead to a risk of deflation (or stag-deflation where a recession would be associated with deflationary forces) rather than the inflation risk that at that time—and for most of 2008—mainstream analysts worried about: slack in goods markets, re-coupling of the rest of the world with the US recession, slack in labor markets, and a sharp fall in commodity price following such US and global contraction would reduce inflationary forces and lead to deflationary forces in the global economy.

How have such predictions fared over time? And will the US and global economy soon face sharp deflationary pressures? The answer deflation and stag-deflation will in six months become the main concern of policy authorities.

First, what has happened in the last few months? The US has entered a severe recession that is already leading to deflationary forces in sectors where supply vastly exceeds demand (housing, consumer durables, motor vehicles, etc.) while now aggregate demand is sharply falling below aggregate supply; the unemployment rate is sharply up while employment has been falling for 10 months in a row; and commodity prices are sharply down—about 30% from their July peak—in the last three months and likely to fall much more in the next few months as the advanced economies recession is becoming global. So both in the US and in other advanced economies we are clearly headed towards a collapse of headline and core inflation.

Is there any doubt about this ongoing inflation capitulation and the beginning of sharp deflationary forces? Take the current views of the economic research group at JP Morgan; this group was in 2007–2008 the leading voice arguing about the risks of rising global inflation, about the associated risks of a global growth reflation and arguing that policy rates would be sharply increased in 2008–2009.

This past week instead this JP Morgan research group published its latest global economic outlook arguing that we are headed towards a global recession, negative global inflation and sharply lower policy rates in the US and advanced economies (a 180 degree turn from its previous position). As written in the most recent JP Morgan Global Data Watch:

"A bad week in hell

Increasingly, the signs point to a deep and synchronized global recession. Today's reported slide in UK 3Q08 GDP is expected to be followed by contractions in the United States (next week), the Euro area, and Japan—confirming that the global downturn began last quarter. More troubling is the additional loss of momentum at quarter end, combined with collapsing October survey readings. These developments appear to be part of a negative loop in which economic and financial weakness are feeding on each other, making the prospects for growth in the coming months decidedly grim. Once again we have taken an axe to near-term growth forecasts for the developed world and will likely follow up with additional downward revisions for emerging market economies in the coming weeks. Already, our forecasts suggest that global GDP will contract at a near 1% annual rate in 4Q08 and 1Q09.

It is still too early to accurately gauge the depth of the downturn, as the outlook depends on how well policy actions contain the financial crisis. From a US perspective, our current forecasts place the contraction in GDP somewhere between the last two mild recessions and the deep contractions of 1973–75 and 1981–82. This picture masks the degree to which the pain of the current downturn is falling on households. From the perspective of wealth losses and declines in real consumption, the current recession is likely to prove more severe than any of the previous ten in the post World War II era (see Special report: How deep is the ocean? Gauging US recession contours). For Western Europe, the current downturn is currently projected to look similar to the one in the early 1990s—the last episode in which regional GDP contracted.

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Inflation and real policy rates to go negative

With part of this year's slide in global growth linked to an inflation shock, the recent collapse in global commodity prices should be seen as an important factor cushioning the downturn. In the six months through August 2008, global consumer prices rose at a 5.6% annual rate, prompting stagnation in real consumption across the globe. Based on recent moves in the price of oil and other commodities, it is likely that the coming six months will see headline inflation dip below zero. While this swing will be a plus for consumers across the globe, it is also a development that will promote a significant growth rotation towards the G3 and Emerging Asian economies that were hurt most severely by this negative shock. In the developed world, this backdrop of contracting GDP, collapsing inflation, and financial market stress opens the door to a powerful monetary policy response (emphasis / bold added)."

So the leading supporters of the view that the global economy risked rising inflation, rising growth reflation and sharply higher policy rates to fight this inflation are now predicting a global recession, global deflation and sharply falling policy rates. What a difference a year makes.

Is there any further doubt that we are headed towards a global deflation or—better—a global stag-deflation? Aggregate demand is now collapsing in the US and advanced economies and sharply decelerating in emerging markets; there is a huge excess capacity for the production of manufactured goods in the global economy as the massive and excessive capex spending in China and Asia (Chinese real investment is now close to 50% of GDP) has created an excess supply of goods that will remain unsold as global aggregate demand falls; commodity prices are in free fall with oil prices alone down over 50% from their July peak (and the Baltic Freight Index—the best measure of international shipping costs—is 90% from its peak in May); while labor market slack is sharply growing in the US and rising in Europe and other advanced economies.

And what are financial markets telling us about the risks of stag-deflation?

First, yields on 10 year Treasury bonds fell by about 50bps since October 14th getting close to their previous 2008 lows; also two-year Treasury yield have fallen by about l50bps in the last month. Second, gold prices—a typical hedge against rising global inflation—are now sharply falling. Finally, and more importantly, yields on TIPS (Treasury Inflation-Protected Securities) due in five years or less have now become higher than yields on conventional Treasuries of similar maturity. The difference between yields on five-year Treasuries and five-year TIPS, known as the breakeven rate, fell to minus 0.43 percentage points; this is a record. Since the difference between the conventional Treasuries and TIPS is a proxy for expected inflation the TIPS market is now signaling that investors expect inflation to be negative over the next five years as a severe recession is ahead of us.

So goods markets, labor markets, commodity markets, financial markets and bond markets are all sending the same message: stagnation/recession and deflation (or stag-deflation) is ahead of us in the US and global economy.

So, we should not be surprised if six months from now the Fed and other central banks in advanced economies will start to worry—as they did in 2002–03 after the 2001 recession—about deflation rather than inflation. In those years where the US experienced a deflation scare Bernanke wrote several pieces explaining how the US could resort to very unorthodox policy actions to prevent a deflation and a liquidity trap like the one experienced by Japan in the 1990s. Those writings may have to be soon carefully read and studied again as the US and global economy faces its worst recession in decades and as deflationary forces envelop the US and other advanced economies. It also highly likely that as deflationary forces mount the Fed will have to cut the Fed Funds rate even further: as I have argued for a while at the bottom of this business cycle the Fed Funds rate is likely to be closer to 0% than to 1%. Indeed, if the Fed cut the Fed Funds rate to 1% during the last recession that was short and shallow it will cut this rate much further if—as likely—the recession will be much more severe and protracted this time around.

Finally, while in the short run a global recession will be associated with deflationary forces shouldn't we worry about rising inflation in the middle run? This argument that the financial crisis will eventually lead to inflation is based on the view that governments will be tempted to monetize the fiscal costs of bailing out the financial system and that this sharp growth in the monetary base will eventually cause high inflation. In a variant of the same argument some argue that—as the US and other economies face debt deflation—it would make sense to reduce the debt burden of borrowers (households and now governments taking on their balance sheet the losses of the private sector) by wiping out the real value of such nominal debt with inflation.

So should we worry that this financial crisis and its fiscal costs will eventually lead to higher inflation? The answer to this complex question is: likely not.

First of all, the massive injection of liquidity in the financial system—literally trillions of dollars in the last few months—is not inflationary as it is accommodating the demand for liquidity that the current financial crisis and investors' panic has triggered. Thus, once the panic recedes and this excess demand for liquidity shrinks, central banks can and will mop up all this excess liquidity that was created in the short run to satisfy the demand for liquidity and prevent a spike in interest rates.

Second, the fiscal costs of bailing out financial institutions would eventually lead to inflation if the increased budget deficits associated with this bailout were to be monetized as opposed to being financed with a larger stock of public debt. As long as such deficits are financed with debt—rather than by running the printing presses—such fiscal costs will not be inflationary as taxes will have to be increased over the next few decades and/or government spending reduced to service this large increase in the stock of public debt.

Third, wouldn't central banks be tempted to monetize these fiscal costs—rather than allow a mushrooming of public debt—and thus wipe out with inflation these fiscal costs of bailing out lenders/investors and borrowers? Not likely in my view: even a relatively dovish Bernanke Fed cannot afford to let the inflation expectations genie out of the bottle via a monetization of the fiscal bailout costs; it cannot afford/be tempted to do that because if the inflation genie gets out of the bottle (with inflation rising from the low single digits to the high single digits or even into the double digits) the rise in inflation expectations will eventually force a nasty and severely recessionary Volcker-style monetary policy tightening to bring back the inflation expectation genie into the bottle. And such Volcker-style disinflation would cause an ugly recession. Indeed, central banks have spent the last 20 years trying to establish and maintain their low inflation credibility; thus destroying such credibility as a way to reduce the direct costs of the fiscal bailout would be highly corrosive and destructive of the inflation credibility that they have worked so hard to achieve and maintain.

Fourth, inflation can reduce the real value of debts as long as it is unexpected and as long as debt is in the form of long-term nominal fixed rate liabilities. The trouble is that an attempt to increase inflation would not be unexpected and thus investors would write debt contracts to hedge themselves against such a risk if monetization of the fiscal deficits does occur. Also, in the US economy a lot of debts—of the government, of the banks, of the households—are not long term nominal fixed rate liabilities. They are rather shorter term, variable rates debts. Thus, a rise in inflation in an attempt to wipe out debt liabilities would lead to a rapid re-pricing of such shorter term, variable rate debt. And thus expected inflation would not succeed in reducing the part of the debts that are now of the long term nominal fixed rate form, i.e., you can fool all of the people some of the time (unexpected inflation) and some of the people all of the time (those with long term nominal fixed rate claims) but you cannot fool all of the people all of the time. Thus, trying to inflict a capital levy on creditors and trying to provide a debt relief to debtors may not work as a lot of short term or variable rate debt will rapidly reprice to reflect the higher expected inflation.

In conclusion, a sharp slack in goods, labor and commodity markets will lead to global deflationary trends over the next year. And the fiscal costs of bailing out borrowers and/or lenders/investors will not be inflationary as central banks will not be willing to incur the high costs of very high inflation as a way to reduce the real value of debt burdens of governments and distressed borrowers. The costs of rising expected and actual inflation will be much higher than the benefits of using the inflation/seignorage tax to pay for the fiscal costs of cleaning up the mess that this most severe financial crisis has created. As long—as likely—as these fiscal costs are financed with public debt rather than with a monetization of these deficits inflation will not be a problem either in the short run or over the medium run.

Given the risk of a deflationary and recessionary spiral in the economy—like the one experienced by Japan in the 1990s after the bursting of its real estate and equity bubble—it is essential to prevent such destructive price deflation from occurring. Thus risk of a deflation is additional argument in favor of an aggressive fiscal stimulus package; such package will reduce the risk of such destabilizing deflationary spiral.

PREPARED STATEMENT OF DR. SIMON JOHNSON, RONALD A. KURTZ PROFESSOR OF ENTREPRENEURSHIP, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Main Points

1) The US is facing a serious recession and subsequent slow growth, due to the effects of a crisis of confidence in and around the global credit system.

2) Some sensible counter-cyclical policies are now being implemented in the US, but problems in other parts of the world are still emerging and most economic forecasts continue to be marked down.

3) In this environment, a total fiscal stimulus of around $450 billion (or roughly 3% of GDP) would be appropriate, with about half front-loaded in the first three quarters of 2009, when there will likely be recession, and the rest following over the next 8–12 quarters, during which otherwise growth will be slow.

Today, it is abundantly clear that not only the United States but much of the world is sliding rapidly into recession. While the Treasury Department, Federal Reserve, and Congress have taken multiple steps to ensure the stability of the financial system, the next question is how to protect the real economy from a severe, prolonged recession and construct a basis for long-term growth and prosperity in the future.

My testimony includes three main sections: first, the roots and evolution of the current global financial crisis; second, the current situation; and third, my recommendations for the stimulus package itself.

The Global Financial Crisis

Roots of the Crisis

For at least the last year and a half, as banks took successive writedowns related to deteriorating mortgage-backed securities, the conventional wisdom was that we were facing a crisis of bank solvency triggered by falling housing prices and magnified by leverage. However, falling housing prices and high leverage alone would not necessarily have created the situation we are now in.

The problems in the U.S. housing market were not themselves big enough to generate the current financial crisis. America's housing stock, at its peak, was estimated to be worth $23 trillion. A 25% decline in the value of housing would generate a paper loss of $5.75 trillion. With an estimated 1-3% of housing wealth gains going into consumption, this could generate a $60–180 billion reduction in total consumption—a modest amount compared to US GDP of $15 trillion. We should have seen a serious impact on consumption, but, there was no a priori reason to believe we were embarking on a crisis of the current scale.

Leverage did increase the riskiness of the system, but did not by itself turn a housing downturn into a global financial crisis. There is no basis on which to say banks were too leveraged in one year but were safe the year before; how leveraged a bank can be depends on many factors, most notably the nature and duration of its assets and liabilities. In the economy at large, credit relative to incomes has been growing over the last 50 years, and even assuming that credit was overextended, today's crisis was not a foregone conclusion.

There are two possible paths to resolution for an excess of credit. The first is an orderly reduction in credit through decisions by institutions and individuals to reduce borrowing, cut lending, and raise underlying capital. This can occur without much harm to the economy over many years. The second path is more dangerous. If creditors make abrupt decisions to withdraw funds, borrowers will be forced to scramble to raise funds, leading to major, abrupt changes in liquidity and asset prices. These credit panics can be self-fulfilling; fears that assets will fall in value can lead directly to falls in their value.

A Crisis of Confidence

We have seen a similar crisis at least once in recent times: the crisis that hit emerging markets in 1997 and 1998. For countries then, read banks (or markets) today. In both cases, a crisis of confidence among short-term creditors caused them to pull out their money, leaving institutions with illiquid long-term assets in the lurch.

This emerging market crisis started in June 1997 in Thailand, where a speculative attack on the currency caused a devaluation, creating fears that large foreign currency debt in the private sector would lead to bankruptcies and recession. Investors almost instantly withdrew funds and cut off credit to Malaysia, Indonesia and the Philippines under the assumption that they were guilty by proximity. All these countries lost access to foreign credit and saw runs on their reserves. Their currencies fell sharply and their creditors suffered major losses.

From there, the contagion spread for no apparent reason to South Korea—which had little exposure to Southeast Asian currencies—and then to Russia. Russia also had little exposure to Asia. However, Russia was funding deficits through short-term ruble bonds, many of which were held by foreign investors. When short-term creditors panicked, the government and the IMF could not prevent a devaluation (and a default on those ruble bonds). GDP fell 10% in the following 12 months. After Russia, the story repeated itself in Brazil. In December 1998 Brazil let the currency float, leading to a sharp depreciation within one month.

In each case, creditors lost confidence that they could get their principal back and rushed to get out at the same time. In such an environment, any institution that borrows short and lends long is vulnerable to an attack of this kind. The victims had one common trait: if credit were cut off they would be unable to maintain their existing activities. The decision of credit markets became self-fulfilling, and policy makers around the world seemed incapable of stopping these waves.

The Acute Stage of the Crisis

The evolution of the current financial crisis seems remarkably similar to the emerging markets crisis of a decade ago.

America's crisis started with creditors fleeing from sub-prime debt in summer 2007. As default rates rose, investment-grade debt—often collateralized debt obligations (CDOs) built out of sub-prime debt—faced large losses. The exodus of creditors caused mortgage finance and home building to collapse.

The second stage began with the Bear Stearns crisis in March 2008 and extended through the bailout of Fannie Mae and Freddie Mac. As investment banks evolved into proprietary trading houses with large blocks of illiquid securities on their books, they became dependent on the ability to roll over their short-term loans, regardless of the quality of their assets. Given sufficient panic, it can become impossible to roll over those loans. And in a matter of days, despite no major news, Bear Stearns was dead. However, while the Federal Reserve and Treasury made sure that Bear Stearns equity holders were penalized, they also made sure that creditors were made whole—a pattern they would follow with Fannie and Freddie. As a result, creditors learned that they could safely continue lending to large financial institutions.

This changed on September 15 and 16 with the failure of Lehman and the "rescue" of AIG, which saw a dramatic and damaging reversal of policy. Once Bear Stearns had fallen, investors focused on Lehman; again, as confidence faded away, Lehman's ability to borrow money evaporated. This time, however, the Fed let Lehman go bankrupt, largely wiping out creditors. AIG was a less obvious candidate target. Despite large exposure to mortgage-backed securities through credit default swaps, no analysts seemed to think its solvency was truly in question. Overnight, however, without any fundamental changes, the markets decided that AIG might be at risk, and the fear became self-fulfilling. As with Lehman, the Fed chose not to protect creditors; because the $85 billion loan was senior to existing creditors, senior debt was left trading at a 40% loss.

This decisive change in policy reflected a growing political movement in Washington to protect taxpayer funds after the Fannie Mae and Freddie Mac actions. In any case, though, the implications for creditors and bond investors were clear: RUN from all entities that might fail, even if they appear solvent. As in the emerging markets crisis of a decade ago, anyone who needed access to the credit markets to survive might lose that access at any time.

As a result, creditors and uninsured depositors at all risky institutions pulled their funds—shifting deposits to Treasuries, moving prime brokerage accounts to the safest institutions (read JPMorgan), and cashing out of securities arranged with any risky institutions. The previously invincible Morgan Stanley and Goldman Sachs saw large jumps in their credit default swap rates. Washington Mutual and Wachovia vanished. LIBOR shot up and short-term US Treasury yields fell as banks stopped lending to each other and lent to the US government instead. The collapse of one money market fund (largely because of exposure to Lehman debt), and the pending collapse of more, sent the US Treasury into crisis mode.

At the same time, the credit market shock waves spread quickly throughout the world. In Europe, interbank loan rates and EURIBOR rates shot up, and banks from Bradford & Bingley to Fortis were nationalized. Further afield, Russia and Brazil each saw major disruptions in their interbank markets and Hong Kong experienced a (small) bank run. From late September, credit markets around the world were paralyzed by the fear that any leveraged financial institution might fail due to a lack of short-term credit. Self-fulfilling collapses can dominate credit markets during these periods of extreme lack of confidence.

The Response

There are two ways to end a crisis in confidence in credit markets. The first is to let events unfold until so much deleveraging and so many defaults have occurred that entities no longer rely on external finance. The economy then effectively operates in a "financially autonomous" manner in which non-financial firms do not need credit. This is the path most emerging markets took in 1997–1998. Shunned by the world investment community, it took many years for credit markets to regenerate confidence in their worthiness as counterparties.

The second is to put a large balance sheet behind each entity that appears to be at risk, making it clear to creditors that they can once again safely lend to those counterparties without risk. This should restore confidence and soften the coming economic recession.

Governmental responses to the crisis were fitful, poorly planned, and abysmally presented to the public. The US government, to its credit, was the first to act, while European countries boasted they would be little affected. Still, though, Messrs. Paulson and Bernanke had made the mistake of insisting right through the Lehman bankruptcy that the system was fundamentally sound. As a result, their rapid reversal and insistence that they needed $700 billion for Mr. Paulson to spend however he wished was greeted coldly on Capitol Hill and in the media.

The initial Paulson Plan was designed to increase confidence in financial institutions by transferring their problematic mortgage-backed securities to the federal government's balance sheet. The plan had many problems, ranging from uncertainty over what price the government would pay for the assets to questions about whether it would be sufficient to stop the crisis of confidence. On September 29, I recommended passing the plan and supplementing it with four additional measures: the first two were unlimited deposit insurance and an equity injection program for financial institutions. (My views throughout the crisis were published at http://BaselineScenario.com and in various other media outlets.)

After the Paulson Plan was passed on October 3, it was quickly overtaken by events. First the UK announced a bank recapitalization program; then, on October 13, it was joined by every major European country, most of which also announced loan guarantees for their banks. On October 14, the US followed suit with a bank recapitalization program, unlimited deposit insurance (for non-interest-bearing accounts), and guarantees of new senior debt. Only then was enough financial force applied for the crisis in the credit markets to begin to ease, with LIBOR finally falling and Treasury yields rising, although they are still a long way from historical levels.

Dangers for Emerging Markets

Although the US and Europe have grabbed most of the headlines, the most vulnerable countries in the current crisis are in emerging markets. Just like highly leveraged banks, highly leveraged countries—such as Iceland—are vulnerable to the flight of capital. Countries that got rich during the commodities boom are also highly vulnerable to a global recession.

The flight to safety is already destabilizing banks around the world. For companies that can get credit, the cost has skyrocketed. These financial sector tremors are sending shock waves through emerging market economies. While wealthy nations can use their balance sheets to shore up banks, many other countries will find this impossible. Like Latin America in the 1980s, or emerging markets after 1997–98, the withdrawal of credit after a boom can lead to steep recessions and major internal disruptions.

Four sets of countries stand to lose.

1. The over-leveraged. With bank assets more than ten times its GDP, Iceland cannot protect its banks from a run. Other countries that borrowed heavily during the boom face a similar situation.

2. The commodity-dependent. Oil has already fallen below $70 per barrel, and demand continues to fall. All other major commodities are falling for the same reasons. Commodity exporters facing sharply reduced revenues will need to cut spending and let their currencies depreciate.

3. The extremely poor. Sub-Saharan Africa, which was a beneficiary of the commodity boom, will be hit hard by the fall in commodity prices. At the same time, wealthy nations are likely to slash their foreign aid budgets. The net effect will be prolonged isolation from the global economy and increased inequality.

4. China. The global slowdown has already had a major impact on several sectors of China's manufacturing economy. The collapse in the Baltic Dry Index shows that demand for commodities and manufactured goods is plummeting. While China's economic influence will only grow in the long term, a global recession could cause a severe crimp in its growth.

Events of the past two weeks, with emerging markets currencies plunging relative to the yen and the dollar, and multiple countries petitioning the IMF for loans, show that the emerging markets crisis is only deepening. This will inflict damage on G7 economies, increase global inequality, and create geo-political instability.

The Current Situation

The Financial System

Today, although it is by no means assured, it seems relatively likely that the financial panic will gradually ease and the successive collapse of many large banks in the US and Europe will not occur. However, the resumption of interbank lending alone will not be enough to reverse the downward trajectory of the real economy. Banks still need to deleverage in a major way and there are doubts about how much lending to the real economy will pick up. For example, mortgage rates in the US actually increased after the recapitalization plan was announced. In a worst case scenario, even some wealthy countries may not be able to absorb the losses sustained by their banks. The US will have to worry not just about its banks, but also about some insurance companies and potentially quasi-financial companies such as GMAC, Ford, and GE.

The Real Economy

Before the severe phase of the crisis began on September 15, the world was already facing an economic slowdown. The credit crisis of the past month and the lingering uncertainty seem certain to produce a global recession. In the face of uncertainty and higher credit costs, many spending and investment decisions will be put on hold. US and European consumption decline along with housing prices. With interest rates rising around the world, companies will pay down debt and reduce spending and investment plans. State and municipal governments will see lower tax revenues and cut spending. No country can rely on exports to provide much cushion, as growth and spending around the world have been affected by the flight from credit.

Recent economic indicators in the US show significant deterioration in the real economy. Because these indicators are from the entire month of September, they probably understate the effect of the acute credit crunch of the second half of the month, which we will not fully appreciate until October data appear in the middle of November. In the meantime, there is abundant anecdotal data, with layoffs by dozens of America's most prominent companies, ranging from Yahoo to Goldman Sachs to General Electric.

Unexpected Distress in Europe

The most recent reports indicate a much sharper downturn in Europe than was expected even a few weeks ago, with the UK already in recession in the third quarter of this year. Even wealthy European countries and members of the Eurozone are threatened by two important developments, in addition to the acute credit crisis that has been with us since the middle of September.

First, many European countries' banking sectors have imported serious financial problems from emerging market countries. In recent years, much of the investment in Eastern Europe and Latin America has come from European banks, which are now seeing their asset values plummet.

Second, and potentially more dangerously, worries are mounting that even members of the Eurozone might default on their sovereign debts. By acting to guarantee the solvency of their domestic banks, European countries have implicitly taken the risk of default onto themselves. As the recession deepens, those banks may fall further and further into the red, requiring their government backers to provide more and more capital. Because, in some cases, domestic bank assets are significantly larger than GDP, there is risk that some governments may simply be unable to bail out their financial sectors. Investor nervousness over this prospect can be seen in the prices of credit default swaps on sovereign debt. The implied risk of default for countries such as Ireland, Italy and Greece has already quadrupled to 12% each.

The real risk here is that these pressures may cause one or more countries to abandon the euro, or at least may require Eurozone nations to expend considerable resources to fight off that prospect. Nations threatened by fleeing creditors and rising interest rates will want looser monetary policy, but have ceded control over monetary policy to the European Central Bank (ECB), which is still dominated by inflation fighters. If the ECB fails to help threatened member nations, domestic politicians will argue that they are better off setting policy at home. The costs of abandoning the euro would be very high, but it could happen. If one nation breaks away, investors will wonder who is next, cutting off financing from other countries. The damage inflicted on the real economy would be enormous.

Emerging Markets Getting Worse and Worse

In just the last week, the outlook for emerging markets has gotten significantly worse. As the wealthiest nations protect their banking sectors, investors and lenders will be less likely to put their money in countries perceived as risky. Iceland is already facing default, either by its banking sector or by its government. After Iceland, the psychology of fear is likely to take over as creditors try to guess which country will be next, just as in 1997–98. Unless a country has a sufficient balance sheet and a very large amount of reserves, it may get drawn into a pattern of selective defaults and large devaluations.

The IMF is stepping in with aid packages to Iceland, Ukraine, and Hungary. However, it is hard to see how the IMF or anyone else can provide resources on a sufficient scale to make a difference. Investors expect multiple countries across Eastern Europe to default, judging by the price of credit default swaps on those countries' debt.

Falling commodity prices due to the coming recession will also hurt many exporting countries. Even Russia, with its large foreign currency reserves (and vast oil and gas reserves) may have a significant mismatch problem between short term liabilities and longer term assets. This is complicated further by large private sector debt in foreign currency. The government may be moving toward deciding which companies they will save. Hopefully, for the companies they do not support, it will be possible to have an orderly workout.

The currency crisis that has blossomed over the last week is only exacerbating the crisis. As emerging market currencies fall; their foreign debts become more and more unmanageable, increasing the risk of default. Whether because of the unwinding of the carry trade or because of old-fashioned flight from assets that are falling in value, the currency crisis has become self-perpetuating. This will have two negative effects on the US economy: first, the strengthening dollar will make it harder for US exporters to compensate for the fall in domestic consumption; second, as all of our trade partners' economies become weaker, the prospects that an external source of economic growth will help lift us out of our recession become dimmer.

Summary

In the United States, we have been aware of an impending economic slowdown for over a year. We will never know how pronounced the slowdown would have been in the absence of the acute credit crisis that began in mid-September. That crisis has triggered an ever-expanding series of impacts on the global economy that have almost certainly plunged our economy into a serious recession. The constriction in the availability of credit itself has a real impact on spending and investment by consumers and businesses. The widespread fear generated by events over the past six weeks has had an additional chilling effect on consumer and business confidence. The financial crisis has triggered severe economic problems in emerging markets, which have spilled back into the economies of some of our most important trading partners. Some prominent economists are raising warnings that de-leveraging in the "shadow banking system," such as by hedge funds, could trigger another wave of asset price falls across global markets.

I am not saying that the sky is falling on the US economy. As of now, most forecasts indicate that we will experience a serious recession, perhaps comparable to the recession of the early 1980s, but nothing like the Great Depression. However, I want to underline the point that most of the most pedigreed economists and policy makers have failed to anticipate the serial effects that the crisis has had, and that it may yet have more surprises for us.

Economic Stimulus

There are a number of steps that the US can take to address the many problems facing the global economy. These include continued action to recapitalize financial institutions under the Emergency Economic Stabilization Act, low interest rates, liquidity measures by the Federal Reserve, actions (coordinated with other G7 countries) to rein in the currency crisis, direct intervention in the housing market, and new forms of financial regulation, both domestic and international. The Federal Reserve must act decisively to forestall any risk of deflation (falling prices and wages). For today, however, the question is how best to stimulate the economy to cushion the impact of the recession and lay the foundation for future long-term growth: specifically, what form the stimulus should take, and how big it should be.

Stimulus Objectives

Before deciding these specific questions, however, we need to define the general objectives of the stimulus. The US economy is going through a massive deleveraging process that is causing significant declines in asset values—first in real estate markets, now in securities markets—that will reduce the purchasing power of consumers for years to come. Attempting to prop up those asset values by putting more money in people's pockets is likely to fail—the amount of money needed would be huge—and would likely only extend the de-leveraging process. The experience of the stimulus package earlier this year was that a large proportion of the tax rebates went toward household savings or paying down debt; asking the American consumer to spend his or her way out of this recession is unlikely to succeed.

So what are we trying to achieve? I think there are three main objectives:

1. Reduce the depth and severity of the recession. The constriction in lending and widespread pessimism among both consumers and businesses risk producing a sharp downturn that pushes asset values far below their sustainable levels. A classic economic stimulus, by encouraging economic activity, can counteract this pessimism and limit the damage. One condition of meeting this objective is that measures should be designed to flow into the economy quickly.

2. Help those people who will be hurt most by the recession. One can argue that this is not, strictly speaking, necessary to economic recovery, but I believe it remains an obligation of our government and society to limit the human misery that will be caused by a recession.

3. Invest in America's long-term growth and productivity. The stimulus plan should encourage behavior that will increase the long-term economic prospects for the country. A simplistic way of putting this is that given the choice, we would rather see investments in infrastructure than in consumption of flat-screen TVs.

Another factor we need to keep in mind is that this is likely to be a relatively long recession, where economic growth may not return to target levels for 24 months or longer. In this context, stimulus measures that might not be considered for a shorter recession should be put on the table.

So, with these considerations in mind, what should the stimulus package include? I divide my recommended stimulus programs into two categories that, for want of a better term, I call short-term and long-term. Short-term programs are those intended to feed money into the economy quickly and in a form that will have a direct impact on economic activity; that is, they should encourage spending rather than saving. Long-term programs are those that may not boost economic growth within one or two quarters, but will help the economy grow out of the recession and will also help increase long-term productivity growth in the economy.

Short-term Programs

Several of the programs I recommend are those favored by other economists and commentators and with which the Committee is already familiar, so I will not describe them in exhaustive detail.

1. Direct aid to state and local governments. This direct aid is desirable for two reasons. First, because it replaces money that state and local governments have been forced to cut from their budgets, it can have a very rapid effect, without the need to design new programs. Second, the money will go to programs that these governments have already decided are important and worth funding, minimizing the risk that the stimulus will be wasted on inappropriate ends. Not only did many states cut budgets for the current fiscal year with the anticipation of reduced tax revenues, but several states have enacted midyear budget cuts as their expectations have deteriorated. According to the Center on Budget and Policy Priorities, states closed $48 billion in shortfalls in enacting their current (fiscal year 2009) budgets, and so far another $12 billion in gaps have opened up since the year began (generally in July). The CBPP is also forecasting shortfalls in the $100 billion range for the following year.

2. Extended unemployment benefits. Congress already extended unemployment benefits by 13 weeks in July 2008, but that measure will currently expire in March 2009. This provision should be extended past March 2009, and other means of expanding unemployment coverage should be considered, such as further extensions based on state-by-state unemployment rates. Extending unemployment benefits has a high "bang for buck" ratio, because needy people are more likely to spend each

incremental dollar. According to testimony by Mark Zandi of Moody's Economy.com before the House Committee on Small Business in July, each dollar in extended unemployment benefits translates into $1.64 in incremental GDP over the following twelve months. Finally, this program helps some of the people who will be most sorely affected by the economic downturn, in most cases through no fault of their own.

3. Expanded food stamp aid. Expanding food stamps has many of the same beneficial characteristics as extending unemployment benefits. Because food stamps cannot be put in the bank or used to pay down debt, they tend to contribute to economic activity quickly. According to Mark Zandi's testimony, each dollar in expanded food stamp aid contributes $1.73 to incremental GDP.

4. Loan modifications for distressed homeowners. To these ideas I would add money for relief to distressed homeowners in the form of government-sponsored loan modifications. This may not be in the fiscal stimulus package per se, but it should not be far behind. The current proposal to guarantee modified loans as an incentive for lenders and servicers to make those modifications is promising. Like any guarantee, however, it raises the possibility that the government may lose money. This would be an appropriate usage of money as part of the stimulus package, as this program should help prevent housing prices from crashing far below their long-term values, and therefore prevent a further depletion of households' spending power.

Long-term programs

In addition, however, a number of other stimulus programs should be considered, for two reasons. First, given the depth of the expected recession, the programs listed above may to be too small to have the desired impact. Second, the expected length of the recession provides an unusual opportunity: an opportunity to invest in our economic future while also combating the recession.

For these reasons, the following initiatives should also be on the table:

1. Investment in basic infrastructure, such as highways and bridges. In order to accelerate the economic impact, money could initially be put into maintenance projects, but new construction projects should not be ruled out.

2. Job retraining programs or grants. The recession will accelerate some of the long-term changes in the American economy; the proposed merger of GM and Chrysler is just one sign of this trend. Tens of thousands of people will need to develop new skills.

3. Expanded student loans. Even before the latest phase of the financial crisis, smaller lenders were exiting the student loan market, especially for community college students, and there is a risk that this trend could reduce the availability of college educations for lower-income students. Student loans will go directly toward paying for tuition and other costs, so they should have a direct impact on the economy.

4. Expanded small business loans. The credit crisis has not only seen a reduction in the availability of credit, but also an increase in the price of credit for small businesses. Government programs to guarantee small business loans or otherwise increase the availability of credit should have a nearly direct impact on the economy. The programs could be designed to discourage companies from getting new loans to pay down existing loans.

5. Investment in alternative energy, through tax incentives, direct grants, or other means. Someday in the next couple years the price of oil will start increasing again; despite its recent fall, long-term projections of the amount of oil in the world have not changed. Moving our economy away off of oil and onto alternative energy sources will not only protect us from inflation in the future, but will give our companies a new avenue for long-term growth.

I am too far from being an expert on all of these topics to go into them in great detail. I know that several of them have been considered by members of Congress. My point is that given the amount of fiscal force that will need to be deployed, and the length of time over which it will need to be deployed, it is appropriate to consider measures that will both stimulate the economy and invest in our long-term future.

Size of Stimulus

In his testimony to the House Budget Committee last week, Martin Baily proposed a stimulus of $200 to $300 billion. His recommendation was based on a range of forecasts about the severity of the recession. As this is not an exact science, I will follow a similar approach with slightly different results.

Baily used two forecasts: the Blue Chip consensus forecast and a more pessimistic scenario that he defined. The Blue Chip forecast included three quarters of contraction, with a trough of -1.1% GDP growth (annual rate) in Q4 2008, with a relatively rapid return to healthy growth (+2.2% in the first post-recession quarter). His pessimistic forecast was for five quarters of recession, with a trough of -4.0% GDP growth in Q4 2008 and Q1 2009.

There are three other forecasts I will mention to give a range of the expected outcomes:

- Goldman Sachs in early October forecast zero growth in Q3 2008, contraction in Q4 and Q1 (trough of -2.0%), and zero growth in Q2 2009.
- The current IMF forecast is for two quarters of recession, followed by one quarter of zero growth.
- JPMorgan forecast 3 quarters of contraction, with a trough of -1.6% and 12 quarters of slow growth.

However, the main issue with any macroeconomic forecast is that, in this environment, it risks being out of date the day after it is made. In just the last week, plunging growth rates in Europe and a full-blown, global currency crisis have become part of the economic landscape. In the US, insurance companies have been deemed at sufficient risk to be included in the Treasury recapitalization plan. Exports, which have been the one bright spot in the US economy in recent quarters, will be hurt by the rising dollar and the declining global economy. Asset values, including both housing and equities, continue to fall steeply. In short, the vast majority of the news has been negative, even relative to generally pessimistic expectations. As a result, I believe there is a large likelihood that all of these forecasts—with the possible expectation of Baily's pessimistic forecast—will later be revised downward.

For planning purposes, then, I think we should think about a world in which the U.S. recession will last 4–5 quarters, with a trough at negative 2–3% GDP growth (annual rate), followed by 8–12 quarters of slow growth.

Baily's method assumes that $1 in spending will contribute $1.50 to GDP, with the $0.50 in follow-on effects spread over several quarters. Based on this assumption, since US GDP is approximately $3.5 trillion per quarter, $35 billion in spending in a given quarter will contribute 1.0% to GDP growth in that quarter, and small amounts thereafter. By matching expenditures on stimulus to the forecast GDP growth figures for each quarter, he concludes that $200–300 billion will be appropriate to cushion the recession and restore the economy to growth.

I would suggest two modifications to this approach. First, I think it is optimistic to expect $1 in immediate impact for every $1 in the stimulus program. There is evidence that a significant proportion of this spring's tax rebates did not end up contributing to spending, and while the measures outlined above are more likely than tax rebates to result in direct increases in economic activity, it would be a mistake to overestimate the effectiveness of any macroeconomic intervention. As a result, I believe it more conservative to plan on something like $0.90 in immediate impact and $0.50 in follow-on impact.

This implies that, for the 2–3 quarters of recession that remain to be affected (assuming there is nothing we can do about Q3 and Q4 this year), approximately $70 billion in stimulus expenditures per quarter may be called for, for a total of roughly $220 billion. The amount of stimulus should decline over the quarters due to follow-on effects, but a major issue is how to spend large sums early in 2009 while ensuring that the money is used well and has a high impact on GDP growth.

Second, I would pay particular attention to the 8–12 quarters of prolonged slow growth. If we want to increase economic growth by an average of 0.5–1% (annual rate) in each of these quarters, this would imply approximately $25 billion in stimulus per quarter, or roughly $250 billion over the entire period.

Added together, this yields a total stimulus package of around $450 billion, or about 3% of GDP, spread over about 3–4 years. It also implies a way to time the short-term and long-term programs described above. Short-term programs can be implemented immediately to inject spending into the economy quickly. Long-term programs, such as infrastructure grants or alternative energy programs, should be announced and implemented quickly, but can take a longer time to bear fruit.

There are, of course, many details that remain to be worked out. My goal has been to describe the types of programs that should be on the table and one approach to quantifying the size and timing of the stimulus package.

PREPARED STATEMENT OF DR. RICHARD K. VEDDER, AMERICAN ENTERPRISE INSTITUTE AND OHIO UNIVERSITY

Madam Chairman, thank you for this opportunity to speak before the Joint Economic Committee. Since its creation by the Employment Act of 1946, the JEC has been the premier congressional forum to discuss economic policy, and as a former staff member of the committee I am honored to participate in this hearing.

I wish to make three points this morning. First, economic history tells us that periods of sharply eroding public confidence in financial institutions have significant negative economic consequences, but they do pass. Also, seeking retribution from persons or institutions perceived to be guilty of contributing to the crisis because of errors of business judgment (as opposed to illegal activity) often does not help, and may actually significantly deter recovery. I am not suggesting that Congress should do absolutely nothing further; for example, a review and probable modification of some existing regulatory and other practices relating to the financial services industry is no doubt in order, but I am urging that caution and moderation be used.

Second, I would observe that this crisis is not simply an example of market failure, of irrational exuberance trumping common sense, thereby requiring government action. I, somewhat reluctantly, supported the $700 billion bailout package and advised some of your colleagues to vote for it. I also believe in perilous times that government has a role to play in restoring confidence. However, I am also convinced that the crisis itself largely reflects a series of public policy miscues. In the absence of these governmental mistakes, this financial crisis would never have happened.

Third, I am very concerned about attempts by an overly zealous Congress to attempt to craft an economic program that likely will have adverse effects. In particular, expansionary fiscal policy in the form of higher government spending is precisely the wrong thing to do at this time, aggravating an explosion in inflationary expectations that I already fear will erupt, having detrimental effects on labor and financial markets.

Historical Observations

Let me briefly comment on each of these factors. Anytime a firm or an entire sector of the economy has low rates of capitalization relative to its liabilities, the possibility of declining asset values leading to a dangerous erosion of net worth increases. When claims against the assets of firms can be made at any time, as is typically the case in the financial services industry, the problem is aggravated. In October 1929, there were roughly 11 dollars in bank deposits for every one dollar of currency in circulation, while in March 1933 there were only about four dollars of deposits per dollar of currency. As cash was removed from banks and converted to currency by nervous depositors, bank cash reserves fell, and with that confidence was eroded in the ability of the banks to meet remaining liabilities. Hence over 40 percent of the banks in the United States closed their doors between 1929 and 1933. I completely agree with Milton Friedman and Anna Schwartz that this was a significant factor in the Great Depression.

As long as we have fractional reserve banking, confidence in financial institutions is vital. Deposit insurance has helped enormously in relieving problems relating to a lack of confidence, and bank failures went from an average of about 600 a year even in the prosperous 1920s to a handful annually shortly after the creation of the FDIC in the Banking Act of 1933. Scholars as diverse as Arthur Schlesinger and Milton Friedman have heralded this as great legislation. Implicitly, people have shown their confidence in the full faith and credit of the United State Government which they have believed is behind the deposit insurance guarantee. Yet that confidence is something we should not take for granted, and the excessive commitment of the government to protect virtually everyone from every possible loss could lead to erosion in confidence in government, and with that the ability of the government to serve as the protector of last resort for the financial system. The government's resources are not limitless, and the evidence from public opinion surveys that young people do not believe that the governmental commitment will be met to provide them with Social Security pensions is an early warning sign that excessive governmental commitments relative to available resources could conceivably lead to a confidence crisis where there is no viable governmental line of defense, and thus to true Financial Armageddon. You must maintain the credibility of that defense by not making commitments that the public knows cannot be met. By the way, Franklin D. Roosevelt was very much aware of this problem in 1933, and the large potential contingent liabilities to the government made him very cool to the whole idea of deposit insurance, and led him to successfully oppose high insurance limits favored by a bipartisan group of Congressmen.

It is worth noting that in some previous panics private solutions to stemming eroding confidence were largely successful. For example, in the Panic of 1907, a group of private bankers led by J.P. Morgan amassed a fund that was used to prop up banks facing pressures from depositor withdrawals. On the other hand, in 1932, the Reconstruction Finance Corporation was created by a Republican President near the end of his term working with a Democratic controlled House and roughly evenly divided Senate, and it helped shore up bank capital by buying preferred stock in commercial banks. Sound familiar? It is also worth noting that the RFC outlived its usefulness, and in its later years after World War II became mired in scandal until it was finally abolished by Congress in 1953 during the Eisenhower Administration.

The Great Depression was needlessly prolonged by dreadful public policies, some not directly related to financial services, especially the high wage policies of both Presidents Hoover and Roosevelt. But the bashing of bankers and other business leaders by governmental officials also contributed to extremely low levels of business confidence and investment during the 1930s. President Hoover supported an increase in top income tax rates from 25 to 63 percent near the bottom of the downturn, ostensibly to raise funds but in part to punish the alleged perpetrators of the 1929 downturn and its aftermath. Congress added to the problem by mercilessly attacking a prime symbol of American capitalism, the second J.P. Morgan, in hostile Congressional hearings in 1931. In the Roosevelt administration, the President's constant attack of businessmen as "economic royalists" and the absolutely unconscionable hounding of Paul Mellon, long time Secretary of the Treasury, donor of the National Gallery of Art located just blocks away, and a prominent leader of the American business community, added to the fear of businesses to invest. Net business investment did not return to 1929 levels until after World War II. The writings of Robert Higgs and Amity Shlaes document these points in far more elaborate detail.

Government Or Market Failure?

There are already persons characterizing the current crisis as an example of market failure, of greedy bankers absorbed with increasing their wealth leading relatively innocent borrowers astray through inappropriate lending practices, aggravated by ill advised financial deregulation. In short, we are told that it was an act of market failure accompanied by a failure of government to perform its appropriate role in correcting market imperfections. I think this interpretation is mostly incorrect, and contributes to a form of governmental hubris that could lead to exceedingly ill advised retaliatory measures and stranglehold regulations that could stifle America in general and our financial services industry in particular, an industry already losing world preeminence because of previous ill advised policy moves, starting as early as the separation of commercial and investment banking in the Banking Act of 1933 (that, ironically, is a casualty of the current crisis) and continuing through Sarbanes-Oxley and beyond.

To be sure, private business people have made lots of mistakes. Banks made too many loans to too many people who were not credit worthy, and also lowered their lending standards and made implicitly dubious and excessively optimistic assumptions about the future of housing prices. The securitization of mortgages, while making some sense in terms of promoting market efficiency, also often largely shielded banks and loan officers from the adverse consequences of making bad and inappropriate lending decisions. The separation of the lending decisions from the adverse consequences of those decisions may on balance have been a mistake.

But even more important were government failures. The Federal Reserve System promoted excessively loose monetary policies including very low and even negative real interest rates, even on long term government securities. The market rate of interest fell below that interest rate consistent with the degree of human preferences for use of funds today rather than in the future, and that led to overinvestment in housing and other capital-intensive variables, very much in keeping with the business cycle theories of Ludwig von Mises and Friedrich A. Hayek. This is demonstrated in the accompanying graph. Inflation-adjusted t-bill rates fell from their customary long term average of roughly 2 percent or so into negative territory in the 2002–2005 period, inappropriately contributing to an increased demand for housing which could be met in the short run only by sharply rising housing prices. When the Fed reversed course, especially in 2006, tighter monetary policies and rising interest rates caused housing prices to start falling and left some persons with not enough money to make payments on mortgages on properties for which they had little or no equity, leading, of course, to massive foreclosures beginning about two years ago.

Congress did not help, failing to deal with Fannie Mae and Freddie Mac despite repeated warnings, and shielding those organizations from rigorous regulation despite their being extremely thinly capitalized and engaging in dubious practices. Politics and campaign contributions trumped good economics. Incidentally, I identified some problems with these organizations in a JEC study done 26 years ago. The Community Reinvestment Act, while well intentioned, has provided an environment where bankers have been encouraged to adopt substandard lending criteria for certain classes of borrowers, no doubt contributing to a culture where traditional lending standards have been considered old-fashioned and no longer applicable. The old admonition that bankers who borrow short should not lend long too much, an adage that historically led banks from shunning very large scale real estate investments, went out the window. Regulators stopped requiring financial institutions to meet solid lending standards. The move to mark-to-market accounting standards, while arguably justified as promoting honest financial transparency, no doubt contributed to the nervousness of investors and the corresponding flight from investing in many businesses.

Reliving the past has limited utility, but it does point out human frailties are not confined to either the private or the public sector of the economy. Seeking to replace private judgments on the allocation of capital resources with public judgments is not in itself a recipe for success, and given the politicization of many public economic decisions in modern times I would bet that on balance a dramatic tilt in decision-making with respect to the allocation of financial capital would have far reaching adverse effects. I rather have thousands of bankers making those allocation decisions rather than one or two Ben Bernankes and/or Treasury secretaries, independent of their competence, integrity, or political affiliation. And past efforts by Congress to mandate certain untenable arrangements, such as the separation of commercial and investment banking, or in more modern times the peculiar status of Fannie Mae and Freddie Mac, does not inspire confidence that rigorous regulation will work—the cure could well be worse than the disease.

Economic Stimulus And Appropriate Future Policy

I am particularly worried that the already announced fiscal and monetary policies, rather than restoring investor confidence, may lead to a sharp rise in inflationary expectations, which, in term, will trigger increases in interest rates and employee compensation that will have significant adverse economic effects, a reprise of the stagflation of the 1970s. The growth in the money supply in recent months has been noteworthy, and the increase in governmental expenditures and the potential inflation arising from both factors bodes very poorly for actual investor performance and thus confidence in the community of persons who finance most of our economic growth. The accompanying table provides regression results that indicate that stock market averages tend to fall when government expenditures rise as a percent of GDP, and when inflation picks up—even adjusting for the business cycle. When government spending crowds out private activity, investors are disheartened, stock values fall, pension fund assets deteriorate, consumption declines, and so forth. The excessive increase in government spending in recent years along with some increased perception that inflation may not be completely under control are, in my judgment, the single most important factors in declining real equity wealth in the U.S. in this decade. The prospects of rising taxes and inflation in the coming years no doubt is contributing to a pall on equity values at the present.

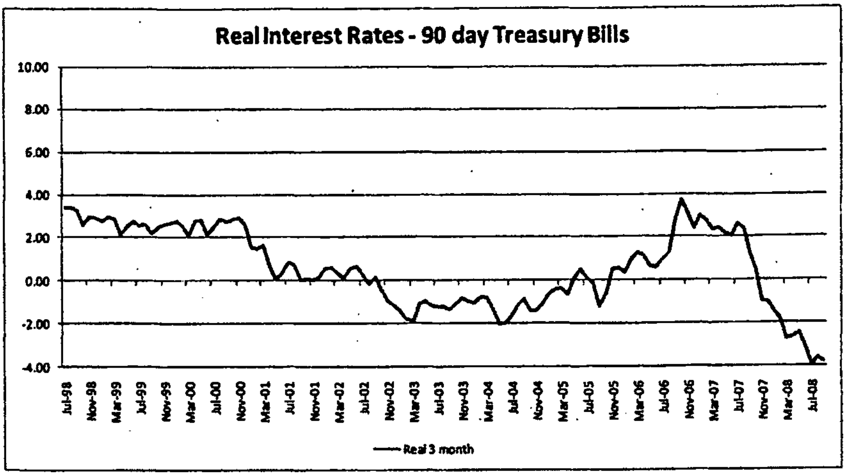
Of special immediate concern is the call for a second economic stimulus package. If we learned one lesson from the era of large budget deficits, it is that fiscal stimulus does not promote economic recovery. Even in the heyday of Keynesian domination of the economics profession, scholars freely admitted that funding governmental infrastructure projects was a dubious way to stimulate the economy, simply because of the practical difficulties of timing— it takes typically years, not months, for new appropriations on infrastructure to actually lead to, for example, new road or school construction. Very often any stimulus provided by such construction comes long after recovery has already occurred, creating inflationary conditions that could have been avoided. That is in addition to other problems arising from financing such stimulus, such as the crowding out effects of higher spending that manifests itself through higher interest rates, inflation rates, and/or taxation. There are no free lunches, and the funding of stimulus packages inevitably would have adverse effects. Raising taxes to fund economic stimulus would be particularly foolhardy, as the disincentive effects of taxation could cause further damage to the real economy.

The creation of an infrastructure construction bureau within the government was, of course, what the Works Progress Administration, or WPA, was all about during the Great Depression. This became the largest New Deal agency before World War II, and at its peak in November 1938 the WPA employed 3.3 million persons. Relating to the timing issue previously mentioned, it is interesting that it took over 3 and one-half years to get to that level of activity, and that was in the era before we had environmental impact and affirmative action requirements that inevitably delay construction. It is noteworthy that the unemployment rate when the WPA hit its peak size was 17.7 percent, only slightly less than the 18.7 percent rate prevailing in April 1935 when the agency was created. Relative to leading European countries like Britain or Germany, our recovery in this period was anemic. It is fairly clear that the WPA was not a big success in creating jobs, and it was formed at a time when the federal budget deficit as a percent of GDP was smaller than today but when unemployment in those days was greater than today, meaning that the crowding out problems implicit in funding stimulus packages are probably even greater today than it that era.

Conclusions

In conclusion, I urge you not to panic. The Federal government has taken the most aggressively interventionist position ever taken to deal with a crisis of investor confidence. For example, your legislative actions have made the government stockholders in vast portions of our financial system. You seem to be poised to provide massive aid, totally inappropriately in my judgment, to the automobile industry, substituting your judgments for that of consumers and producers operating through markets. You have authorized a vast potential unfunded liability through the radical expansion of deposit insurance, which I think I can assure you Franklin D. Roosevelt would have opposed if somehow he could have come back to life for a day. By the way, I personally do believe some expansion in deposit insurance probably was justified, but it needs to be funded, and that is not without its problems, and raises the moral hazard issue and the possibility that unsound banking practices will be subsidized rather than discouraged. You have already muted the important signals that markets give off that lead to what on the whole are growth-inducing reallocations of resources. The impact of all of this may be to prevent an imminent collapse of the financial system, but only at the possible price of future stagflation, declining income and wealth, and a rise in national malaise reminiscent of the 1970s if not 1930s. You have done enough for now, probably more than enough. Relax and recover from your labors and allow the healing properties of markets to be asserted again.

Thank you for your attention.


Real Interest Rates - 90 day Treasury Bills
10.00
8.00
6.00
4.00
2.00
0.00
-2.00
-4.00
Jul-98
Nov-98
Mar-99
Jul-99
Nov-99
Mar-00
Jul-00
Nov-00
Mar-01
Jul-01
Nov-01
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Mar-05
Jul-05
Nov-05
Mar-06
Jul-06
Nov-06
Mar-07
Jul-07
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Mar-08
Jul-08
Real 3 month

Dependent Variable: REAL_SP_500				
Method: Least Squares				
Date: 10/29/08 Time: 09:41				
Sample(adjusted): 1 154				
Included observations: 154 after adjusting endpoints				
Convergence achieved after 22 iterations				
Backcast: -4 0				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	10024.81	1102.462	9.09311	0.00000
PERCENTCHCPI	-111.833	28.00107	-3.99389	0.00010
GOVGDP	-313.706	47.33265	-6.62768	0.00000
UNEMPLOYMENT	-158.301	45.96725	-3.44379	0.00075
MA(1)	1.308486	0.081075	16.13914	0.00000
MA(2)	1.349681	0.116504	11.58482	0.00000
MA(3)	1.227476	0.128638	9.542101	0.00000
MA(4)	0.895551	0.119073	7.521015	0.00000
MA(5)	0.328755	0.082276	3.995748	0.00010
R-squared	0.972932	**Mean dependent var**		2320.105
Adjusted R-squared	0.971438	**S.D. dependent var**		1405.252
S.E. of regression	237.4903	**Akaike info criterion**		13.8348
Sum squared resid	8178240	**Schwarz criterion**		14.01228
Log likelihood	-1056.28	**F-statistic**		651.4793
Durbin-Watson stat	1.755846	**Prob(F-statistic)**		0
Inverted MA Roots	.23 -.87i -0.67	.23+.87i	-.54 -.56i	-.54+.56i

Dependent Variable: REAL_DJ				
Method: Least Squares				
Date: 10/29/08 Time: 09:43				
Sample(adjusted): 1 154				
Included observations: 154 after adjusting endpoints				
Convergence achieved after 20 iterations				
Backcast: -4 0				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	25539.21	3197.33	7.987666	0.00000
PERCENTCHCPI	-303.043	82.35887	-3.67954	0.00033
GOVGDP	-774.307	135.0164	-5.73491	0.00000
UNEMPLOYMENT	-387.542	141.999	-2.72919	0.00714
MA(1)	1.437822	0.082577	17.41188	0.00000
MA(2)	1.494018	0.125912	11.86559	0.00000
MA(3)	1.340847	0.141379	9.484038	0.00000
MA(4)	0.943099	0.128838	7.320027	0.00000
MA(5)	0.29777	0.082139	3.625191	0.00040
R-squared	0.972619	**Mean dependent var**		6491.195
Adjusted R-squared	0.971108	**S.D. dependent var**		4014.194
S.E. of regression	682.3187	**Akaike info criterion**		15.94553
Sum squared resid	67506024	**Schwarz criterion**		16.12302
Log likelihood	-1218.81	**F-statistic**		643.8226
Durbin-Watson stat	1.772639	**Prob(F-statistic)**		0
Inverted MA Roots	.18 -.88i -0.6	.18+.88i	-.60 -.51i	-.60+.51i

PREPARED TESTIMONY OF VINCENT DEMARCO, PRESIDENT, MARYLAND CITIZENS' HEALTH INITIATIVE

Thank you, Chairman Schumer, Vice-Chairwoman Maloney, and Members of the Committee for this opportunity to testify before you. I am Vincent DeMarco, President of the Maryland Citizens' Health Initiative, a nonprofit advocacy organization working to achieve quality, affordable health care for all Marylanders. Over a thousand faith, community, labor, business and health care groups are part of our Health Care For All! Coalition (www.healthcareforall.com). We, like you, have been inspired by Dr. Martin Luther King, Jr., who taught us that, "Of all the forms of inequality, injustice in health care is the most shocking and inhumane."

It is particularly an honor to be before the Honorable Elijah Cummings, who prior to joining your ranks was a courageous leader of the Maryland House of Delegates, and who then, as now, makes sure that we all do what is right for the people who need help the most.

I greatly appreciate the chance to talk with this Committee about how the economic downturn is harming health care for Marylanders and how this harm would get increasingly worse without some help from the US Congress. I will describe what is happening in Maryland and present some ideas of how Congress can help us. Most importantly, we ask that you increase our state's Federal Medical Assistance Percentage (FMAP) to help us fund our very important new Medicaid expansion.

Over the past two years, under the leadership of Governor Martin O'Malley, the State of Maryland has made great progress in expanding health care access. This includes allowing young people up to age 25 to stay on their parents' health care and helping seniors afford their prescription drugs. Most important was the Governor's Working Families and Small Business Health Care Coverage Act of 2007 which, over the next three years, is designed to provide health care coverage for over 100,000 uninsured Marylanders by expanding Medicaid eligibility and providing grants to small businesses. The law increased Medicaid eligibility to 116% of the federal poverty level for custodial parents on July 1, 2008, and will expand benefits for adults without children on July 1, 2009.

Because of Governor O'Malley's initiative, and after careful balancing of State Budget priorities, Maryland went from 44th in the country to 21st in providing Medicaid coverage to adults. We have been working hard since it took effect to inform Marylanders about this new law. Our outreach efforts include a media campaign we funded featuring Governor O'Malley and prominent Baltimore Ravens players such as Ed Reed. As a result, in just three months, over 16,000 uninsured Marylanders have signed up for coverage, demonstrating the great need for this expansion.

On July 7, Governor O'Malley gave the first new Medical Assistance for Families card to Alanna and Adamantious Boulis. As you can see from the front page article in The Baltimore Sun that is attached to my written testimony, both of the Boulis' had several health issues, including colon cancer and diabetes. They were only able to receive the treatment they needed for these illnesses because of Maryland's new law. Because they now can address these health issues, the Boulis will not have to wait until they get so sick that they are forced to go to the emergency room for costly critical care. This will reduce the amount all Marylanders now pay through higher insurance premiums for the hospitalization of the uninsured.

Now, the health care coverage of the Boulis' as well as the coverage for tens of thousands of other Marylanders is directly threatened by the current economic crisis. As you know, the downturn is dramatically lowering states' tax revenues, forcing them to re-evaluate priorities, and make necessary cuts to important programs. Right now Maryland is among those states—facing a deficit of hundreds of millions of dollars, despite having recently taken aggressive measures to deal with a structural budget problem. Governor O'Malley is to be commended for doing all that he can to deal with this deficit in a creative way that has not yet significantly reduced the Medicaid program or health care coverage. But, as the national economy keeps getting worse, the dire need for federal help continues.

We know that many of the people who would be hurt if Maryland's new Medicaid expansion is curtailed are in particular need of health care coverage now because of the economic downturn. Among the people who are eligible for the new expansion are a plumber on the Eastern Shore and a single mom in Prince George's county. Both of them had health care coverage through their jobs until recently but both of them lost their jobs and their coverage this year due to workforce cuts made by their employers necessitated by the economic downturn. Now, thanks to the new Medicaid expansion made possible by the State, they can at least have health care coverage while they try to find new jobs.

The impact of people not having health care coverage can be devastating. We all know the statistics that many bankruptcies and foreclosures are caused by unaffordable health care bills and that health care costs are rising much faster than wages. But these statistics translate directly into human disaster.

There is, for example, the very sad story of Mr. William Paul from Fruitland, Maryland, who worked every day of his life at odd jobs trying to make ends meet. He had a tough family life, and though he graduated from high school and spent some time in the armed service, he was never able to find more than odd jobs in restaurants and yard work to make ends meet. He was diabetic. He also found out from a free clinic at the local health department that he needed to see a cardiologist, but no doctor would see him because he didn't have health insurance. The next day, he died of a heart attack, while mowing someone's lawn.

Because he died in the yard alone, it was considered to be an unattended death. In Maryland, corpses under those guidelines must be sent to Baltimore for autopsy but there is a charge for this "service" which cleaned out Paul's meager savings and life insurance policy benefits that would have been passed along to his companion Joanne. There was no money for a memorial service, but thankfully a friend donated a plot of land in the local cemetery. The widowed companion still mourns that she will not be able to be buried beside her beloved because she can't afford it. She lives on $660 monthly social security check, food stamps, and the invaluable friendship of neighbors in their small community. Paul was described as a man who "never had any luck in his life" but someone who would "help ANYBODY in the world; it didn't matter who they were or what they were going through. If he could help you out, he did." He is sorely missed. And it is unfortunate that if he had been able to see the doctor, he might still be with his friends and family.

And, there is the sad story of the 54-year-old brother of Ms. Judith Campbell of Baltimore City. As Ms. Campbell told us, "My brother took his life earlier this year because he found out he had treatable but potentially fatal cancer and was turned down by the state for health care assistance. He worked as a security guard for $8.49/hr and his company did not offer health insurance."

Both Mr. Paul and Mr. Campbell would have been eligible under Maryland's new Medicaid expansion. It would be very sad if the economic downturn prevented us from fully implementing this expansion and saving many other Marylanders from the economic distress, health care woes and possibly even death that can result from the lack of health insurance. But the current economic trend makes it much harder for states to sustain this kind of program.

It is not just the Medicaid expansion that is threatened by cuts forced by the state of the national economy. Under Governor O'Malley and Maryland Secretary of Health John Colmers, our Health Department has done much to make sure that other health programs work well. For example, they put additional money into dental services to make sure that children in Maryland's Medicaid program get the dental care to which they are entitled. This will prevent the kind of tragedy that occurred a couple of years ago when a young boy in Prince George's County died because he did not get proper dental care. Congressman Cummings has spoken often and eloquently about the circumstances that led to the death of Deamonte Driver and we hope that the progress we have made to prevent such deaths will not be rolled back due to more forced cuts.

We strongly urge that Congress and the next Administration move quickly to enact an additional economic stimulus package that would directly help states like Maryland pay for critical health care needs. Specifically, we ask that a new stimulus package include an increase in our state's Federal Medical Assistance Percentage (FMAP). Additional federal Medicaid dollars would help forestall significant cuts in the Medicaid program. As you can see from the attached letter to the US Congress from Governors Edward G. Rendell and James H. Douglas, the National Governors' Association is calling for an increase in FMAP as part of an economic stimulus package. Increasing the FMAP would help us in Maryland in two important ways.

First, the stimulus package would spur economic growth which would generate more revenue for our state and thereby help prevent cutbacks in our Medicaid program. According to Families USA's well-documented Medicaid Multiplier Effect analysis, for every $1 million in additional Medicaid funds that Maryland would receive, there would be $2.2 million in additional business activity, including 20 new jobs and $765,000 in additional wages. So, if you enact a measure like S. 2819, which unfortunately did not pass in the 110th Congress, Maryland would receive an additional $118.5 million in federal dollars which would generate $210.6 million in additional business activity, or 1800 new jobs and $72.4 million in additional wages. In addition to putting people to work, this new business activity would translate into substantial new tax revenues for the state which would help fund our Medicaid expansion. Attached for you are charts done by Families USA on the economic impact on the states of both S. 2819 and the similar House passed H.R. 7110.

Second, of course, the FMAP increase would put money directly into our Medicaid program, making funding of our expansion much easier. As described above, the expansion for custodial parents has already gone into effect but the expansion for non-parents is not set to take effect until July 1, 2009. There is already some pressure to delay the non-parental expansion because of the budget deficit. Additional federal money added to the Medicaid program would help us ensure that the rest of the expansion takes effect on July 1, 2009 as planned. This would keep tens of thousands of Marylanders healthy and out of economic distress, and even save some from an early, preventable death.

In addition to the critically necessary FMAP increase, there are two other ways that the United States Congress can help Maryland and other states expand health care access in these tough economic times. First, we urge you to pass as soon as possible an expanded State Children's Health Insurance Program—or SCHIP—extension like the one which you passed and President Bush unfortunately vetoed earlier this year. Passage of this legislation is vital to our ability to keep our Maryland Children's Health Insurance Program fully funded. We strongly support the tobacco tax increase funding mechanism that you included in the SCHIP bill. We passed a $1 per pack tobacco tax increase in Maryland in 2007 which experts estimate will save 50,000 Maryland children from smoking. Tobacco tax increases are a great way to fund health care expansion while at the same time saving lives from tobacco which will in the long run greatly reduce health care costs.

Second, we ask your help in removing federal obstacles to health care expansion at the state level. Although we will work closely with you to achieve our common goal of a federal law that guarantees quality, affordable health care for all Americans, we hope you agree with us that the federal government should not stand in the way of states' efforts to expand health care while we are working toward that goal. Specifically, we are here asking your help in removing two federal obstacles to health care expansion in Maryland and across the country.

In 2005, Maryland enacted a landmark measure that was unanimously approved by the Maryland General Assembly that would significantly reduce prescription drug prices for hundreds of thousands of lower income Marylanders by allowing them to get the same drug discounts that the State's Medicaid program gets. Unfortunately, the Bush Administration denied a waiver request that our state submitted to allow it to implement this measure. We strongly urge the Members of this Committee and your colleagues to support legislation introduced by Congressman Chris Van Hollen, The Voluntary State Discount Prescription Drug Plan Act—or H.R. 3309—that would allow states to implement such measures.

In 2006, Maryland enacted another landmark law which would have required large companies to pay their fair share of the state's health care costs. Unfortunately, the Fourth Circuit Court of Appeals ruled that our Fair Share Health Care Law was preempted by ERISA. We were encouraged by the Ninth Circuit's recent decision upholding a similar San Francisco measure. We urge Congress and the next Administration to amend ERISA to allow states to enact measures that would make sure that all employers, particularly large ones, pay their fair share of the rising costs of health care. By doing so, you will help us expand health care access in our state and reduce the burden of paying for the hospitalization of the uninsured now borne by employers who provide full health care coverage for their employees.

Thank you again so much for giving me this opportunity to share with you the harmful and very real effects that the economic downturn has on the health of Marylanders and how we think the United States Congress can help us. We look forward to working with you to enable states to alleviate the health care injustice Dr. King warned us about by achieving quality, affordable health care for all Americans. I would be happy to answer any questions you may have.

From Tuesday's Sun

Medicaid reaches more

Maryland is patching together expanded coverage for the low-income uninsured

By Laura Smitherman | Sun reporter
8:18 PM EDT, June 30, 2008

As one of thousands of uninsured Marylanders, Adamantious Boulis put off trips to the doctor to treat his diabetes and colon cancer because he knew he wouldn't be able to pay the medical bills.

Now he is faced with more medical problems -- Monday, he was back at Johns Hopkins Hospital, waiting for biopsy results.

Only this time, he and his wife are less worried about the bills: They are now eligible for Medicaid under an expansion of the state's health insurance program for the poor that takes effect Tuesday.

"They should have done this long ago," said his wife, Alanna Boulis. "It is nerve-wracking, especially for him. I worry more for him than for myself."

The Medicaid expansion is one of several measures enacted in the past eight months that state officials say will eventually take more than 100,000 residents off the uninsured rolls.

The patchwork of health-care measures has a cradle-to-grave effect -- not only bringing more children and families into Medicaid but also helping small businesses to provide employees with coverage and seniors to buy prescription drugs. Other bills aim to regulate pharmacy benefit managers, possibly leading to lower costs.

With little federal action to establish universal health care, states have taken the lead in efforts to expand coverage in recent years. Maryland's new laws don't bring the state as far as Massachusetts, which established universal coverage two years ago through a combination of subsidies, mandates and the creation of a new health insurance exchange.

But state officials say the bills are a crucial first step toward making sure all Marylanders have access to care.

"This moves Maryland back into a leadership position that we had ceded for some time," Maryland Health Secretary John M. Colmers said of the package of new laws.

"While it does not solve all of the problems, it does make a major dent in the number of uninsured. Until the federal government acts, we are going to have to look for making important incremental changes when we can."

About 800,000 residents, or 14 percent of the state's population, lack health insurance. While Maryland has one of the most comprehensive Medicaid programs for children, it ranked among the most limited in terms of eligibility for adults.

That meant that heads of households like Alanna and Adamantious Boulis were able to get care for their children but not for themselves.

The Baltimore couple, who are in their 50s, care for their teenage daughter and often their young grandchildren, including a granddaughter with Down syndrome. Alanna Boulis said Monday after visiting with a doctor that more tests were ordered for her husband.

Under the new law, parents with annual incomes up to 116 percent of federal poverty guidelines, or about $20,500 for a family of three, are eligible for Medicaid.

Under the old standards, the income cap for such a family was less than $7,100. To address fiscal concerns about the cost of the program, legislators decided to phase in eligibility for all adults, including those without children, over the next several years.

Whether the future expansions happen could depend on November's referendum on legalizing slot machines.

Gov. Martin O'Malley and legislative leaders are counting on roughly $600 million the state would receive from licensing slots parlors to balance the budget and to pay for health care and education initiatives.

The state covers children in families earning up to three times the poverty level. Still, about 140,000 Maryland children lack insurance, including 90,000 who are eligible for assistance but haven't been enrolled.

Another law that takes effect Tuesday aims to change that. It requires that families indicate on their income tax forms whether their children have insurance. The comptroller will use that information to send parents enrollment forms for Medicaid if they meet the income requirements.

In addition, about 100,000 adults under 25 years old are uninsured. Under a new law that took effect earlier this year, insurers that are regulated by the state are required to allow people in that age group to stay on their parents' plans.

Even more residents are expected to get health insurance through a new subsidy to encourage more small businesses to offer coverage to their employees. A business that has fewer than nine employees with the average wage below $50,000 is eligible for subsidies to cover up to 50 percent of premiums.

With prescription drug costs becoming too high for many residents, the legislature also approved a program that begins next year to help seniors bridge the "doughnut hole," an often-criticized cost-saving measure built into the Medicare prescription drug benefit passed by Congress in 2003. CareFirst BlueCross BlueShield, the region's largest insurer, pledged to fund the $7 million annual program that will help an estimated 7,500 lower-income residents.

In addition, the legislature passed a series of bills to regulate pharmacy benefit managers.

The effort comes after companies including CVS/Caremark Corp. and Medco Health Solutions Inc. have settled with state regulators in cases involving consumers allegedly being switched from lower- to higher-cost medications without any medical benefit.

Those bills, which become effective in October, require pharmacy benefit managers to register with the Maryland Insurance Administration and to disclose information about drug changes and rebates received from drug manufacturers.

Del. Peter A. Hammen, a Baltimore Democrat and chairman of the Health and Government Operations Committee, said the measures could lead to lower costs for consumers. About 95 percent of Maryland patients get their prescription drug coverage through such companies.

"This represents the first real effort to appropriately regulate pharmacy benefit managers in the country," Hammen said.

laura.smitherman@baltsun.com

PREPARED STATEMENT OF DONALD C. FRY, PRESIDENT AND CEO, THE GREATER BALTIMORE COMMITTEE

Mr. Chairman, and Members of the Committee, my name is Donald C. Fry. I am the President and Chief Executive Officer of the Greater Baltimore Committee (GBC). The GBC is the leading business organization serving Baltimore City and Anne Arundel, Baltimore, Carroll, Harford and Howard counties in the State of Maryland, a region with a population of approximately 2.6 million residents. The GBC is a fifty-three year old private sector membership organization with a rich legacy of working in collaboration with government to find solutions to problems that negatively affect our competitiveness and viability as a region. It is an organization that prides itself on advocating for changes in public policies that strengthen the business community while improving the quality of life in the region.

First of all, I want to thank the Joint Committee for the foresight and initiative to pursue an aggressive agenda to achieve economic recovery. By highlighting infrastructure needs, you definitely are keyed in to a vital means of sustained employment and of moving our country forward.

I am pleased to be here today to discuss the need for economic stimulus and how the current economy is affecting business. I plan to discuss specifically the need to invest in infrastructure, particularly transportation infrastructure. While I am prepared to address some projects that would benefit from such a stimulus, it must be noted that as a business advocacy group we are not directly involved in decision making regarding project delivery from the State of Maryland's perspective. We have, been on the forefront, however, with respect to spurring the advocacy of the business community for increased investment in transportation projects and the need for a substantial increase in transportation funding. I am happy to lend my voice to the efforts to move our country forward in meeting its infrastructure and transportation needs.

Our transportation systems are under stress. If infrastructure does not keep pace with growth and changing patterns in population and employment, as well as associated development trends, the consequences will be enormous. Already, we are seeing intolerable congestion, stifling of growth and economic development in cities, towns, and older suburbs, more sprawling development, more demands for public water, sewers, schools, and transportation, detrimental environmental impacts, and an overall degradation of our quality of life.

Nationally, our transportation infrastructure is deteriorating from insufficient investment. Just last year, the Urban Land Institute and Ernst & Young reported in Infrastructure 2007: A Global Perspective that the emerging crisis in mobility will significantly affect the United State's ability to compete on the international stage. A report by the American Society of Civil Engineers expressed strong concern with not only the condition of our transportation infrastructure but also the electricity power grids, water and wastewater systems. The price tag placed on the needed repairs to our nation's infrastructure was $1.6 trillion. Further, the National Surface Transportation Policy & Revenue Study Commission examined the nation's surface transportation modes and concluded that an annual investment of 3-4 times in excess of the current annual capital investment was needed to sufficiently address the investment gap existing in surface transportation.

The primary cause for our failure to invest in infrastructure is lack of money. I would suggest that another significant factor has been our failure to appropriately recognize infrastructure investment as a public policy priority essential to our economic growth.

In Maryland, the state's 6-year Consolidated Transportation Plan (CTP) includes over 90 transportation projects in the planning cycle. These are projects that have been identified as meritorious by elected officials and transportation officials. None of these projects have a single dollar allocated for future construction. The current cost to construct those projects falls in the range of $40 billion to $60 billion.

Just a few months ago, Maryland deferred $1.1 billion in transportation projects in its current six year CTP, each of which is desperately needed. Maryland's Transportation Secretary cited lagging revenues to the state's Transportation Trust Fund and uncertainty over federal funding as the primary reasons for deferring budgeted spending.

This action directly affects 100 state projects in the state's six year transportation plan. Some of the more pronounced projects affect our transit systems. These result in deferral of funds for light rail and Maryland Commuter Rail, or MARC, maintenance projects, including station rehabilitations and parking improvements. Moreover, just recently, the State has announced further cuts to its transit system, primarily to commuter bus routes, and eliminating several trains from MARC's Penn Line and Brunswick services. Such actions come at a time when the Baltimore area's transit needs were already stressed with increased ridership that grew significantly due to spiking fuel costs.

It should be noted that Maryland, like many states in the country, as well as the federal government, relies heavily on motor vehicle related charges such as gasoline taxes, vehicle registration fees, sales tax on motor vehicles, and similar assessments to fund its Transportation Trust Fund. The sharp increase in the price of oil combined with the downturn in the economy significantly reduced the amount of funds available for transportation projects resulting in the decimation of the state's six year transportation plan. This deferral of transportation projects occurred despite the Maryland General Assembly enacting a series of funding increases in November 2007 that added close to $400 million per year to its Transportation Trust Fund.

This dynamic highlights the need for Maryland and other states to alter transportation funding formulas to address growing transportation needs without a reliance on motor vehicle related taxes and assessments. To address this challenging issue, the Greater Baltimore Committee has formed a private sector task force to study, evaluate and recommend alternative revenue sources or formulas that are inflation sensitive and are capable of meeting ever expanding transportation needs and demands.

Just yesterday, Maryland's Transportation Secretary John Porcari stated in testimony before the House Transportation and Infrastructure Committee that nearly three dozen projects have been identified with a cost of about $150 million that could be obligated within 120 days should federal funds be made available. Of these three dozen projects, approximately 80 percent are in urban/metropolitan areas with the balance located in the rural areas of the state. The fact remains that as these projects are deferred, the needs continue to grow and the price tag only escalates due to increased deterioration of roadways and inflationary material and construction costs. In order to avoid such circumstances the need is there to act now to effectuate these long sought repairs and construction plans.

On August 1, 2007, our country was shocked at the vivid pictures of a critical bridge failure as the bulk of the I-35 bridge in Minneapolis, Minnesota, collapsed killing seven people and injuring 59. Similarly, the Chesapeake Bay Bridge connecting the eastern and western shores of Maryland, one year later, experienced a deadly crash as a swerving car sent a tractor trailer banging against both sides of the bridge until it punched a ten foot opening in the bridge's concrete railing. Subsequent examination by the State of Maryland's bridge experts revealed a previously undisclosed failure in the bolts that are critical to the structure. There was understandable public concern over each of these sad events. Yet, we inevitably go back into our torpor until the next tragedy. Mr. Chairman, something must be done, and soon, to avert similar catastrophes.

Inasmuch as Baltimore is on the Northeast Corridor which is utilized by both our local commuter service and interstate passenger rail, I would like to emphasize two projects that have been lingering for many years without attention. They are the two tunnels—one northeast of Penn Station, the Union tunnel, and one southwest of Penn Station, the Baltimore & Potomac Tunnel. Both of these structures are well over one hundred years old and are in dire need of rehabilitation, or replacement. Legislation recently passed by Congress and signed into law by the President has authorized over $14 billion in railway improvements across the nation, with $60 million dedicated for attention to the Baltimore tunnel choke points. A stimulus package focused on infrastructure investment could very well move this project and other rail programs forward.

One key statistic that has been noted in recent reports suggests that every one billion dollars in federal transportation investment supports approximately 35,000 jobs and $1.3 billion in employment income. An investment in infrastructure would be significant to the construction industry sector as the housing decline and tight credit market has caused many construction workers to join the ranks of the unemployed.

The Bureau of Labor Statistics estimates a loss of more than 600,000 jobs in the construction industry sector from 2007–2008. The time appears ripe to "jump start" the construction industry. An investment in infrastructure will buttress the construction industry's sagging employment levels while simultaneously investing in our weakening infrastructure.

An infusion of money for needed infrastructure projects can also benefit small businesses and minority and woman owned businesses. Urging, and perhaps establishing incentives for equity relationships between majority and minority and woman-owned businesses, beyond the customary MBE/WBE requirements, can result in the creation of opportunities for minority and woman-owned companies to significantly participate in infrastructure projects thus expanding their capacity to compete for future project awards.

Congressional efforts should be directed toward creating both short term jobs, as well as creating lasting value for our country by investing in infrastructure that can help the nation compete in a global economy, achieve energy independence, and provide capacity for the projected population growth that the United States will experience by 2050 and the threefold increase in GDP that will ensue over the same time period.

As part of any stimulus package, I urge Congress to develop an Infrastructure Investment Plan that would invest in intercity and high-speed rail networks, invest in goods movement and seaports, strengthen the electrical grid and its technology, extend broadband communication to rural areas, repair aging and ailing water and sewer infrastructure systems of our nation's metropolitan areas, and retrofit the nation's existing energy systems so that they are more energy efficient.

If Congress were to enact such a plan it would create new jobs in engineering and construction, would move goods and people more efficiently thereby reducing costs to business, and would provide the necessary infrastructure to move to a renewable energy economy.

I offer these points in the hopes that you and your colleagues can unite to pass legislation that will truly begin to restore the quality of our nation's infrastructure while strengthening our position in this competitive global economy.

PREPARED STATEMENT OF JOSEPH HASKINS, JR., PRESIDENT AND CEO, HARBOR BANKSHARES CORPORATION

Good Morning, Chairman Schumer, Vice Chair Maloney and Members of the Committee. Thank you for the opportunity to address the Committee.

I am the Chairman, President and CEO of Harbor Bankshares Corporation that owns a $300 million dollar bank (The Harbor Bank of Maryland) headquartered in Baltimore, Maryland. My market is Main Street America.

I recognize that the U.S. Government has taken extraordinary steps over the course of the last few months to address the monumental problems we are experiencing in our credit markets and the erosion of public confidence in our financial institutions.

While many, if not all, of these actions were necessary and went a long way to insure that our country did not fall into a deep recession or worse, these actions, by and large, were designed to aid and assist the larger financial institutions in the United States and, thus far, have done little to directly assist smaller financial institutions such as my bank, The Harbor Bank of Maryland (Harbor Bank).

I am pleased to share my experiences and thoughts on the state of the economy from a community banker's perspective. I have five (5) points to make.

First, I am fortunate to have avoided the subprime crisis. Senior Management of Harbor Bank decided four (4) years ago to get out of the market. Our decision was made based on increasing errors, misrepresentations, and in some cases out right fraud that we found on residential mortgage applications. Incomes were inflated, work histories were altered, and credit scores were changed.

Harbor Bank and other small community banks for the most part did not participate in the subprime mortgage loan debacle but because of the misdeeds and bad judgments of many larger institutions have nonetheless suffered tremendously. These smaller financial institutions did not participate in making loans to people who could ill afford them. They did not package them up and sell them to unsuspecting investors all over the globe.

These problems in part help to lead to a FDIC Insurance costs increase for all banks.

Second point, when the major financial organizations continued to stumble and show large losses, a heightened level of concern spread throughout the deposit base of smaller banks. In particular, a major event that panicked the bank customers was watching television and seeing depositors attempting to get their money out of a failing bank.

Shortly thereafter, Harbor Bank lost deposits as customers feared for the safety of their money. Many customers moved their money to larger banks as they believed they would be better protected. Fortunately, the increased FDIC coverage has allowed us to reclaim some of the lost deposits.

Third point, the current negative economic conditions have led to increased delinquencies in our loan portfolio across all sectors. We have record leveled loan charge-offs (the 2008 level is 2.5 times higher than the highest previous years). Earnings have been substantially reduced as additional funds have been allocated to the Allowance for Loan Loss Reserves to protect against anticipated losses associated with residential development. Harbor Bank and other small banks have experienced eroding capital and reduced earnings.

Harbor Bank and many other smaller Banks need the Treasury to make capital available. Smaller financial institutions are much more dedicated to the concept of using these capital infusions as a stimulus for additional lending in their communities. Some of the larger institutions are using the additional capital to purchase other institutions to gain market share or to make themselves more attractive take-over candidates instead of using this capital to support the banking footprint they serve. I am not suggesting that this additional capital should not be used to merge troubled institutions into healthier ones but I do feel that smaller institutions will be more prone to put the additional capital to work in the communities they serve. Even if smaller banks are allowed to participate in the capital assistance program from the Treasury and they use some of these proceeds to acquire troubled institutions in their trade areas, these combined institutions for the most part will remain small by comparison to the regional banks and major financial institutions that have already accessed capital from the Treasury. These combined or merged small banks will still be more prone to put the money out to small businesses and individuals residing in their banking territories.

Fourth point, smaller banks need the opportunity to have the government buy out its problem loans and unmarketable mortgage backed securities and/or preferred shares with Fannie Mae or Freddie Mac. This will create more liquidity and free management from heavy loan monitoring and collection activities.

Fifth point, I would like to address is the plight of small broker-dealer firms that service small municipalities and counties in this country. Our bank also has a small broker-dealer subsidiary. It has struggled mightily under the strain of the locked up public debt markets. Our broker-dealer subsidiary underwrites investment grade public debt primarily for small municipalities comprised mostly of low income individuals and minorities. Most large broker-dealers do not seek or want this business because for them it is not profitable. It is a segment of the market that is often ignored by Wall Street. These small communities are suffering much more than larger cities and counties in the country. The tax base in these areas is much more limited but they are not immune from the foreclosure rates or job losses haunting larger areas. Their problems have become exacerbated with the virtual exit of insurance companies who historically have provided low cost guarantees of their bonded indebtedness. As a result, many public improvement projects such as schools, jails, infrastructure improvements, and the like are going unfunded. Our broker-dealer subsidiary has seen its capital diminish significantly due to the lack of business activity in the small municipal markets it has traditionally served. Also, securities issued by these small municipalities have been disproportionately devalued in the credit markets. Our firm has experienced maintenance calls due to haircuts assigned to the public debt of these small issuers of public debt resulting in the erosion of capital in our broker-dealer subsidiary. Our firm underwrites only investment grade municipal bonds which are being treated by clearing firms as junk bonds. The Treasury capital assistance program should be extended to include small broker-dealers who specialize in serving the under-served communities in our country. They are federally regulated just as banks are and serve a purpose in helping to unlock the credit markets in this country. Bolstering the capital base of the large banks will do nothing to help those municipalities and counties that are not heavily populated and do not have a large industrial base to provide jobs and a larger tax base. The default rate on bonds issued by these small towns and counties is practically non-existent but their access to the credit markets has completely dried up and they do not have investment banks willing to underwrite their debt.

In closing I would like to reiterate one major point which I think deserves immediate attention. Small community banks and small broker-dealer firms should be allowed to access the capital assistance program being sponsored by the Treasury. The preferred stock purchased by the Treasury from these smaller institutions should be less costly than the coupon rate currently being charged to the large institutions who were in large part responsible for the problems we are facing today. This will help to insure that the bailout program, which has thus far been limited and directed at only the large financial institutions, is expanded to assist those under-served borrowers who are customers of community banks and also small municipalities and counties which in the present credit crunch environment have been forgotten and neglected but are just as important to the economic recovery of our nation as the big banks and investment banking houses on Wall Street.

Times are tough on Main Street and the best way to improve the economy is to get stimulus funds in the hands of community based financial services companies.

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