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THE ROAD TO ECONOMIC RECOVERY: POLICIES TO FOSTER JOB CREATION AND CONTINUED GROWTH

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
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JOINT ECONOMIC COMMITTEE

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THE ROAD TO ECONOMIC RECOVERY: POLICIES TO FOSTER JOB CREATION AND CONTINUED GROWTH

TUESDAY, FEBRUARY 23, 2010

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

The committee met, pursuant to call, at 11:30 a.m., in Room 2325, Rayburn House Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

Representatives present: Maloney, Hinchey, Sanchez, Cummings, Snyder, Brady, Paul, Burgess, and Campbell.

Senators present: Casey and Brownback.

Staff present: Brenda Arredondo, Andrea Camp, Gail Cohen, Colleen Healy, Andrew Wilson, Rachel Greszler, Jeff Schlagenhauf, Ted Boll, and Robert O'Quinn.

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

Chair Maloney. The meeting has come to order. I would like to thank everybody for coming. And I would like to thank you for being here. And we are waiting for the ranking member to get here, and given time constraints for Members on both sides of the aisle—we are all trying to make up snow days and have many, many hearings planned—we are going to give all members a chance to ask questions. I would like to limit the ranking member or his designee for 5 minutes and others for 3 minutes.

I would like to give my opening statement before I introduce Doug Elmendorf, who will be testifying before us today. Today's hearing continues the JEC's focus on our country's unemployment problem, an effort that we are intensifying this year. The historic one-two punch of snow a few weeks ago delayed our series but we are trying to get back on track today. We will be examining ways to help our economy recover from the great recession of 2007, which was fueled by the double blow of crises in both the housing and financial services sectors.

Most economists believe we have two broad job-creating policies: increased demand through stimulus and giving incentives to employers to hire additional workers.

Today we welcome the Honorable Doug Elmendorf, Director of the Congressional Budget Office. He will give CBO's assessment of policies and strategies to spur job creation in the near term.

On Friday we will continue our hearing from business leaders and economic forecasters as we explore the prospects for employment growth in the coming months.

Today's hearing is timely, since the Senate plans to consider additional actions this week to put Americans back to work. Creating jobs is the top priority for Congress on both sides of the aisle and for our country.

With almost 15 million Americans out of work, it is clear that immediate targeted actions are needed to spur hiring and boost employment. The questions before us are: How do we create jobs quickly? And which policies are most efficient? Which offer the most bang for the dollar? This hearing will help shine a light on the specific actions Congress should take right now, not in some distant future.

Just over 1 year ago, the current administration took office taking the helm of a country suffering from the worst crisis since the Great Depression. During the last 3 months of the Bush administration, we lost an average of 720,000 jobs per month. In contrast, the most recent 3 months of the Obama administration, we lost an average of 35,000 jobs each month. The trend is heading in the right direction.

Thanks to the Recovery Act, the economy is growing. The Bureau of Economic Analysis reported that in the final quarter of 2009, the economy expanded at a rate of 5.7 percent. The Recovery Act included a tax cut for 95 percent of American families and created jobs while investing in clean energy technologies, infrastructure, and education.

While we have brought the economy back from the brink, we are not yet where we need to be in terms of job creation. Over 8.4 million jobs have been lost during this great recession, and in addition to the 14.8 million workers who are currently unemployed, there are 8.3 million workers who currently work part-time but would like to work full-time.

In the last year, Congress has enacted policies to support struggling families and encourage job creation. These actions include creating and extending the first-time home buyers credit; boosting funding for small business loans via the Small Business Administration; extending safety net programs, such as unemployment benefits and food stamps; and extending the net operating loss carryback provision that will help small businesses hire new employees.

But we need to redouble our efforts to create jobs. In order to bring creative ideas on job creation to Congress, I started the year reaching out to CEOs of Fortune 100 companies and leaders of small businesses. And I asked these employers to share with us their ideas for job creation.

In order to jump-start job growth, I have introduced an employer tax credit cosponsored in the Senate by my JEC colleague, Senator Casey, and my fellow New Yorker, Senator Kirsten Gillibrand. The idea was suggested by several of the responders to our survey. The credit will give employers an incentive to hire new workers and raise wages. This will help workers get back on their feet, spark consumer spending, and brighten our economic climate.

I welcome CBO's input about how to best design an employer tax credit. A recent CBO study showed that an employer tax credit, similar to the one in our bill, is one of the most effective and efficient ways of spurring hiring. The object of this week's hearing is to get feedback from experts to make sure that our actions work and help to create jobs. For example, CBO has pointed out that one of the lessons of the 1970s employer tax credit was that many employers did not even know about the tax credit until they filed their returns, too late to effect hiring decisions.

I look forward to CBO's perspective on finding solutions to the most pressing issue of the day—creating jobs. Thank you very much.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 30.]

And I recognize Mr. Brownback, the ranking member, for 5 minutes.

OPENING STATEMENT OF THE HONORABLE SAM BROWNBACK, RANKING MINORITY, A U.S. SENATOR FROM KANSAS

Senator Brownback. I thank the Chair for the hearing. I appreciate this very much.

Director Elmendorf, you have one of the most challenging jobs in government. I welcome you here, and I look forward to the question-and-answer session.

I will submit my full statement into the record so we can get to the questions as soon as possible. But the one thing I would note to the director is, we are seeing the Fed now start developing policies to pull back some on the monetary supply, which I think is a wise move on the Fed's part, having put a lot of money out there during the recession, the key parts of it, to try to keep the banks going, keep the economy as liquid as you possibly could. And I think that is a wise move on the Fed's part.

I sure think on our part, then, we ought to be looking at how we get our deficits down. I mean, you would think if the Fed is looking at the economy and saying, okay, it is probably starting to hit bottom, maybe it is going to start coming out, and I would love to hear your thoughts and comments on this. We have to work on the jobless rate, yet it almost seems like now would be the time period we would start looking at how you pull back on some of the deficits that the Federal Government is running?

And those numbers are absolutely horrific. We have seen the President's proposed budget. The publicly held national debt will nearly double from 40 percent of GDP in 2008 to 75 percent of GDP in 2018. And that is the publicly held debt. The total U.S. debt will surpass 90 percent of GDP this very year. I know, Director, you know these numbers very, very well. But that 90 percent total debt threshold number is one that I have heard a number of economists cite and say, this is a troubling level.

Now, when you get to this point in your debt level, then it starts being a drag on your economy and can drag it down. I have seen numbers as high as reducing it 4 percent in its growth rate. So it seems to me that we are at one of these crossroads that the Fed has identified that now, after having put a lot of money out there to try to stimulate the economy to try to help, now you have got this debt and deficit debt at 90 percent of GDP, and it is time you start looking at ways to pull this back so that you can get that under control so it won't drag on your economy or so that the Fed's numbers won't create an inflationary situation. And I really think this is something we have got to start looking at aggressively for us as a country.

I would note, finally, that I will be hosting, along with my colleague, Mr. Brady, a discussion this afternoon, a seminar at the Capitol Visitor Center, about return to prosperity, creating the strongest economy of the 21st century. We have a Nobel prize winning laureate, Dr. Edward Prescott; a noted monetary economist, Dr. Allan Meltzer; a former OMB director and some others at that. I think we have to start looking at this in the big broad picture.

I think we all want the same thing; we want a strong vibrant growing economy. But you have got to start making these moves to get the deficit under control. That is what we control. And I hope you can help us identify some of the paths and ways that we can do this so that the deficit and the debt doesn't drag our potential for some real economic growth to take place. I want to thank the Chair again for the hearing.

[The prepared statement of Senator Brownback appears in the Submissions for the Record on page 31.]

Chair Maloney. Thank you.

Representative Sanchez.

Representative Sanchez. I have no opening statement.

Chair Maloney. Okay.

Mr. Campbell.

Representative Campbell. No.

Chair Maloney. Representative Snyder.

OPENING STATEMENT OF THE HONORABLE VIC SNYDER, A U.S. REPRESENTATIVE FROM ARKANSAS

Representative Snyder. Thank you, Madam Chair.

Mr. Director, I appreciate you being here. I want to make a few comments about banking. I know you are not a banker. It was actually me that had my staff call to get a list of all your publications over your entire life, just to see if you have ventured into the area of banking, and I decided you had the kind of background I could ask the question to, so I am going to take advantage of this time.

I want to tell my own personal experience about overdraft fees and some of the things with Bank of America and then lead up to my comment. But $35 overdraft fees. I had the experience some time ago of discovering the hard way that the checks are processed in your account not in the order that you incur them but in the order of biggest to smallest. You are probably aware of that. I pulled it on a Saturday, checked my account, had $140 or something, took out $100. By the time it was processed that following Monday, the $100 was, the order was changed. So, in fact, the $100 incurred an overdraft fee because they are processed not in the order in which I took money out but in an order that is most advantageous to Bank of America to drive me into overdraft fees.

And then we are all familiar with the delay. From the time I make a purchase, it may show on my account pending Starbucks $3.95, but it may be a while before the merchant gets that dollar. The banks are holding that money and making some money on that.

But this is what got me started. I was approached at a ball game not long ago in Little Rock by an employee of Bank of America who said there are some practices going on that are shameful. He said that what is happening is that people may well get their overdraft—and we are all responsible for keeping track of our money; I make mistakes on this stuff like a lot of people can—but he said, in fact, that money then does not immediately go to the merchant. It is still held for a period of time, during which the Bank of America makes money on that. And he said, how can this money suddenly have a new owner? It is either mine, or it is the merchant's. It is not the bank's. So I am paying $35 for the privilege of the merchant getting the money, but in fact the bank is holding the money for an additional period of time. And he came to me because he was embarrassed by what, in his view, I don't know if he is right or not, but this is what he told me happened. And then the occasion of——

Chair Maloney. The gentleman's time is almost up.

Representative Snyder [continuing]. I am sorry.

And then if you want to have a cash transfer made from your Bank of America credit card into your checking account, it is a 25 percent interest rate. And the last time I did that, a few weeks ago, I felt like I was dealing with a loan shark. And the comment and question I want to make is, how can we think small business in the American community, business community, is going to do well if their bankers are not on their side? It is like we are no longer dealing with Jimmy Stewart; we are dealing with Mr. Potter, to put it in a metaphor that we can all understand from "It is a Wonderful Life."

And I know the chairwoman has done a lot of work on this. But you are talking a lot about job creation. It seems like we still have an issue that the dynamic between business people and customers and their bankers has changed over the last several decades.

Thank you, Madam Chair.

Chair Maloney. Thank you. Mr. Brady.

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

Representative Brady. Thank you, Madam Chairman.

Director Elmendorf, thank you for being available to the committee this morning. Given the depth and length of this recession, economists would normally expect a sharp V-shaped recovery with a strong rebound in output and employment. As we all know, this hasn't been the case. Real GDP grew at an annualized rate of 2.2 percent in the third quarter of last year. It accelerated to 5.7 percent, which was encouraging, but most of that growth was due to one-off restocking of inventory. So the fourth quarter spike revealed how deeply businesses emptied their shelves last year, but doesn't give us an indication of how confident they are in bringing back workers or hiring new ones. Real final sales, which probably are a better indicator, rose by just 2.2 percent last quarter.

This is consistent with the sluggish economic growth forecast for the next 2 years. You, the CBO, forecast real GDP will grow by 2.2 percent this year, a little less than 2 percent, 1.9 next. The February Blue Chip Consensus is a little more optimistic but still slow when compared to the normal growth after a severe recession like this. Weak economic growth means less job creation. It will be anemic. The unemployment rate will remain elevated for a number of years. CBO again has forecast an average unemployment rate 10.1 percent for this year; slightly lower, 9.5 percent, in 2011.

And I think, while January's declining unemployment rate to 9.7 percent is encouraging, most of the improvement was attributable to an increased number of part-time jobs reported by households. Payroll employment fell by another 20,000 jobs. And this divergence between the household and establishment surveys is unusual. I think we will all be watching in the future to see exactly what all this portends.

When I look at the recovery under the Obama administration versus that after the August of 1981 to November of 1982 recession, which was similar in depth and length, there are major differences. Comparing the Reagan and Obama recoveries so far, the average annualized rate of real growth was 7.2 percent in the first two full quarters of the Reagan recovery, compared with about half of that, 4 percent, in the first two full quarters of this recovery. During the first 7 months of the Reagan recovery, payroll jobs increased by 1.2 million jobs. We lost about that amount, 1.1, in the first 7 months of the Obama recovery.

So the question is, why are jobs and real GDP growth so different? I really believe, as Senator Brownback said, the uncertainty; cap and trade, tax increases, health care mandates, all that they are seeing up here is having a dramatic effect on businesses' decisions to invest capital, make that expansion decision, bring back an old worker, hire a new. And one of the questions, Director, I am going to ask you is how that plays into some of your economic projections going forward. Thank you.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 32.]

Chair Maloney. Mr. Hinchey.

OPENING STATEMENT OF THE HONORABLE MAURICE D. HINCHEY, A U.S. REPRESENTATIVE FROM NEW YORK

Representative Hinchey. Well, thank you very much, Madam Chairman.

And Mr. Director, it is nice to see you. And thank you very much for being here. I am looking very forward to all the things you are going to tell us so that we can solve this problem. And we know it is a serious problem because last year we experienced, at least, the largest deficit that we had seen since the Second World War.

Now, a lot of that has to do with the way in which spending was engaged in over the previous administration over the loss of the last several years and including tax cuts. There was a big tax cut which concentrated wealth in the hands of the wealthiest 1 percent of the population of this country. So we have right now the greatest concentration of wealth in the wealthiest 1 percent of the people of this country since 1929. Now, that is indicative also in many ways of the economic circumstances that we are dealing with.

Also, the prescription drug plan. The prescription drug plan took a huge amount of funding out and increased this budget deficit hugely. That is another thing that has to be dealt with and has to be corrected.

And, of course, the war in Iraq; the war in Iraq, which had no justification whatsoever and which has cost us huge amounts of money, hundreds of billions of dollars. There are estimations that that amount may go to as high at $1 trillion at some point in the not-too-distant future.

And all of these things have to be corrected. And there are other things that have to be corrected. We have a lot of the manufacturing operations in this country that have been exported out to other places around the world. That has got to be dealt with, and we have got to deal with that intelligently. There is an interesting reluctance on the part of a number of members of the Congress here to invest appropriately in this economy, not those three things that I just mentioned, the tax cuts, the prescription drug plan, the war in Iraq, but to invest in the internal needs of this country. And there is a reluctance to do that, even though there was no reluctance to do the three things that I mentioned in the past.

That has got to happen. This is a country that needs to focus attention on the internal needs and therefore the creation of jobs. It was very interesting to me about how the Senate yesterday passed that jobs bill. And if I remember correctly, I think there were four Republicans, including one brand new one, who voted for that bill, enabling it to pass. And that jobs bill is going to stimulate a lot of economic growth through the creation of jobs, including the manufacturing or the upgrading of the transportation industry in this country, roads, bridges, et cetera. All of those things are in dire circumstances.

We have had too many administrations that failed to focus their attention, and too many Congresses, that failed to focus their attention on the internal needs of this country and to invest in it appropriately to create the jobs and to stimulate economic growth generally. All of that really needs to be done. And it needs to be done in the way in which other administrations, if you think back to the Great Depression, the way in which the Roosevelt administration did and how they continued to operate until 1937, until a larger number of people said, oh, my goodness, we are spending too much money, and then it stopped.

And the increase in the economic growth stopped, and the recession dropped down deeply again, making it even worse. So there are an awful lot of things that we know. All you have to do is look back on history for the answer to a lot of questions. And all you have to do is look accurately and honestly in the context of the circumstances that we are dealing with to get the answer to those questions as well.

Hopefully this Congress, maybe even through the example of what happened in the Senate yesterday, may now be on the edge of doing things in the right way; stimulating economic growth, investing in the internal needs of this country and creating the kind of jobs that we need. I am very interested in seeing what you have to say about all those things.

Chair Maloney. Thank you very much.

And I now would like to introduce Dr. Doug Elmendorf—Mr. Cummings, oh, I am sorry, I didn't see you.

OPENING STATEMENT OF THE HONORABLE ELIJAH E. CUMMINGS, A U.S. REPRESENTATIVE FROM MARYLAND

Representative Cummings. That is okay. That is all right.

Thank you very much, Madam Chairlady.

And I want to thank you, Director Elmendorf, for being here.

You know, I was thinking about what Mr. Hinchey said, and I associate myself with his words.

I held my third foreclosure-prevention event the other day. More than 1,000 people showed up, and we were able to get bankers and lenders to come together, and we saved at least 700 or 800 people's houses. And they are all consistently like that.

But there are some people we can't save. Those are the people who have lost their jobs. And it is really, really very sad. And I guess, you know, going back to what Mr. Hinchey said, you know, everybody jumped up and down when Scott Brown was elected on the other side. But do you know what? I thought about it yesterday, and maybe it will work just the opposite. Maybe he will be a breath of fresh air coming in. And thinking about the people that I saw on Saturday, the ones that left my prevention conference in tears, you know, sometimes I wonder whether we up here don't think about enough people, like the fellow and his wife who were sitting on the front row in my conference with tears running down their face the whole time I was talking, for 15 minutes, trying to tell them to save their houses. And so I think we are going in the right direction.

To be frank with you, I don't think the Senate bill does enough, but it damn sure beats standing still. I mean, at least we are now getting our Republican friends to work with us. And I encourage the President to continue to reach out, because he is right; it is not about us. Sometimes I think we think this is about us. It is not about us. It is about the people that we represent and the people you try to help every day.

And so, you know, I am glad you are here. I don't know whether you are going to comment on the Senate bill or the House bill. But I do want to know what you see as being the most effective and efficient and fastest way to get people back to work because, and as you said in your testimony, a lot of these jobs aren't coming back. So then we have to deal with training and things of that nature. So I look forward to your testimony.

Madam Chair, and with that, I yield back.

Chair Maloney. Thank you very much for all your hard work in preventing foreclosures and for policies that create jobs.

I now would like to introduce Director Elmendorf, Director of the Congressional Budget Office. And immediately prior to becoming the CBO Director, he was a senior fellow in the Economic Studies Programs at the Brookings Institution. He served as co-editor of the "Brookings Papers on Economic Activity," and the director of the Hamilton Project, an initiative to promote broadly-shared economic growth.

Director Elmendorf also served as a Deputy Assistant Secretary for Economic Policy at the Treasury Department and an Assistant Director of the Division of Research and Statistics at the Federal Reserve Board.

Thank you for your service. We look forward to your comments. Thank you.

STATEMENT OF THE HONORABLE DOUGLAS W. ELMENDORF, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. Elmendorf. Thank you, Chairman Maloney and Senator Brownback.

To all the committee, I appreciate the opportunity to testify today on policies to foster economic growth and employment this year and next.

The United States has just suffered the most severe recession since the 1930s. At 9.7 percent, the unemployment rate is nearly twice what it was before the recession began in December of 2007. Since that time, employers have shed about 8.5 million jobs. And if one accounts for the jobs that would have been created had the economic expansion continued, the recession has lowered employment by about 11 million jobs relative to what it otherwise would have been.

The economy is starting to recover with inflation-adjusted GDP growing in the second half of 2009. Moreover, as Congressman Brady mentioned, severe economic downturns often sow the seeds of robust recoveries. During a slump in economic activity, consumers defer purchases, especially for housing and durable goods, and businesses postpone capital spending and try to cut inventories. Once demand in the economy picks up, spending by consumers and businesses can accelerate rapidly, which in turn generates demand for workers.

Although CBO expects that the current recovery will be spurred by that dynamic, in all likelihood, recovery will also be dampened by a number of significant factors. Those factors include the continuing fragility of some financial markets and institutions; declining support from fiscal and monetary policy; and limited increases in household spending because of slow income growth, lost wealth, and a large number of vacant houses.

We expect that these factors will cause spending, output and employment to rebound only slowly, a view shared by most private forecasters. As shown by the first figure, CBO projects that the unemployment rate will average slightly above 10 percent in the first half of this year; fall below 8 percent only in 2012; and return to its long-run sustainable level of 5 percent only in 2014.

As a result, more of the pain of unemployment from this downturn lies ahead of us than behind us. Concerns that the recovery will be slow and protracted have prompted the consideration of further fiscal policy actions. For a number of policies that have received public attention, CBO used evidence from empirical studies and models to estimate the impact on output and employment. I want to emphasize the uncertainty of the 10 such estimates, which we have tied to communicate using ranges of numbers.

The second figure summarizes the results of our analysis. I am afraid it is a little small to see on that screen. I will try to talk through it. The figure shows for each policy the cumulative effect on years of full-time equivalent employment per million dollars of budgetary cost. In other words, this is the cost effectiveness of different policies at increasing employment, and we measure cost effectiveness per million dollars of total budgetary cost by its cumulative effect on years of full-time employment.

The lighter set of bars at the top of the picture refer to policy options that are estimated to have a substantial proportion of their impact beginning in 2010. On the darker bars are options that were estimated to have most of their impact beginning in 2011.

Let me briefly run through the policy options we considered. The top bar reflects increasing aid to the unemployed. Households receiving unemployment benefits tend to spend the additional benefits quickly, making this option both timely and cost effective in spurring output and employment.

The second bar is the effect of reducing employers' payroll taxes. Firms will probably respond to this sort of tax cut through a combination of lower prices, higher wages, and higher profits. The changes in prices, wages and profits would spur additional spending, which would boost employment. In addition, the reduced cost of labor would directly encourage the use of more labor and production.

The third bar shows the effect of reducing employers' payroll taxes only for firms that increase their payroll. This policy would generate a larger employment gain than the previous one per dollar of budgetary cost because the tax cut is linked to payroll growth and therefore uses fewer dollars to cut taxes for workers who would have been employed anyway. Alternative ways of designing such a tax cut could have significant impact on its effectiveness, and I would be happy to discuss that if you would like.

The next bar shows the effect of reducing employees' payroll taxes. This option would have a smaller stimulative effect than reducing employers' taxes. It would not immediately affect employers' costs, but instead would have an effect similar to those of reducing other taxes for those people. That is, it would raise spending and therefore production and employment.

The next bar is the effect of providing an additional one-time Social Security payment which would increase consumer spending.

And the last of the light bars would allow for full or partial expensing of investment costs which would provide a greater incentive for business investment.

Now I will turn to the darker bars, the ones for policies that we estimate would have their largest effect beginning in 2011. The highest of those darker bars is investing infrastructure. Many, but not all, infrastructure projects involve considerable start-up lags; thus most of the increases in output and employment from this option, even if enacted in the very near term, would probably occur after 2011.

The next bar is providing aid to States for purposes other than infrastructure. As most States struggle to respond to huge budget gaps, additional Federal aid would lead to fewer layoffs of State employees, smaller increases in State taxes and so on.

The next bar is providing additional refundable tax credits for lower- and middle-income households in 2011. This approach would increase after-tax income for households that are likely to spend the significant share of the funds received.

The next bar, now I am down to the next to last bar, is extending higher exemption amounts for the AMT in 2010. This option would have a more limited impact on spending because it largely affects households whose spending is not constrained by their income in a given year.

And the last bar shows the effect of reducing income taxes broadly in 2011. Again, only a fraction of such a tax cut would probably be spent.

In conclusion, in our analysis, fiscal policy actions, if properly designed, would promote economic growth and increase employment in 2010 and 2011. However, despite the potential economic benefits in the short run, such actions would add to already large projected budget deficits, as Senator Brownback noted. Unless offsetting actions were taken to reverse the accumulation of additional government debt, future incomes would tend to be lower than they otherwise would have been. Thank you. I am happy to take your questions.

[The prepared statement of Dr. Douglas W. Elmendorf appears in the Submissions for the Record on page 34.]

Chair Maloney. Thank you very much.

And I think that—oh, Mr. Casey just came.

Is he here?

Welcome. And I would like to have you begin the questioning since I know you have to get back immediately.

Senator Casey. Well, thank you very much.

Mr. Elmendorf, thank you again. I appreciate your testimony today and your service.

I was struck by the graphic that you walked through that differentiates between impacts in 2010 versus 2011, especially in a couple of different areas. One is obviously the bar for impact in 2010, according to your graph, is substantial as it relates to aid to the unemployed. Is that correct?

Dr. Elmendorf. Yes. We think that policy is cost effective and can work very quickly.

Senator Casey. Just so I am reading, I want to make sure I am reading the graphic right, you are saying that years of full-time employment—I want to have you say it—in terms of the impact that an extension of unemployment compensation insurance, what that would provide in terms of a job impact?

Dr. Elmendorf. What this picture shows in the top bar is that over 2010 and 2011 together, that increasing aid to the unemployed would add in our estimate between 8 and 19 years of full-time equivalent employment per million dollars of budgetary cost.

Senator Casey. And I know that in the Senate as well as in the House, we are going to be debating extending so-called safety-net provisions, whether that is unemployment insurance or COBRA health insurance as well as food stamps. So that is very helpful for our deliberations about how to do that.

The other part that I wanted to review is with regard to payroll taxes. I have a bill in the Senate, a tax credit proposal, which would provide a tax credit for employers that are adding to their payroll. For less than a hundred they would get a 20 percent credit, and above a hundred would get a 15 percent credit. Chairwoman Maloney has a companion bill in the House, and we think it is a really good idea for a number of reasons, in addition to several other tax credit ideas that are out there.

I want to have you walk through the next two if you could, or maybe the next three, in terms of what a—and I should say for the record, although I won't be able to quote from it directly, but I know that CBO, the Congressional Budget Office, has given this kind of idea a good review, and we are grateful for that.

But if you can just walk through the payroll tax sections here and the impact of a tax credit. I know I have just described mine in broad terms, but just your thoughts on that to help us with our own deliberations.

Dr. Elmendorf. Let me just note briefly, as you know, we have written you a letter analyzing the effects of—alternative ways of designing a tax credit of this sort. Of course, we don't review proposals with an eye to supporting or objecting to them. We are just doing an analysis, and it is up to you and your colleagues to decide what policies to pursue.

Senator Casey. I was doing my best to put words in your mouth.

Dr. Elmendorf. And I am doing my best not to let you, Senator.

What we have said in our initial report and our letter to you, and you can see in those bars, is that in our judgment, policies that cut employers' payroll taxes are more cost effective in terms of stimulating employment over the next couple of years than many of the other policies that we have considered.

In our judgment, what firms will do with a cut of that sort is partly to take advantage of their lower cost by cutting the prices of their goods and thus trying to stimulate demand, and it is really the shortfall in demand that is the crux of the recession and the crux of the problem in hiring.

Additionally, these tax credits provide an incentive to use more labor by lowering the cost of labor in particular. In our judgment, a broad tax, payroll tax cut applying to all firms would raise full-time equivalent employment by 5 to 13 years per million dollars of total budgetary cost. A tax cut that was focused on firms that increased their payroll would have a larger effect of 8 to 18 years of full-time equivalent employment per million dollars. It has a larger effect in our judgment because less of the money goes toward paying for jobs that would have existed anyway. By only granting the tax cut for firms that are increasing employment, it is more focused on those increases. So per dollar of lost revenue, there is a greater incentive effect.

Now, as people have noted, for firms that have kept their payrolls going, that sort of approach does not provide a reward, and that is a tradeoff that you need to wrestle with.

We have not analyzed your specific proposal. It is complicated enough to do hypothetical proposals of the sort that we have been working on for a number of months, and we haven't tried to apply this methodology to any of the actual bills moving or being discussed in the Congress because there have just been a lot of pieces on all of these bills, not all of which we have analyzed, and specific features of your legislation and others that we haven't modeled at this point. So I can't give numbers to your proposal, but this is the basic thrust of our analysis.

Senator Casey. Thank you. I know I am out of time. I just say by way of comment, it is helpful that you have not only differentiated between tax credits versus other strategies, but within the realm of tax credits with increase payroll, those kinds of tax credits have a bigger impact, and that you are talking about 2010, so that is very helpful. Thank you very much.

Dr. Elmendorf. Thank you, Senator.

Chair Maloney. Thank you very much.

Senator Brownback.

Senator Brownback. Thanks, Madam Chair. I appreciate that.

Director Elmendorf, I asked you as I walked in whether you had any number of projections on the administration's new health care proposal. And what you told me is that you do not; you do not have the detail necessary to make budget projection. Is that correct?

Dr. Elmendorf. That is right, Senator.

We saw that proposal for the first time yesterday when you and others did and have started to look through it. In our initial read, we don't think there is enough detail on some aspects of the proposal for us to do a cost estimate. And even if such detail were provided, it would take us some time to do that. As Members of Congress have learned over the past year, for very complicated proposals, we try to do a very careful analysis, and that takes us a good deal of time.

Senator Brownback. I noted to you in my opening comments that our debt is now 90 percent of GDP, our total debt, and that most economists believe when you get at that 90 percent level you have a significant drag on your overall economy. Do you agree with the assessment of most economists that when you get that level of debt that it is a drag on your overall economy?

Dr. Elmendorf. We certainly agree, Senator, that increasing levels of government debt provide an increasing drag.

Whether there are tipping points, and if so, what they are, is a much more difficult point to ferret out of the data. And there certainly has been some prominent analysis that suggest that 90 percent of GDP is a sort of tipping point; that countries that have had debt above those levels have experienced significantly slower growth than countries with debt below those levels.

But as I say, I think the level to which one can take debt and how the risks rise as one increases the level is a difficult thing for economists to quantify. I think there isn't as much consensus around that. But there is a very clear consensus that rising levels of debt will over time reduce standards of living, will reduce the flexibility of the government to deal with crises, and will raise the risks of some sort of financial crisis.

Senator Brownback. Is there general agreement among economists that once you get over 90 percent debt to GDP, that this does create a significant drag on the economy? Would you agree with that and would you say that there is general agreement among economists on that notion?

Dr. Elmendorf. I am reluctant, Senator, to point specific levels.

I think that is a very subtle proposition. For example, many economists and we at CBO tend to focus on publicly held debt, which will be, at the end of this fiscal year, we think about 60 percent of GDP, rather than gross debt that you point to.

But again, that is one of the issues that people do disagree about. So I don't want to point to there being a specific number that most economists think is a sort of tipping point. But I think, again, it is a very widespread view that if we go through the next decade with debt at 60 percent of GDP and going up, that will mean lower standards of living over time than if we were persisting through this decade with debt at say 40 percent of GDP, where it was a few years ago.

Senator Brownback. On our current trajectory, we are on a track to have lower standards of living.

Dr. Elmendorf. Yes, that is right, Senator.

Relative to what otherwise would have happened, of course—there is other progress in the economy as well, and we project rising GDP over time. But relative to what would have happened with lower debt, the path that we are on, would represent a lower standard of living.

Senator Brownback. So clearly it would be wise to get that debt and deficit down?

Dr. Elmendorf. I think there is widespread agreement among analysts that getting that deficit and debt down over time is important. At this point in time, it is more complicated. I think there is a very substantial group of economists who believe that, given the current shortfall of employment relative to what it could be, of production relative to what it could be, that there should be stimulus provided at this point.

I think there are very few economists who argue that we should be looking for higher deficits 5, 6, 7, 8, 9, 10 years from now. I think there is much more disagreement about what should happen in the near term. And partly that is because, under current law, as CBO projects it, deficit does fall considerably in the next few years. As the economy recovers, even though we are looking for a slow recovery, we are expecting the deficit to fall from nearly 10 percent of GDP this year to about 4 percent 2 years from now, in fiscal year 2012. So under current law, and, again, that assumes that tax cuts are not extended and so on, there is a very substantial fiscal consolidation (a term people often use) over the next few years. And some economists are worried that that is too fast; others think that is not fast enough.

But what I think there is a very widespread consensus about is that the persistence of deficits beyond the cyclical downturn at the levels we expect under current law, and even more so if you extend tax cuts and make other changes, are a level that would be very damaging to the U.S. economy.

Senator Brownback. Or enact other spending that would exacerbate the deficit or debt.

Dr. Elmendorf. Yes, that is right, over that longer time frame, yes, would be harmful, yes, that is right.

Senator Brownback. Thank you, Chair.

Chair Maloney. Thank you.

And also, Ms. Sanchez is under a time constraint, so I recognize her for 5 minutes.

Representative Sanchez. Thank you, Madam Chair.

And thank you, Director, for being before us and for your really great report actually.

I think back to my economic training and the whole issue of how one invests for the long term, which is ideally the way I always think about things when I look at my own personal household income, for example. And we always look at things like education, movement of goods or people, communication, i.e., e-mail, Internet, et cetera, health of people, your basic investment in research, and then I think also to that, your access to capital is an important issue there.

And I think as we have been trying to pass policies and as we put forward the Recovery Act and as we are looking at this jobs act, we are really trying to take care of people in the short run but, at the same time, understanding that we need to invest in the long term in order for us to be able to pay back what we are pulling forward and spending right now.

And I think your graph shows that, you know, when you keep people—when you extend unemployment, when you give more moneys to commodities for food for people who really don't have jobs, et cetera. And then where you go into investment of infrastructure, we can see how something impacts immediately and how something will impact a little bit later as the funds come out.

But my question, and it goes back to what you and I were discussing before everybody came in, this whole issue of jobs are really created at the local level by our smaller- and medium-sized businesses and their real lack of ability to get that working capital that they need. And I gave you some examples of people that I have been talking to, some very close to me, about just what is happening out there.

What policy could you counsel us to think about really in trying to make a little bit more liquid the place for small- and medium-sized businesses to go and get that working capital they need to start the economic machine to go?

Dr. Elmendorf. You ask a very important question, Congresswoman, and I am afraid I don't have an answer equal to it. We have not had an opportunity yet to look hard at ways in which the government could improve the flow of capital to particular sectors of the economy.

It is certainly true that small businesses are having the most persistent problems in gaining access to capital. For large businesses, particularly for large businesses, with better credit ratings, capital is available, but less, much less so for small businesses. And the lack of capital is repeatedly cited as an obstacle to small businesses.

And I should say that a larger obstacle in the minds of small business people, according to surveys and another one was released this morning, is a lack of demand for their products. And one thing that would help them is for that demand to increase through higher consumer spending or business spending or government spending, and the policies that we are talking about today have some potential for doing that.

In terms of increasing access to capital, it is difficult, I think, for the government to set up a bank of its own in a sense. Part of what has worked and is important for small businesses is their connection with bankers who know their business and know them. And if those banks that they are used to dealing with, as you mentioned to me earlier, go out of business themselves or are taken over by other banks, that connection is broken, and it is very difficult to replace that. And there is some evidence that one of the reasons that recoveries from financial crises tend to be protracted in other countries and the U.S. in past history is because of a breakdown in some of that financial intermediation. So you put your finger on an important question, but we just haven't done enough work ourselves to offer options on policies.

Representative Sanchez. We do have guarantee type of organizations like SBA, which, you know, when you look at trying to get through that paper work and the weight that it takes on, something like that, and really the higher level of loan that one needs to take out from that many times, it doesn't hit those businesses that really are looking to hire one or two people. So I am hoping that maybe, and I have got to go talk to, obviously, Nydia Velazquez, who is our chairwoman over here on Small Business, but how we really drive maybe the Small Business Administration to be less full of red tape and paper work and time and maybe to smaller loans that can really be accessed by our local businesses.

Chair Maloney. Thank you. The gentlewoman's time is expired. Mr. Campbell is recognized.

Representative Campbell. Thank you, Madam Chair.

And thank you, Director Elmendorf.

Several questions. First one. In this committee last October, Christina Romer, the chairman of the President's Council of Economic Advisers, said that the stimulus would have its most, greatest effect on growth in 2009 and that, by mid-2010, would have little effect on growth. But yet it is my understanding that only a third roughly of the money has gone out the door yet. And those two, the statement and that fact, don't seem to work together for me. So I guess my question is, how much of the money is out? How do you see that? What is the effect now and in the future of the stimulus plan?

Dr. Elmendorf. Of course, I don't want to try to interpret what Christina Romer meant particularly, but from our perspective, I think the way to think of this is that as the money flows out, and that is partly on the spending side and partly in the form of lower taxes, so essentially less money coming in if you will, but as that deficit effect mounts, that provides a stimulus to consumer spending and business spending and spending at State and local government levels, and that helps to push up GDP relative to what it otherwise would have been. Actually a better hand gesture would say GDP is going like this, and our judgment, the stimulus act brought it like this. And that happens as the money goes out.

As more money goes out, then the effect gets larger. But you reach a point at which, even if the flow of money continues so that the level of GDP is still above where it otherwise would have been, as it is in our judgment, you are not stimulating the growth anymore. And then, in fact, as the stimulus effects wane over time, which we think begins to happen later this year, then even if the level remains a little higher than it used to be, you start to come back on to the path you would have been on otherwise so that you are not really raising growth; you are actually lowering the growth rate of the economy later this year relative to what would have been basically because you have gone into less deep of a hole.

Representative Campbell. Does that mean that, using your kind of efficiency sort of chart that you have there, that if we reduced some of that spending, in other words, if we took some of that stimulus money that hasn't been spent yet and didn't spend it, that perhaps that might be an efficient way for the government to save a little money and reduce the deficit and debt?

Dr. Elmendorf. Taking back that money fast—taking back that money, not using the rest that was intended to be used, so it would save the government money would, in our estimation, make the economic outcomes a little worse. That part of the economy would recover more slowly without the continuing flow of those funds. How those particular policies compare to other uses of the funds you might make, we haven't done that analysis.

Representative Campbell. Right. Because the question becomes an efficiency thing, sort of.

Okay. Another question. The Federal Government spending as a share of GDP is now, I believe, over 25 percent, which is I think the highest since the end of the World War II or something like that. State and local governments, it is my understanding, are about another 10 percent. So you add those together, and the public sector, if you will, governments at all level, is now over 35 percent of the total economy, over a third of the total economy.

And I would argue that the public sector and governments right now are in some trouble. Now, from California, where I come from, obviously, my State is in deep trouble, but other States are as well. I am in the greater Los Angeles area. The City of Los Angeles, a former mayor believes that the city will have no alternative but to declare bankruptcy at some point in the future; City of Los Angeles is in deep trouble. And we know that the Federal Government is in deep trouble, in terms of what you and everyone agrees is an unsustainable level of deficit and debt. What impact—I mean, my concern is that the public sector now is bigger than it has been, and it is in trouble, and that the public sector may actually be dragging the economy down in the future through this debt or through whatever actions, because they got to tax more, spend less, or all of this, or they crash. And so what is your view on how the public sector may be actually dampening the private sector going forward?

Dr. Elmendorf. I think, in the view of most analysts, during the recession and in its early period of recovery, when we were still so far short of full employment and full use of our capacity, that the extra spending and lower taxes that the government is doing, partly through the automatic stabilizers and partly through the discretionary actions that have been taken, are helping to fill in for some private demand that is not there.

And that is why, in our estimation, the automatic stabilizers and the stimulus package have improved outcomes relative to what they otherwise would have been. But as you go forward and as private demand recovers, which we and others expect that it will, albeit somewhat slowly, then the government ends up being in competition with private spending and private investment. And it is at that point when the budget deficits become increasingly costly to the economy.

And that is the usual discussion that economists will provide about how deficits are damaging. And it is that gap between spending and revenue which has to be borrowed, competing in capital markets with the borrowing that large and small businesses are trying to do, and households are trying to do to buy homes and mortgages and so on, and that crowding out is what lowers standards of living over time.

But I think the focus then is on the deficit as it will be 3, 4, 5 years from now, less so than what it is in the next few years when in this recession and the slow recovery the government is helping to fill in for some private demand that is not there. I think that is the consensus view of the situation that you describe.

Representative Campbell. Thank you.

Chair Maloney. I would like to look at the deficit that we have been talking about and ask about the impact of the recession on the tax revenues and the deficit. But I would like to understand more about it. What percentage of the deficit over the next 10 years is due to the stimulus and due to TARP?

Dr. Elmendorf. I haven't done those calculations exactly. Our baseline forecast for the deficit for the next 10 years under current law is about $6 trillion. The stimulus legislation we think has the cost of about $850 billion. That is not all in the next 10 years; some has already happened and I can't do all of that math in my head. The 850, of course, is less than a sixth of the $6 trillion that we project in deficit over the next 10 years.

The net cost of the TARP is turning out to be about $100 billion. Of course, that is less than we initially estimated because there was a lot of uncertainty at the beginning of this process of installing the TARP about which way the financial system would go. And as it turned out, the financial system has healed in a way that it has lowered the cost.

Chair Maloney. How much of it is due, do you believe, to the Bush tax cuts?

Dr. Elmendorf. I don't have an estimate of that. In our budget outlook, we do report what the effects would be of extending the tax cuts versus letting them expire as scheduled. Under current law, the 2001 and 2003 tax cuts expire at the end of this year. In that sense it has no effect on the next 10 years if you assume that they expire. If you want to see what the cost is if continued, it is in our book. I don't recall offhand. It is several trillion dollars.

Chair Maloney. And how much is due to the wars in Iraq and Afghanistan?

Dr. Elmendorf. Again, as you know the way that we project discretionary spending over time is to take the latest levels that Congress has approved for budget authority and to project that forward.

What actually happens in Iraq and Afghanistan, of course, depends on policy judgments here in Washington and effects around the world. So how much it will actually affect deficits, I don't know. I don't know what the projected amount of spending is based on the most recent appropriations.

Chair Maloney. What is the impact of Medicare Part D?

Dr. Elmendorf. Again, I don't have an answer. I don't know the forecast of that. We are currently updating our baseline in connection with the analysis of the President's budget and we will report that for you in a few weeks.

Chair Maloney. And then talking about the stimulus that some of my colleagues have raised, in your November reports you estimated that the Recovery Act added between 1.2 and 3.2 percentage points to growth by the third quarter. Additionally, CBO estimated that between 600,000 and 1.2 million additional people were employed by the third quarter of 2009 due to the Recovery Act.

How do you respond to critics who say that the Recovery Act has not worked when the numbers from CBO, the numbers from communities, the numbers that have been given from other economic institutions, are very similar to yours?

Dr. Elmendorf. So let me note first, Chairman Maloney, that we will be releasing today our analysis of the fourth quarter. We are required by the ARRA law to release a quarterly review of the numbers being collected by the administration. That report will be coming out today.

As we say in the report, we don't actually put much weight on the counts of jobs, which I think are very limited in their scope, in addition to issues of their reliability. We rely on economic modeling, and as I said in reference to our analysis of potential future policies, there is a very uncertain business. In our judgment, and I think it is consistent qualitatively with the judgment of a number of outside forecasters and analysts, the policies that were enacted in the stimulus bill are increasing GDP and employment relative to what it otherwise would be. To be sure, not every analyst agrees with that proposition. But we think it is well founded in economic degree and evidence. And I am happy if you want to talk, probably off-line, about some of the details of that analysis.

Chair Maloney. And your numbers are coming out at what time today?

Dr. Elmendorf. I am not sure. I had a nearly final draft in my hand before we left. I am told they have come out.

Chair Maloney. They have come out. Great. Can you share them with us?

Dr. Elmendorf. Our analysis is that the effects of the ARRA law were to raise the level of GDP in the fourth quarter by between 1½ and 3½ percent. That is not the growth rate in the fourth quarter. It represents the cumulative effect of the higher growth rates over the preceding three quarters. And we think it has raised the level of employment in the fourth quarter by about 1 to 2 million jobs, with slightly larger effects on full-time equivalent employment which is the measure we have used in this analysis and tries to incorporate not just the number of extra people with jobs, but also people moving from part-time to full-time work.

Chair Maloney. Thank you very much.

Mr. Brady.

Representative Brady. Thank you, Director, for being here. Now, I think if you are a government worker or belong to a teachers union, the stimulus has worked. But if you are in a manufacturing business or if you work in a construction industry, or in the private sector in general, those employment numbers have decreased. And I think that has been one of the main criticisms, government jobs only stay stimulated if taxpayers keep paying for them. Private sector jobs are investments that can drive the economy and almost every economist agrees the only way we will have a sustainable recovery is if the private sector begins rehiring, new expansions, increasing new hires. I appreciated, Director, your identification of some of the policy options, what the impact is.

I am not sure economic models work as well in this environment. And I say this because I think we are in uncertain times. Over the District Work Period, I had a number of roundtables with small- and mid-size businesses simply asking them, "What would it take for you to rehire and make that expansion decision?" I ran through many of those options in both the House and the Senate bill from tax credits for rehiring to lowering payroll taxes and all of that. They rejected all of those.

And here is what they said just listening to them. Looking at my notes from the roundtables, Keith Walls who has a dry cleaning business encapsulated everything. He said: Get rid of the fear. The fear of health care mandates, the cap and trade costs on energy prices, the fear of tax increases and reregulation, he said is holding back their decisions.

Margie Claybar has a cafe in Orange said: We need certainty. Sue Cleveland in Lumberton, Texas, just north of Beaumont, they do renovation work in homes and businesses and she said: Basically it is the fear about what is going to happen. Again, health care, cap and trade, tax increases across the board. And Lori from State Farm Insurance said people are scared to invest.

And I think what we are seeing is the issue of economic rational expectations. What businesses and people will do looking forward. Does all of this spending require tax increases in the future? Clearly, yes, it does. And it is having as one business said last week, "it is hard enough for you to predict the market, trying to predict the market and Congress both is impossible, so we are holding our cash. We are not willing to make that decision until we see where things are going."

And this morning in The Wall Street Journal, Robert Barro, a Harvard University economist did an op-ed and basically talked about what the impact of the multiplier for deficit finance government spending is. And his point is, since the fiscal multiplier was less than one in the first year of the stimulus, that the stimulus itself was partially offset by lower private consumption and investment expenditures. His summary was the stimulus plan likely reduced our economy about $300 billion over the next 4 years because private expenditures are reduced more than the stimulus spending. Rational expectations.

Again, you have a good area of study. You guys do a lot of modeling. It is difficult, obviously, by the ranges you gave us. Do your models incorporate the concept of rational expectations in a very uncertain market economy at this point?

Dr. Elmendorf. So I should say I am familiar with the work of Robert Barro. He is one of my teachers in economics and we cite the study of his in the appendix of our report on ARRA where we talk about different methodologies for doing these kinds of estimates. So we take that approach seriously.

I think economic models are not very good. Even the best of them are not very good. And that is why we use ranges and so on. And

I think you are hitting on an important point which is that even if a model provides accurate estimates in the normal course of affairs, it may not do a very good job under particular circumstances. And we wrestled with that in doing these estimates.

I think this current situation is unusual but it is unusual in different sorts of ways. I think the uncertainty about policy plays a role. And future tax policy, future regulatory policy, there is a good deal of uncertainty. Our own judgment is that the biggest uncertainty—and I think your businesspeople would agree with this—is about the demand for their products. And the extent to which the government can provide additional demand, we think that does help to stimulate activity.

On this jobs tax credit, for example, we think one way that works is that firms, business even though they might not decide themselves at first blush to hire workers, lower costs so that they can lower prices and get more business in the door. And then that business then can indirectly spur hiring.

Now, so it is hard to know from specific answers how things will play out in a complicated economy. We are relying on cumulative evidence, but we do not have evidence of what happens in recessions like this one, this deep, caused in this way, under this set of policy circumstances.

Under rational expectations, we do give some weight, and models generally give weight to people looking ahead. How well they look ahead, how rational those expectations are, is one of the disputed issues in economics. And the models that we rely on don't assume that people are completely rational. But they do have some forward looking behavior and we have written about this that a temporary tax cut has less effect on spending than a permanent tax cut because you are trying to figure out if this is $100 that you have every year or $100 that you only have this year.

So we have some forward looking behavior. It is not as rational I think as Robert Barro would support. Or as Ed Prescott, who you are hearing this afternoon, would support. We are solidly in the mainstream of the economics profession, and particularly the people who focus on forecasting employment output over the near term and we are pleased that our estimates of GDP and employment bracket the private forecasters that we have seen. But there is no guarantee that that is right. I would readily admit that.

Chair Maloney. The gentleman's time has expired.

Representative Brady. I understand. Thank you, Director.

Chair Maloney. Mr. Snyder.

Representative Snyder. Thank you, Ms. Maloney. Mr. Elmendorf, I am going to continue my discussion about banking because it relates to a lot of these discussions here and I know it does not fall under the CBO kind of thing. I agree with you that businesses will take the incentives over the moneys available; it may not be determinative of their decision.

I met with a businessman some time, a landscaper who wanted to buy a small excavator. A guy who never had problems getting money from the bank. Couldn't get the loan. Had to lease an excavator. What that means is whoever makes small excavators did not get that product to sell. So it was one less product to sell, which relates back to banking and credit policies that I think we are talking about.

If you have any comment—and I am prepared for you to not have any comment—but it seems to me that, and I will overstate it, that banks have become more of an adversary as institutions. Wonderful people at Bank of America in Little Rock. Every person I talk to on the phone politely enforces their policies. But it seems there are too many banking policies that work as adversary. More interested in encouraging policies that encourage overdrafts rather than finding Mr. Brady's businesspeople to loan money to because they would like to advance a product.

Do you have any comments about the nature of what banking has become in America over the last two or three decades?

Dr. Elmendorf. Congressman, I appreciate your confidence in the breadth of my knowledge, but I am afraid that I have to disappoint you. I actually don't know anything about overdraft fees or these payments—I am aware of them from my own statements from my bank, but I don't know of any analysis of them. It is not a topic that CBO has done a lot of work on, although there may be some that does not come to my mind offhand.

I think economists believe that most businesspeople are mostly interested in supporting their business. And Adam Smith, founder in a sense of modern economics, said that it is not through the benevolence of the butcher that we get our meat or the baker that we get our bread. They are looking out for themselves, the way they provide for themselves is they provide a service or product that somebody else wants to buy. And that in a competitive market, leaving aside a whole variety of complicated and important issues, that competition induces people to run businesses in a way that provides value to others and that is how they sell their products.

Representative Snyder. I think that makes sense, but the examples I gave, if I have an employee that comes to me and says here is how it is working. We debit your account, we hold the money for several days so we can make money, the businessman does not have it that I bought the product from, I don't have it.

They stole my money for several days and then charged me $35 for that honor. That doesn't seem to be the kind of thing that Adam Smith would think was good policy for building America. Would you agree with that.

Dr. Elmendorf. I think I am already too far out on a limb speaking for Adam Smith.

Representative Snyder. I did not know him.

Dr. Elmendorf. Nor I. I have been to where he is buried in Edinburgh, Scotland. An interesting place. The issue for banks, seriously, is that they need to make a profit like other businesses, and there are different ways, different combinations of interest rates they can charge, interest they can pay on accounts, and fees for other services. And I just do not know how those decisions are made or how they really evolve over time. It is not something I have looked into.

But I think in some ways one might think about the overall profit that banks make. Might also of think about how they do. Whether they are doing it by pricing certain kinds of services in certain ways. So I think the issue you raised is of how they are doing it, but the broader issue is do you think they are making too much money and how would one judge that?

And the last few years, of course, a lot of banks have taken very substantial losses. Given the losses on the loans, the interest that they are paying to customers on their bank accounts, interest that they are charging on new loans, a lot of banks have been in trouble. So one needs to weigh that against the other examples you raise, cases where it seems like they are maybe making money in ways that seem to you undesirable. But we just haven't looked at that carefully.

Representative Snyder. Can we ultimately solve our indebtedness if we don't grapple with the costs of health care, whether it is military health care, veterans health care, Medicare, Medicaid or Indian Health Service?

Dr. Elmendorf. No, I don't think so, practically speaking. I mean, the health spending is now a large share of total Federal spending. It is growing more rapidly than the rest of spending, more rapidly than GDP, and thus more rapidly than the tax base. For some period of time, one could cut other spending or taxes enough to cover the cost of rising health care. But if the current rate of growth of health spending at the Federal level continues for decades in the future, that becomes increasingly untenable.

Representative Snyder. Thank you for being here.

Chair Maloney. Thank you. And Mr. Hinchey.

Representative Hinchey. Well, this is always a fascinating discussion, and I very much appreciate you and your work. The circumstances we are dealing with are very complex, and I think that if we are going to deal with them effectively, we need to understand what we are dealing with.

So fundamentally, the sort of deregulation of the financial industry, which began back in the mid-1990s and which generated that Wall Street bailout was one of the major problems that we had to deal with and we consistently have to deal with. The other things I mentioned in the first context of these question, the Bush tax cuts, which I understand expires now at end of this year. Is that true?

Dr. Elmendorf. The 2001 and 2003 tax cuts expire at the end of this year.

Representative Hinchey. The end of this year?

Dr. Elmendorf. Right.

Representative Hinchey. So that will be a positive thing. Those tax cuts are going to make some more money available, won't it?

Dr. Elmendorf. The expiration of the tax cuts increases Federal revenue relative to extending them. Just remember our baseline assumes those tax cuts expire. So if Congress takes no action and they expire and everything else turns out just the way we expect, then we will have the same forecast for the budget deficit than we now have.

Representative Hinchey. We will have the same?

Dr. Elmendorf. Our baseline forecast assumes current law so it assumes the expiration.

Representative Hinchey. So your baseline forecast assumes the elimination of these tax cuts and then the moving into availability more money that is going to come into the Federal Government from those tax cuts?

Dr. Elmendorf. That is assumed. That is part of why the deficit narrows after this fiscal year.

Representative Hinchey. That is one of the problems that we are dealing with. The loss of that money over this long period of time. The prescription drug plan and I mentioned the war in Iraq and all of those things are the issues that we are dealing with.

Have you done—now, I assume that you make recommendations specifically to this Congress and to the President in some way, one way or another. Or at least the analysis that you create becomes available to them. That is the way it is.

Dr. Elmendorf. We make no recommendations. All our analysis is made available to you.

Representative Hinchey. You just provide the information and anybody can take advantage of the information if they want to?

Dr. Elmendorf. Right.

Representative Hinchey. Have you provided any information with regard to the context of the budget situation that the Obama administration inherited when they came into office?

Dr. Elmendorf. I am not sure we have written it up in quite that way. As you know we report several times a year on the budget projections and one could go back to the projection we made before the Obama administration took office and look at our current projection. And we try to decompose revisions into those caused by legislation and those caused by evolution in the economy or technical factors. We haven't put those features together in the way that you are asking about.

Representative Hinchey. You haven't put them together? You don't think it is necessary to do so or you don't think it is part of your responsibility?

Dr. Elmendorf. We have been busy. We haven't had a specific request to do the analysis this that way. I think the information is out there in the document to be used.

Representative Hinchey. I am just focusing on the title of your representation here today which you presented up there in the TV screen: The policies for increasing economic growth and employment in the short term. So in effect, you are making recommendations. You are talking about the policies that could come into play and should come into play.

Dr. Elmendorf. We are analyzing policies that we know have been discussed in the Congress. And we are providing the information so you can make your choice but we don't have favorites among them. The omission of things from the list shouldn't be viewed as a negative sign or the inclusion as a positive sign. It is a set of policies that we thought we knew how to analyze.

Representative Hinchey. You are just making the information available, if anybody wants to tap into it, it might be useful and it might be helpful.

We know that in the productive, intelligent expenditures of funding can be profitable, can generate huge amounts of money. Now that can be done personally by individuals or can only be done by larger organizations including this entire country. So the use of the expenditures that are going to generate funding could be very, very profitable in terms of generating a stronger economy.

We know, for example, based on one experience that for every dollar that you invest appropriately, internally, in the internal needs of the country, generates back more than a dollar.

Dr. Elmendorf. Well, I think it depends on the sort of investment. Right? So there are good investments and bad investments. That is not always known until after the fact.

Representative Hinchey. If you identify the needs and you invest in those needs and those needs then stimulate the kind of growth that you are anticipating, that generates more economic growth. And that is somewhat consistent, in the investing in infrastructure that you have here. But it is a very small piece. The investing in the infrastructure is something—like if that bill passes and was signed by the President, the one that passed yesterday in the Senate, that is going to generate a significant amount of money for this economy. That is going to generate jobs immediately. For example, in people who are doing construction. Construction work.

And then flowing out of that through the investment in the internal needs of the country, you generate jobs immediately, but you also generate general economic growth through the expansion in a positive way of the internal needs of the circumstances that you have to deal with. The obligations that you have in order to maintain this country for a growing population. All of those things really need to be done, don't you think?

Dr. Elmendorf. Well, again, I don't make recommendations. It is up to you and your colleagues Congressman to decide those things. Our analysis here focuses on the short term effects, the next few years which come principally from the hiring of workers to do projects, the spending that they do, and the additional workers get hired and so on. And we think there is what economists call a multiplier process of that sort.

Over time, if the infrastructure that is built turns out to be useful, that will support economic activity in the future. It can be an investment of the sort that you are describing in our economic wellbeing down the road. The thing to keep in mind there is that the government borrowing, if that persists over a longer period of time, well, when the economy gets back to full employment will crowd out some private borrowing that would have gone to private investment. When investments by the Federal Government are deficit financed, one needs to weigh the extra public investment that has occurred and the private investment that does not occur indirectly in ways that are not so visible but will not occur as a result.

A different approach, of course, is to do more investment of the sort you are describing. Paying for that through other spending reductions or tax increases today. In that case, then the trade-off is between the extra public investment and whatever other Federal spending is cut back or whatever private spending does not occur because of the tax increase. There is always a trade-off there in how the money is used.

Representative Hinchey. Thank you.

Chair Maloney. Thank you. I don't know if you read The Washington Post op-ed article that was written by Dr.—professor Alan

Blinder, who was supposed to be part of your panel on February 9th and it was canceled and he turned his testimony into an op-ed. And in it he addresses three major ways that employers may game a jobs tax credit. And I would like to ask a few questions about a job tax credit and the way it should be formulated. My colleague, Mr. Casey, and I have one bill, but there are numerous approaches out there.

If you had to design a tax credit or a jobs credit, what would be the key parts? For example, would we target firms of a particular size or age? Would you include everyone? Would you target it?

Dr. Elmendorf. Well, so our analysis is focused on a single criterion which is the cost-effectiveness in terms of number of full-time equivalent jobs per dollar budget cost. Other criteria can well matter and we have said this a number of times in our analysis of stimulus policies. But from that sole criterion of the cost-effectiveness, our judgment is that restricting the tax credit to smaller firms as is sometimes discussed, actually reduces its cost-effectiveness. Jobs created at big firms are good jobs too. Many small businesses tend to be more volatile, they tend to have rapid job growth and sometimes when things don't work out unfortunately large job declines. What that means is that any jobs that you are creating through the policy may be shorter lived than jobs created at more stable large firms.

Chair Maloney. Our proposal covered all firms. And one way firms can game the credit is to both hire and fire workers. And our bill only allows a credit for existing firms that increase head counts or payroll. But Professor Blinder, in his article, points out that firms that slashed employment during the recession will not be eligible for the tax credit. Is there some way to reward these firms without allowing others to gain the credit?

Dr. Elmendorf. I think that is very difficult. Again, in our analysis, only rewarding firms that increased payroll is more cost-effective than rewarding others but there is, as I mentioned earlier, a consequence that firms that have kept their payrolls up, sometimes struggling to do that, don't get rewarded then.

I think the choice that you have is to broaden, if you would like, to broaden the scope of the credit to include not just those who increase but others. That does whittle away the cost-effectiveness to some extent, but may provide other benefits that are important. It is not an either/or thing. I think you can give larger credits to firms that increase payroll and a smaller credit to all other firms if you wanted to find some balance between those alternatives.

Chair Maloney. I recently had a conversation with Professor Shiller, who is a critic of rational expectations and the author of Irrational Exuberance. And it seems to me that a lot of the uncertainty, especially about consumer spending, is due to the housing bubble, and most of the blame for the housing bubble can be blamed on lax regulations. There was absolutely no regulation of certain sectors of the housing market. In that case, I am certain it could have been avoided by better regulation.

In the future, there is much uncertainty about the price of carbon and how to limit health care spending and some of the areas that were discussed here today and it seems that the House has tried to limit uncertainty. When we have come forward with regulation, we are basically trying to limit uncertainty. What is your opinion on that?

Dr. Elmendorf. I think if, I understand you right, I agree that one can eliminate uncertainty by not regulating and sticking with it or by establishing regulations of a certain form and sticking with them. And I think that is absolutely right. Of course, the sort of regulation may have other effects. But in terms of the uncertainty alone, I agree that the key issue is establishing a policy that is then maintained.

And so there are several ways to do that. Obviously adopting the House-passed legislation in various fronts would be one way of reducing the uncertainty. I think that is right.

Chair Maloney. Because there was some criticism of action. It seems it was an effort to solve problems and to create certainty. My colleague, do you have further questions?

Representative Hinchey. No.

Chair Maloney. Well, I just would like to close by thanking you very much for coming today and reorganizing your schedule after the snowstorm. And I just would like to comment that I was confused by assertions made today by some of my Republican colleagues that unspent funds would be returned to the Treasury. Many of my colleagues on both the Democratic and Republican side have really spoken out very positively about how the recovery funds have provided jobs or created jobs and improved infrastructure in their districts.

Your testimony today—we appreciate very much your insights on policies to promote growth and lower unemployment. We appreciate that and I hope that your comments will help enlighten the debate in the Senate that is taking place this week as they try to move forward with jobs-creation legislation. And we will be continuing this discussion on Friday when we will have members of the private sector, a panel of business leaders and other forecasters, come forward. We appreciate your public service and we appreciate you being here. Thank you. This meeting is adjourned.

[Whereupon, at 1:00 p.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF CAROLYN MALONEY, CHAIR, JOINT ECONOMIC COMMITTEE

Today's hearing continues the JEC's focus on our country's unemployment problem—an effort that we are intensifying this year. The historic one-two punch of snow a few weeks ago delayed our series a bit, but with today's hearing, we are getting back on track. We will be examining ways to help our economy recover from the Great Recession of 2007, which was fueled by the double blow of crises in both the housing and financial sectors.

Today, we welcome the Honorable Doug Elmendorf, Director of the Congressional Budget Office. He will give CBO's assessment of policies and strategies to spur job creation in the near term. On Friday, we will continue by hearing from business leaders and economic forecasters as we explore the prospects for employment growth in the coming months.

Today's hearing is timely since the Senate plans to consider additional actions this week to put Americans back to work.

Creating jobs is the top priority for Congress and for our country. With almost 15 million Americans out of work, it's clear that immediate, targeted actions are needed to spur hiring and boost employment.

The questions before us are:

- How do we create jobs quickly? and
- Which policies are most efficient—which offer the most bang for the buck?

This hearing will help shine a light on the specific actions Congress should take right now—not in some distant future.

Just over one year ago, the current Administration took office, taking helm of a country suffering the worst crisis since the Great Depression. During the last three months of the Bush administration, we lost an average of 727,000 jobs per month. In contrast, during the most recent 3 months of the Obama administration, we lost an average of 35,000 jobs each month.

The trend is heading in the right direction. Thanks to the Recovery Act, the economy is growing. The Bureau of Economic Analysis reported that in the final quarter of 2009, the economy expanded at a rate of 5.7 percent. The Recovery Act included a tax cut for 95 percent of American families and created jobs while investing in clean energy technologies, infrastructure, and education.

While we have brought the economy back from the brink, we are not yet where we need to be in terms of job creation. Over 8.4 million jobs have been lost during the "Great Recession." And in addition to the 14.8 million workers who are currently unemployed, there are 8.3 million workers who currently work part-time, but would like to work full-time.

In the last year, Congress has enacted policies that support struggling families and encourage job creation. These actions include:

- Creating and extending the first-time homebuyers credit,
- Boosting funding for small business loans via the Small Business Administration,
- Extending safety net programs, and
- Extending the net operating loss carry-back provision that will help small businesses hire new employees.

But we need to redouble our efforts to create jobs.

In order to bring creative ideas on job creation to Congress, I started the year reaching out to CEOs of Fortune 100 companies and leaders of small businesses. I asked these employers to share new ideas on ways to create jobs.

In order to jump-start job growth, I have introduced an employer tax credit (cosponsored in the Senate by my JEC colleague Bob Casey and my fellow New Yorker, Kristen Gillibrand). This idea was suggested by several of the respondents to our survey. The credit will give employers an incentive to hire new workers and raise wages. This will help workers get back on their feet, spark consumer spending, and brighten our economic climate.

I welcome CBO's input about how to best design an employer tax credit. A recent CBO study showed that an employer tax credit similar to the one in my bill is one of the most effective and efficient ways of spurring hiring. The object of this week's hearings is to get feedback from experts to make sure that our actions work quickly to create jobs.

For example, CBO has pointed out that one of the lessons of the 1970s employer tax credit was that many employers didn't know about the tax credit until they filed their tax returns—too late to affect hiring decisions.

I look forward to CBO's perspective on finding solutions to the most pressing issue of the day: creating jobs.

PREPARED STATEMENT OF SENATOR SAM BROWNBACK, RANKING MINORITY MEMBER

Thank you Chairwoman Maloney for scheduling today's hearing on "The Road to Economic Recovery: Policies to Foster Job Creation and Continued Growth," and thank you Dr. Elmendorf for taking the time to join us this morning.

This hearing on job creation and economic growth comes as the House and Senate are both considering implementing a third round of deficit financed stimulus aimed at combating what has, no doubt, been a very severe economic downturn. While I agree that the weak projected economic recovery is of serious concern to the U.S. and particularly to unemployed workers and their families, to me, the greatest threat our nation currently faces is a national debt that has spiraled out of control.

To-date, the federal government has enacted more than $1 trillion in deficit-financed stimulus spending, and on top of that, the Federal Reserve and Treasury Department have extended multiple trillions of dollars in liquidity and financial backing. The impact of stimulus spending to date is highly uncertain. As we will hear from Dr. Elmendorf, the expected effects on output and employment of further proposed stimulus measures are also very uncertain. However, the CBO does note that many of the proposed stimulus measures, such as spending on infrastructure and aid to the states will not have any substantial impact on the economy until 2011.

With two quarters of economic growth already in place through the end of 2009, additional stimulus support in 2011 could potentially prove detrimental to a recovery already significantly underway in 2011. Of the proposed stimulus measures which CBO deems to have substantial impacts beginning in 2010, only one policy—increasing aid to the unemployed—has an average expected multiplier effect of one or higher. All the other policies were estimated to have an average multiplier effect of between 0.60 and 0.85, meaning that each dollar of spending would only generate between sixty cents and eighty-five cents in additional output.

Furthermore, the estimated cost per new full-time equivalent job created by these policies would be extremely high—ranging from $74,000 for increased aid to the unemployed to $182,000 for investment expensing. In my view, these estimates indicate that additional stimulus spending is not worth the added debt and lower future incomes that CBO warns will result if offsetting actions are not taken to reverse the accumulation of additional government debt.

Under the President's proposed budget, our publicly held national debt will nearly double from 40% of GDP in 2008 to 75% of GDP in 2018. And the total U.S. debt will surpass 90% of GDP this very year. Surpassing the 90% total debt threshold is a troubling reality: a recent study by economists Reinhart and Rogoff found that a total debt level of 90% of GDP has historically served as a tipping point for reduced economic growth.

If the U.S. does not stop spending beyond its means and fails to address long-run imbalances contained in its unfunded entitlement promises, the often hailed U.S. economic powerhouse could quickly lose its status as an engine of growth and leave younger and future generations with a lower standard of living. Our projected level of debt has the potential to cause serious consequences to growth: failure to confront our current and long-run budget deficits and rising national debt could cause a significant rise in interest rates that will crowd out private investment, raise future borrowing costs and interest payments on the debt, and potentially force policymakers to enact prohibitively high tax rates that could spur a downward spiral in output and the U.S. standard of living.

These threats are not just theoretical—they are very real. The recent crisis of confidence in Greece is a clear example of the potential debt threat facing the U.S. The only difference is that no one will be there to bail out the U.S. if financiers of our debt lose confidence in the U.S.'s ability to repay it.

Rather than contemplate ways in which the U.S. can further increase our debt in attempts to alleviate the current economic downturn, I believe we need to change gears and get serious about addressing our out-of-control budget-deficits and exploding national debt that threaten to cause our generation to become the first in history to leave our children and grandchildren with a worse future.

Finally, I'd like to note for my colleagues that Mr. Brady and I will be hosting an event at 1 p.m. this afternoon in the Capitol Visitor Center titled "RETURN TO PROSPERITY: CREATING TIIE STRONGEST ECONOMY OF THE 21ST CENTURY." We have four outstanding speakers including 2004 Nobel Prize winner Dr. Edward Prescott, noted monetary economist Dr. Allan Meltzer, former OMB Director and Federal Trade Commission Chairman Jim Miller, and President of the Institute for Research on the Economics of Taxation Steve Entin. If members want to hear how to get the economy back on track by returning government to its proper role and through sound monetary policy, all are invited to join us—as is the public.

Prepared Statement of Representative Kevin Brady

I am pleased to join in welcoming Director Elmendorf before the Committee this afternoon.

Given the depth and length of this recession, economists would normally expect a sharp V-shaped recovery with a strong rebound in output and employment. However, this has not been the case so far.

Real GDP grew at an annualized rate of 2.2 percent in the third quarter of 2009. While the real GDP growth rate accelerated to 5.7 percent in the fourth quarter, more than 57 percent of the growth in the fourth quarter was due to a one-off restocking of inventory. The fourth quarter spike reveals how deeply businesses emptied their shelves last year but gives no indication they are confident in bringing workers back or hiring new ones. Real final sales, which are a better measure of the underlying trend in real GDP than the headline number, rose by only 2.2 percent in the fourth quarter of 2009.

This is consistent with the sluggish economic growth forecasted for the next two years. The Congressional Budget Office (CBO) forecasts that real GDP will grow by 2.2 percent in 2010 and 1.9 percent in 2011. Likewise, the February Blue Chip consensus of private economists forecasts that real GDP will grow by 3.0 percent in 2010 and 3.1 percent in 2011, somewhat faster than CBO, but still slow when compared with normal growth after a severe recession.

Weak economic growth means that job creation will be anemic and the unemployment rate will remain elevated for a number of years. Indeed, the CBO forecasts that the average unemployment rate will be 10.1 percent in 2010 and 9.5 percent in 2011. Again, the February Blue Chip consensus is somewhat more optimistic than the CBO, but not much, forecasting average unemployment rates of 10.0 percent in 2010 and 9.2 percent in 2011.

While January's decline in the unemployment rate to 9.7 percent is encouraging, most of the improvement is attributable to an increase in the number part-time jobs reported by households. At the same time, payroll employment fell by another 20,000 jobs. This divergence between the household and establishment surveys is unusual. We must await future employment reports to see how this inconsistency between the two surveys is resolved.

Let's compare the recovery after the recession that began in December 2007 with the recovery after the August 1981 to November 1982 recession, which is similar in depth and length to the recent recession. The National Bureau of Economic Research has not yet determined the official bottom for the recent recession. However, industrial production hit its bottom in June 2009, and real GDP began to grow in July 2009. So, until the National Bureau of Economic Research makes its official determination, let's assume that the bottom of the recent recession occurred in June 2009.

Comparing the Reagan and Obama recoveries so far, we find:

- The average annualized rate of real GDP growth was 7.2 percent in the first two full quarters of the Reagan recovery compared with 4.0 percent in the first two full quarters of the Obama recovery.
- During the first seven months of the Reagan recovery, payroll employment had increased by 1.2 million jobs, while during the first seven months of the Obama recovery payroll employment fell by 1.1 million jobs.

Why are both real GDP growth and job creation so slow after this recession? Unfortunately for American workers and their families, the current economic recovery is fighting the head winds of excessive government spending and debt, the prospect of higher income taxes in the near future, and uncertainty over the future of health care and "cap and trade" legislation.

The expectations among entrepreneurs and business leaders for new costly and intrusive regulations and higher taxes on income, capital gains, and dividends starting in 2011 that will continue rising to service the explosion of federal debt under the Obama budget are the reason why firms, especially small businesses, are neither investing nor hiring new workers.

Congress should not waste taxpayer dollars on another stimulus bill, deceptively packaged as a "jobs bill." Instead of pushing controversial, costly, and job-killing healthcare and "cap and trade" bills, Washington should reduce federal spending from President Obama's 23 percent of GDP to no more than the post-war average of 19.5 percent of GDP over the next five years. Recently, Moody's warned the United States that its reckless fiscal course threatens its triple-A credit rating. Congressional action to reduce and then eliminate the federal budget deficit through spending reductions and entitlement reforms will do more to increase business confidence and create new jobs than any "jobs bill."

I look forward to hearing today's testimony.

Congressional Budget Office

Testimony

Statement of
Douglas W. Elmendorf
Director

Policies for Increasing Economic Growth and Employment in the Short Term

prepared for the
Joint Economic Committee
U.S. Congress

February 2010

This document was prepared and provided to the committee for a hearing scheduled for Tuesday, February 9, 2010. The hearing was postponed because of the weather.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Congresswoman Maloney, Senator Schumer, Congressman Brady, Senator Brownback, and Members of the Committee, thank you for the opportunity to testify today on policies to foster economic growth and employment this year and next. My statement is drawn from the Congressional Budget Office's (CBO's) recent work on that topic.[1]

The United States has just suffered through the most severe recession since the 1930s. The economy's output is currently about 6 percent below CBO's estimate of potential gross domestic product (GDP)—the output the economy would produce if its resources were fully employed. At 9.7 percent, the unemployment rate is about twice what it was in December 2007. Since that time, employers shed about 8.4 million jobs. Moreover, if employment had grown during that period at the same rate at which it grew from 1990 to 2007, millions of additional jobs would have been added to the economy. All told, the recession has lowered employment by about 11 million jobs relative to what it would otherwise be.

The good news is that the economy appears to be starting to recover. Real (inflation-adjusted) GDP grew during the second half of 2009, after having fallen 3.7 percent since the recession began in the fourth quarter of 2007. Severe economic downturns often sow the seeds of robust recoveries. During a slump in economic activity, consumers defer purchases, especially for housing and durable goods, and businesses postpone capital spending and try to cut inventories. Once demand in the economy picks up, the disparity between the desired and actual stocks of capital assets and consumer durable goods widens quickly, and spending by consumers and businesses can accelerate rapidly. Although CBO expects that the current recovery will be spurred by that dynamic, in all likelihood the recovery will also be dampened by a number of factors. Those factors include the continuing fragility of some financial markets and institutions; declining support from fiscal and monetary policy; and limited increases in households' spending because of slow income growth, lost wealth, and a large number of vacant houses.

Therefore, CBO anticipates, as do most private forecasters, that the pace of the economic recovery will be slow. The agency's latest forecast is presented and explained in *The Budget and Economic Outlook,* which was released two weeks ago.[2] CBO projects that, under current law, real GDP will increase by 2.1 percent between the fourth quarter of 2009 and the fourth quarter of 2010 and by 2.4 percent in 2011. Growth of real GDP will accelerate after 2011, spurred by stronger business investment and residential construction. For 2012 through 2014, CBO projects that real GDP will increase by an average of 4.4 percent per year, which would close the gap between actual output and potential output completely by the end of 2014.

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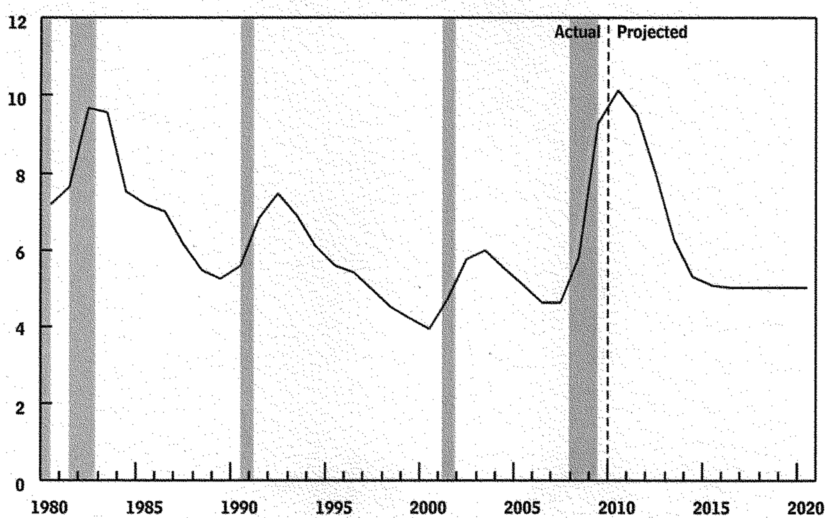
1. See Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011* (January 2010); and Congressional Budget Office, letter to the Honorable Robert P. Casey Jr. providing information on various approaches to reducing employers' payroll taxes to encourage employment (February 3, 2010).

2. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020* (January 2010),

Figure 1.

Unemployment Rate

(Percent)



Source: Congressional Budget Office.

Note: The shaded bars indicate periods of recession.

Hiring usually lags behind output during the initial stages of a recovery because firms tend to increase output first by boosting productivity and by raising the number of hours that existing employees work; adding employees tends to occur later. CBO expects that the unemployment rate will average slightly above 10 percent in the first half of this year and then turn downward in the second half (see Figure 1). In CBO's projection, the unemployment rate does not fall below 8 percent until 2012 and does not return to its long-run sustainable level of 5 percent until 2014.

Reflecting the large amount of slack in the economy, inflation will decrease further from its already low level in 2009, CBO forecasts. The core price index for personal consumption expenditures (that is, the PCE price index excluding the prices of food and energy) will rise by about 1 percent (on a fourth-quarter-to-fourth-quarter basis) in 2010 and 2011. The overall PCE price index will rise by 1.4 percent in 2010 and 1.1 percent in 2011.

During the past three years, the government has implemented a range of policies to address the severe recession as well as the turmoil in the housing and financial markets. Concerns that the economic recovery will be slow and protracted have prompted the consideration of further fiscal policy actions. In previous reports and testimony, CBO identified three key criteria for judging policy options for spurring economic growth and increasing employment:

- Timing—providing help when it is needed most;
- Cost-effectiveness—providing the most growth and employment per dollar cost to the federal budget; and
- Consistency with long-term fiscal objectives—preventing a short-term deficit increase due to stimulative policy from adding excessively to federal debt in the long run.

Other considerations affecting the design of policy options include uncertainty about a policy's effectiveness, the distribution of benefits among different people, and the value of additional goods and services that would be produced.[3]

This testimony summarizes the outlook for the labor market and assesses the potential impact that a variety of policy options would have on economic growth and employment. Some of the options that CBO analyzed would reduce taxes on individuals or increase aid to the unemployed and others, thereby increasing households' disposable income and boosting demand. Other policies would increase the flow of cash and reduce taxes for businesses, which would encourage them to invest and hire and thus increase employment. Additional options would increase federal spending by investing in infrastructure or providing aid to state governments, which would strengthen demand for goods and services and reduce further losses of state and local government jobs.

CBO concludes that further policy actions, if properly designed, would promote economic growth and increase employment in 2010 and 2011. The policies analyzed vary in cost-effectiveness as measured by the cumulative effects on GDP and employment per dollar of budgetary cost and in the timing of those effects. Policies that could be implemented relatively quickly or targeted toward people whose consumption tends to be restricted by their income, such as reducing payroll taxes for firms that increase payroll or boosting aid to the unemployed, would have the largest effects on output and employment per dollar of budgetary cost in 2010 and 2011. By contrast, policies that temporarily increased the after-tax income of people with relatively high income, such as an across-the-board reduction in income taxes or an increase in the exemption amount for the alternative minimum tax (AMT), would have smaller effects because such tax cuts would probably not affect the recipients' spending significantly.

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3. See Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness* (January 2008); and statement of Douglas W. Elmendorf, Director, Congressional Budget Office, before the House Committee on the Budget, *The State of the Economy and Issues in Developing an Effective Policy Response* (January 27, 2009).

Despite the potential economic benefits in the short run, such actions would add to the already large projected budget deficits. Unless offsetting actions were taken to reverse the accumulation of additional government debt, future incomes would tend to be lower than they otherwise would have been.

The Outlook for the Labor Market

Conditions in the labor market deteriorated less rapidly during the second half of 2009 than in the preceding year and a half, but a sustained turnaround in the unemployment rate and a recovery in employment are clearly lagging behind the recovery in production and output. The unemployment rate continued to rise in the second half of the year, reaching 10.1 percent in October and finishing the year at 10.0 percent. The rate then fell to 9.7 percent in January, surprising CBO and most private forecasters; whether that decline represents a temporary improvement or heralds the beginning of a downtrend is not clear. Payroll employment dropped sharply during much of 2009 but appeared to be leveling out by the end of the year. Still, payroll employment has not yet shown significant growth. New claims for unemployment insurance have fallen substantially since early 2009, but they remain well above prerecession levels. At the same time, hiring rates are still very low, with only weak signals pointing to imminent improvement.

That pattern is typical of recent recessions, in which the unemployment rate continued to rise and employment continued to fall for 6 to 12 months after real GDP began to grow. Hiring usually lags behind output during the initial stages of a recovery because firms tend to increase output first by boosting productivity and by raising the number of hours existing employees work; adding to payrolls tends to occur somewhat later. Indeed, productivity in the nonfarm business sector surged at an annual rate averaging about 6.7 percent from the second quarter through the fourth quarter of 2009. Moreover, the unemployment rate generally lags further behind the turning point in output because the number of people seeking work also increases in a recovery.

Effects of the Recession on Unemployment

At the beginning of the recession, only 4 states had an unemployment rate of 6 percent or higher. In November 2009, that number increased to 48; in 15 states, the rate was above 10 percent, and the highest rate was 14.7 percent.

In the recent recession, those who have been hit especially hard include men, younger workers, and less educated workers. The unemployment rate for men age 20 or older rose from 4 percent in the fourth quarter of 2007 to 10 percent in the fourth quarter of 2009; the rate for women, also 4 percent in late 2007, rose less—to 8 percent. Unemployment among workers between ages 20 and 24 rose from 9 percent in late 2007 to 16 percent in the fourth quarter of 2009. During the same period, the unemployment rate for workers age 25 or older who had less than a high school diploma rose from 8 percent to 15 percent.

The long duration of this recession has sharply increased the number of discouraged workers and part-time workers. An alternative measure of unemployment that accounts for "marginally attached" workers (people who say they have given up looking for work) and for part-time workers who would prefer full-time employment rose from 9 percent in December 2007 to 17 percent in December 2009.[4]

The recession has also had dramatic effects on the flows of workers through the job market. In an average month in 2007, about 5.3 million people were hired, and 5.2 million people left their jobs (constituting separations by quitting, retiring, being fired, or changing jobs). The net effect of those huge flows was an increase in employment each month of about 100,000. By the third quarter of 2009, the average monthly number of people hired and separated had fallen to about 4.1 million and 4.3 million, respectively; those smaller but still very large flows resulted in a net decline in employment that averaged about 240,000 each month. Separations declined despite an increase in layoffs and discharges because the number of people quitting their jobs declined dramatically.

Factors Leading to a Slow Recovery in Employment and Unemployment

Like the consensus in the most recent *Blue Chip* survey (compiled from about 50 private-sector forecasts), CBO envisions only a gradual recovery in employment and other measures of the labor market.

The first and most important factor underlying that assessment is that output is expected to grow fairly slowly. Following the two previous most severe recessions in the postwar period—the 1973–1975 and 1981–1982 recessions—employment recovered much more rapidly than CBO and others currently expect. But those recoveries featured much faster growth in output than is now anticipated; real GDP grew by 6.2 percent in the four quarters following the 1973–1975 recession and by 7.8 percent in the same period following the 1981–1982 recession. In contrast, employment changed little during the four quarters following the 1990–1991 recession, when real GDP rose by 2.6 percent; and employment fell by more than 1 million in the six quarters following the 2001 recession, when real GDP grew at an average annual rate of 2.1 percent. CBO currently projects that real GDP will increase by an average annual rate of about 2¼ percent from the fourth quarter of 2009 to the fourth quarter of 2011.

Second, average weekly hours worked in private industries fell sharply during the most recent recession, to a level well below their long-term downward trend. Increasing the hours worked by existing employees is one way that employers can increase

4. Department of Labor, Bureau of Labor Statistics, Table A-12, "Alternative Measures of Labor Underutilization," measure U 6. The data are available from 1994. Marginally attached workers are people who currently are not working and are not looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. People employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

labor input without having to bear the fixed costs of hiring new workers. Although average weekly hours worked increased in late 2009, they remain below the long-term trend, suggesting that many firms will increase workers' hours before doing new hiring on a large scale.

Third, the movement of unemployed workers into new jobs will probably be more difficult in this recovery than in past ones. Recessions often accelerate the demise or shrinkage of less efficient and less profitable firms, especially those in declining industries and sectors. Thus, the share of unemployed workers whose previous jobs are permanently lost tends to rise during recessions; the rise has been especially pronounced during the past two years. At the same time, workers who have been temporarily laid off represent a smaller percentage of the unemployed than they did in past recessions.

As a result, gains in employment after this recession will probably rely more than usual on the creation of new jobs, possibly in new firms that are located in different places and require workers with different skills than those needed in the jobs that have disappeared. For workers who have lost jobs to which they cannot return, acquiring new skills can take time. (In contrast, it is easier for workers who have been laid off temporarily to return to their jobs because the employers already know the workers and the workers already have the right skills and are familiar with the work.) For workers who need to move to different regions to find new jobs, the sharp declines in home prices during this recession, combined with the high loan-to-value ratios on many mortgages before the downturn, will hinder relocation. With a significant share of homeowners now owing more on their mortgages than their homes are worth, many people may not be able to sell their house for enough money to enable them to buy one in a new area.

Finally, the labor force is expected to begin to grow again, which will slow the pace of decline in the unemployment rate. During the recession, many workers were discouraged from looking for a job; when they stopped actively seeking work, they were no longer counted as part of the labor force. When they again actively seek work, they will be counted among the unemployed. Following the pattern of past recessions, those workers will probably return to the labor force as economic conditions improve, slowing the decrease in the unemployment rate.

Although all of those factors suggest that the pace of the recovery in employment is likely to be slow during the next few years, several indicators suggest that hiring conditions may improve in the near future. Employment in temporary help services, a leading indicator for the labor market, showed large gains in late 2009. Moreover, the increase in output that began in mid-2009 was achieved by increased productivity rather than increased employment. Although such a surge in productivity is quite typical around the end of a recession and in the early stage of a recovery, in the past such surges have not lasted more than a few quarters. Consequently, the pace of productivity growth will probably slow significantly in 2010, and as long as economic activity continues to grow at even a modest pace, some new hiring can be anticipated.

Assessing Policy Options for Increasing Economic Growth and Employment

CBO has assessed the potential of a variety of fiscal policy options for promoting economic growth and increasing employment. In particular, the agency has evaluated the timing and cost-effectiveness of the stimulus to output and employment that would be provided by different fiscal actions.

Types of Policy Options Considered

The different policy options would work somewhat differently depending on whether they sought to support spending by households, businesses, or governments.

Policy options aimed at assisting households would spur demand for goods and services to varying degrees and thereby boost production to varying degrees. Because businesses' decisions on investing and hiring depend on the demand for their products, higher demand and production would lead to more investment and hiring. The size of those effects would depend largely on which households got the money. Policies that temporarily increased the after-tax income of people who are relatively well off would probably have little effect on their spending because they generally would be able finance their consumption out of their income or assets without such a change. However, policies that increased the resources of families with lower income, few assets, and poor credit would probably have a larger impact on consumption spending. Because of the extent of job losses and declines in asset prices in this recession, more families probably fit that description now than was the case in the immediate aftermath of many previous recessions.

Policy options that support businesses would operate somewhat differently. Some policies would seek to encourage business spending by providing incentives for new investment, such as allowing firms to "expense" their investment costs for tax purposes —that is, to deduct the cost of an investment in the year it is made. Those policies would increase firms' after-tax return on investment by reducing the present value of taxes, and they would increase firms' cash flow for the year in which the new investment is made. The success of such incentives in encouraging spending would depend on the economic conditions when the incentives were in effect: A reduction in the cost of capital will generally not cause a business to buy new machinery if demand for the business's output is so low that the machinery would stand idle. Several studies suggest that the impact of being able to expense investment costs in the early 2000s, when demand was depressed (though not nearly as weak as it is now), was modest.[5]

Other policies would encourage hiring by temporarily or permanently reducing the cost of labor. The cost-effectiveness of those policies would depend on firms' responses to the tax benefits received—whether they passed the benefits on to custom-

5. For a summary of the literature on the effects of partial expensing and bonus depreciation in the early 2000s, see Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness.*

ers in the form of lower prices, to employees in the form of higher wages, or implicitly to shareholders by retaining them as profits—and the extent to which they increased employment and hours worked during a period when doing so would be temporarily less expensive.

Additional government spending would also boost output and employment, both directly through the government-funded activity and indirectly through increases in consumers' demand for goods and services resulting from the higher income of the households and firms that directly benefited from the government activity. The federal government can boost demand by increasing its own purchases of goods and services or by providing funds to state and local governments to increase their purchases of goods and services. How fast significant sums of money could be wisely spent, however, is unclear. In general, large increases in funding tend to be spent more slowly. Also, many public infrastructure projects, which require coordination among different levels of government, take a long time to implement. Such projects can be cost-effective in terms of the number of jobs generated per dollar of budgetary cost because they involve direct purchases of goods and the hiring of workers, but only a small share of the full effect is likely to be felt in the first two years after a proposal becomes law.

Federal grants to state and local governments can contribute to national economic growth—and aid people in the jurisdictions that receive the funds—by reducing the need for those governments to cut spending or raise taxes to narrow their budget shortfalls. Analysts expect those shortfalls to be very large in the next few years. For fiscal year 2010, 18 states are projected to have budget gaps (projected revenue shortfalls as a percentage of general fund expenditures) that exceed 20 percent, and 3 have gaps exceeding 40 percent.[6] Aid would be less effective in increasing employment if it simply allowed jurisdictions to borrow less. However, in the current economic environment, most states have already borrowed as much as they can under their own budget rules and will probably remain up against those limits during the next few years.

CBO's Modeling Approach

For each policy, CBO used evidence from empirical studies and econometric models to estimate the impact on:

- Output—the cumulative effects on GDP per dollar of total budgetary cost (additional government spending or reduction in tax collections), and

- Employment—the cumulative effects on years of full-time-equivalent employment per million dollars of total budgetary cost.

6. Calculation based on data from Pew Center for the States, *Beyond California: States in Fiscal Peril* (Washington, D.C.: Pew Charitable Trusts, November 2009).

The approach CBO adopted to measure a policy's effect on output is similar to the method the agency previously used to assess the effects of the American Recovery and Reinvestment Act (ARRA, Public Law 111-5).[7] The estimated impacts include both direct and indirect effects. Direct effects consist of immediate (or first-round) effects on economic activity. For example, government purchases of goods and services directly elicit economic activity and thereby have a direct dollar-for-dollar impact on output. Indirect effects are the second-round effects, which may enhance or offset the direct effects. For example, if the economy has idle resources, as it does now, government funding for projects can lead to the hiring of otherwise unemployed workers; and the additional spending by those workers, who now would have more income, would constitute a positive indirect effect. In contrast, a substantial increase in government spending tends to drive up interest rates, which discourages spending on investment and on durable goods by raising the cost of borrowed funds. Those indirect "crowding-out" effects would offset some of the direct effect. On the basis of its assessment of the available research, CBO chose low and high estimates of multipliers for a given policy to encompass most economists' views about the effects of that type of policy.

To assess a policy's impact on employment, CBO used a series of steps to translate the estimated effects on output into estimated effects on cumulative years of full-time-equivalent employment. First, CBO calculated the impact on the output gap—the percentage difference between actual output and potential output (the amount that the economy is capable of producing given its labor supply, capital stock, and technology). Next, CBO calculated the magnitude and timing of effects of changes in the output gap on productivity, hours per worker, and the unemployment rate using the historical relationships between those measures. Changes in the output gap initially have the largest effects on productivity; they affect hours per worker and unemployment gradually over several quarters. CBO also took account of the effect of changes in the unemployment rate on the labor force, because discouraged workers and people who have chosen to pursue activities such as schooling rather than work tend to return to the labor force when unemployment declines and the economic environment improves.

For policy options that would reduce labor costs and provide direct incentives for increasing employment and hours worked, CBO also accounted for firms' possible reactions, which would probably take several forms. Some firms would use additional labor to enhance the quality of products and services in ways not reflected in GDP. Some would use additional labor to increase maintenance of existing plants and equipment (such as doing preventive maintenance on motor vehicles), which would make plants and equipment last longer and delay the need to invest in replacements. Depending on the type of products they made, some firms would also increase their

7. For the methodology to assess the economic effects of ARRA and the range of multipliers used for each policy category, see Congressional Budget Office, *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output as of September 2009* (November 2009).

use of labor that was temporarily less expensive while the policy was in effect and reduce their use of labor later. Last, some firms would hire a little sooner to cover anticipated increases in their labor needs.

By measuring employment impacts in cumulative years of full-time-equivalent employment, each defined as 40 hours of employment per week for one year, this analysis incorporates the effects of policies on hours worked in addition to their effects on the number of people who would be employed. Thus, it includes increases in hours among part-time employees and possibly some overtime for full-time employees. In contrast, CBO's earlier analysis of ARRA was based on the number of employed people at a point in time and did not include shifts from part-time to full-time work or overtime.

Another difference between this analysis and the analysis done for ARRA is that, instead of reporting a policy's multiplier or impact at a point in time, this analysis focuses on cumulative changes over specific time periods. Effects on output were measured as the cumulative effects between 2010 and 2015, with a particular focus on the increase in years of full-time-equivalent employment in 2010 and 2011. The estimates include the effect of fiscal policy actions on monetary policy, reflecting an expectation that the Federal Reserve would gradually begin to offset such fiscal policy actions at the end of 2011 in order to avoid increasing the risk of inflation; as a result, some policies would generate cumulative effects on employment that were lower for 2010 through 2015 than for 2010 through 2011.[8]

For this analysis, policies were assumed to be temporary (that is, to be in effect for specific time periods or for specific dollar amounts), although some of the policies could also be designed to be permanent. The total effect of a policy on economic growth and employment would depend critically on the magnitude of the reduction in taxes or increase in spending that would occur. The largest feasible magnitude of the budgetary change would vary among the policies, but all of the options considered would be sufficiently scalable to allow tens of billions of dollars of spending increases or tax cuts in 2010 and 2011.

8. When estimating ARRA's effects, CBO assumed that the Federal Reserve would not reduce the amount of stimulus it was providing with its own policy levers (such as low interest rates and its efforts to increase liquidity by other means) to offset the output growth caused by ARRA. That assumption rested on the assessment that the economic outlook was sufficiently worrisome that the Federal Reserve was trying to provide a great deal of stimulus and would have welcomed additional stimulus from fiscal policy. However, CBO now assumes that as the recovery progresses, the Federal Reserve will see less need to provide monetary stimulus. Under CBO's economic forecast, that assumption implies that at the end of 2011 the Federal Reserve will gradually begin to offset fiscal policy actions by raising interest rates (or engaging in other actions to tighten monetary policy) in order to reduce the risk of excessive inflation. As a result, fiscal policy actions that would initially have a positive impact on output in 2010 or 2011 would have a smaller negative effect later; consequently, for some policies, the cumulative effects on years of full-time-equivalent employment from 2010 to 2015 would be smaller than the effects in 2010 and 2011.

Table 1.

Estimated Effects of Policy Options on Output and Employment

	Cumulative Effects on GDP, 2010–2015[a] (Dollars per dollar of total budgetary cost)		Cumulative Effects on Employment[b] (Years of full-time-equivalent employment per million dollars of total budgetary cost)					
			2010		2010–2011		2010–2015	
	Low	High	Low	High	Low	High	Low	High
	Policy Options with a Substantial Proportion of Impacts Beginning in 2010							
Increasing Aid to the Unemployed[c]	0.70	1.90	4	7	8	19	6	15
Reducing Employers' Payroll Taxes	0.40	1.20	3	5	5	13	4	11
Reducing Employers' Payroll Taxes for Firms That Increase Their Payroll	0.40	1.30	5	9	8	18	7	16
Reducing Employees' Payroll Taxes	0.30	0.90	2	4	3	9	2	7
Providing an Additional One-Time Social Security Payment	0.30	0.90	2	6	3	9	2	8
Allowing Full or Partial Expensing of Investment Costs[d]	0.20	1.00	1	3	2	9	1	8
	Policy Options with a Substantial Proportion of Impacts Beginning in 2011							
Investing in Infrastructure[e]	0.50	1.20	*	1	2	4	4	10
Providing Aid to States for Purposes Other Than Infrastructure[e]	0.40	1.10	1	1	3	7	3	9
Providing Additional Refundable Tax Credits for Lower- and Middle-Income Households in 2011	0.30	0.90	*	*	3	6	3	7
Extending Higher Exemption Amounts for the Alternative Minimum Tax	0.10	0.40	*	*	1	4	1	4
Reducing Income Taxes in 2011[f]	0.10	0.40	*	*	1	3	1	4

Source: Congressional Budget Office.

Notes: In estimates of the effects on output and employment, the total budgetary cost is the amount of tax revenues or budget authority over the full duration of the policies' effects unless otherwise specified.

All years are calendar years.

The ranges between low and high estimates are designed to encompass most economists' views.

Unless otherwise specified, spending policy options are assumed to provide budget authority as of April 2010, and tax policy options are assumed to be in effect for 2010 only.

* = between zero and 0.5.

a. Estimated as gross domestic product (GDP) with a policy minus GDP without the policy.

b. Estimated as years of full-time-equivalent employment (FTE-years) with a policy minus FTE-years without the policy. An FTE-year is 40 hours of employment per week for one year. For example, four people working 20 hours per week for six months equals one FTE-year.

c. Spending begins in March 2010, and no benefit payments are made after July 2011.

d. Initial reductions in revenues are nearly fully offset by later increases. The policy's effects are therefore estimated per dollar of the present discounted value of the policy (discounted at the businesses' cost of debt and equity) instead of per dollar of total budgetary cost.

e. Timing of spending from new funding follows historical experience.

f. Includes the effects of extending higher exemption amounts for the alternative minimum tax in 2010.

Policy Options with a Substantial Proportion of Impacts Beginning in 2010
Among the policy options considered in CBO's analysis, those that were estimated to have a substantial proportion of their impacts beginning in 2010 are increasing aid to the unemployed, reducing employers' payroll taxes, reducing payroll taxes for firms that increase their payroll, reducing employees' payroll taxes, providing an additional one-time Social Security payment, and allowing full or partial expensing of investment costs (see Table 1 and Figure 2).

Increasing Aid to the Unemployed. Under current law, some people who exhaust their unemployment benefits by the end of February 2010 will be eligible for additional weeks of benefits through emergency unemployment compensation. People receiving those benefits also are eligible to collect an additional weekly payment of $25; payments for those supplements are scheduled to be phased out beginning in March 2010. In addition, under amendments to the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA, Public Law 99-272), the government will pay for 65 percent of health insurance premiums for up to 15 months for individuals whose employment was involuntarily terminated between September 2008 and February 2010. The policy option analyzed by CBO would provide further assistance to the unemployed by extending through December 2010 the benefits that will begin to be phased out in March 2010 under current law; under this option, no added benefits would be paid after July 2011.

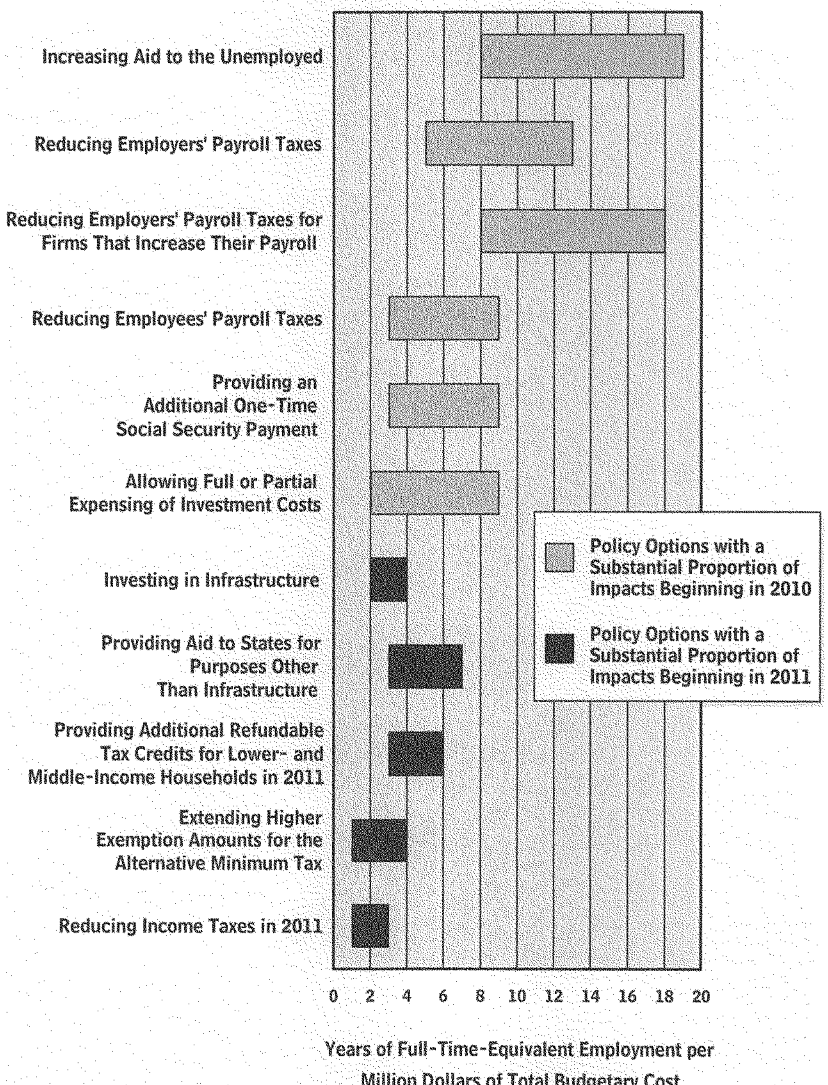
Extending additional unemployment benefits would directly help those who would otherwise exhaust their unemployment benefits between March and December of this year. Households receiving unemployment benefits tend to spend the additional benefits quickly, making this option both timely and cost-effective in spurring economic activity and employment. A variant of this option would extend assistance with paying health insurance premiums, which would allow some recipients to maintain health insurance coverage they would otherwise have dropped. This variant would result in increased demand for health care services, and it would increase the income available to purchase other goods and services for recipients who would have purchased insurance even without this special assistance. Both policy options could dampen people's efforts to look for work, although that concern is less of a factor when employment opportunities are expected to be limited for some time.

CBO estimates that those policies would raise output cumulatively between 2010 and 2015 by $0.70 to $1.90 per dollar of total budgetary cost. CBO also estimates that the policies would add 8 to 19 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Reducing Employers' Payroll Taxes. Social Security, which consists of Old-Age, Survivors, and Disability Insurance, is financed by payroll taxes. Under current law, both employers and employees pay 6.2 percent of an employee's annual earnings up to a ceiling that is adjusted for wage growth and equals $106,800 in 2010. CBO analyzed an option that would reduce employers' payroll taxes for 2010.

Figure 2.

Cumulative Effects of Policy Options on Employment in 2010 and 2011, Range of Low to High Estimates



Source: Congressional Budget Office.

Firms would probably respond to this temporary reduction in their portion of the payroll tax through a combination of four channels. First, some firms would respond to lower employment costs by reducing the prices they charge in order to sell more goods or services. Those higher sales would in turn spur production, which would then increase hours worked and hiring. Second, some firms would pass the tax savings on to employees in the form of higher wages or other forms of compensation, which would encourage more spending by those employees. However, wages tend to be inflexible in the short run because of negotiation and administrative costs, so that response is not likely to be very large. Third, some firms would retain the tax savings as profits. Higher profits would raise companies' stock prices, and the resulting higher household wealth would encourage more consumption, although shareholders are likely to spend only a small portion of their gains. Higher profits would also improve cash flow, enabling firms facing borrowing constraints to buy new equipment. Fourth, some firms would use slightly more labor during a period when it was temporarily less expensive. However, most of the money forgone by the government would go to reduce employers' taxes for existing workers, so—per dollar of forgone revenues—the added incentive to increase employment and hours worked would be small.

CBO estimates that reducing employers' payroll taxes would raise output cumulatively between 2010 and 2015 by $0.40 to $1.20 per dollar of total budgetary cost. CBO also estimates that the policy would add 5 to 13 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Reducing Employers' Payroll Taxes for Firms That Increase Their Payroll. In the late 1970s, the New Jobs Tax Credit was enacted in order to increase employment by reducing labor costs. CBO analyzed a related policy that would give employers a one-year nonrefundable credit against their payroll tax liability for incremental increases in their payroll during 2010. Because the credit would be nonrefundable, the credit amount would not exceed the firm's payroll tax liability. Such a credit could be based on payrolls in each calendar quarter so that firms could receive the credit quickly. To prevent firms from firing existing employees and hiring new ones, the credit could be based on the difference between the wage base in the current quarter and the wage base four quarters previously (the "reference period"). Also, to reduce the incentive for firms to delay hiring or to lower their wage base before the policy was implemented, the policy could be retroactive to the beginning of the quarter of enactment. In addition, the eligible wage base could be capped at an annual amount for each employee. Wage bases for the Federal Insurance Contributions Act (up to $106,800 in annual earnings for 2010) and the Federal Unemployment Tax Act (up to $7,000 in annual earnings) can be calculated quarterly for most employers from information already reported to the Internal Revenue Service, thus reducing the administrative costs of this option.

Providing tax credits for increases in payrolls would increase both output and employment. The effect on output would come through the same four channels as the effect on output of reducing employers' payroll taxes. CBO estimates that this option and the preceding one would have approximately the same economic impact per dollar of budgetary cost through the first three channels discussed above. Through the fourth channel, however, this option would provide a substantially larger increase in employment and hours than the previous option because this policy would provide tax benefits linked to payroll *growth*; fewer budget dollars would be used to cut taxes for workers who would have been employed anyway, so the incentive to increase payroll per dollar of forgone revenues would be greater.

CBO estimates that reducing payroll taxes for firms that increase their payroll would raise output cumulatively between 2010 and 2015 by $0.40 to $1.30 per dollar of total budgetary cost. CBO also estimates that the policy would add 8 to 18 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Various alternatives in the design of such a policy would affect its impact on employment:[9]

- Each firm's tax cut could be limited to a fixed dollar amount, a percentage of the firm's payroll in a base year, or both. Such a cap would reduce the policy's total budgetary cost, but it would also limit the incentives to increase employment. A firm that would have boosted its payroll in the absence of the policy by enough to reach the cap would receive the maximum tax cut under this alternative, but it would receive no additional tax cut for further expanding employment. Thus, the policy would give such a firm tax benefits but no extra incentive to hire more workers, decreasing the employment effect per dollar of budgetary cost.

- The tax cut could be offered only to firms with a total number of employees or total revenues below a specified threshold. However, employment at small firms is especially volatile: Those firms exhibit high rates of job creation and job loss as well as high rates of entering and leaving the markets in which they sell their products. As a result, the average duration of jobs subsidized under such a targeted tax cut would probably be shorter than the average duration under a broad-based policy. Moreover, small firms that do expand have proportionally higher average payroll growth than large firms that expand, so a larger fraction of the tax cut would fund payroll growth that would have occurred anyway. Consequently, CBO concludes, restricting eligibility to small firms would decrease the employment effect per dollar of budgetary cost.

- The eligible wage base could be limited. A low maximum (say, the wage base for federal unemployment taxes) would mean that the tax reduction would apply essentially to the net change in the number of employees, which would especially encourage the hiring of low-wage and part-time workers. A higher maximum (say,

9. More discussion of these and other design elements can be found in Congressional Budget Office, *Policies for Increasing Economic Growth and Employment*; and Congressional Budget Office, letter to the Honorable Robert P. Casey Jr. (February 3, 2010).

the wage base for Social Security taxes) would induce greater increases in hours per employee.

- The tax cut could be based on the total payroll for newly hired workers (with a requirement that firms not decrease their total payroll) rather than on the net change in a firm's payroll. CBO estimates that the total payroll in 2010 for newly hired workers at growing firms would be about as large as the net change in payroll for those firms from what it was a year ago.[10] As a result, a similar share of the tax reduction would provide incentives for additional employment under both policies, and the impact on employment per dollar of budgetary cost would be about the same.

- Government funds could be used to raise awareness of the tax change. One of the lessons of the New Jobs Tax Credit of the 1970s was that many employers did not know about the credit until they filed their tax returns—at which point the credit could no longer affect hiring decisions. If a new payroll tax cut was enacted, an outreach campaign could make firms more aware of the tax benefits of expanding employment. Although such a campaign would require additional resources, an effective outreach program would probably increase the employment effect per dollar of overall budgetary cost.

Reducing Employees' Payroll Taxes. Employees pay Social Security payroll taxes equal to 6.2 percent of their annual earnings, and self-employed workers pay 12.4 percent of their earnings up—both up to a ceiling that equals $106,800 in 2010. This option would reduce those taxes for 2010.

A temporary reduction in employees' portion of the payroll tax would not immediately affect employers' costs. Instead, it would have initial effects similar to those of reducing other taxes for people below the 2010 income cap. The increase in take-home pay would spur additional spending by the households receiving the higher income, and that higher spending would, in turn, increase production and employment. Those effects would be spread over time, however, and the majority of the increased take-home pay would be saved rather than spent.

CBO estimates that reducing employees' payroll taxes would raise output cumulatively between 2010 and 2015 by $0.30 to $0.90 per dollar of total budgetary cost.

10. That result is specific to the time period used in the analysis (March through December 2010), and other policy durations would have different results. The result stems from two offsetting effects. The net change in payroll would tend to be smaller because it would include the impact of job losses at those firms, whereas the payroll increase for newly hired workers would not. But net payroll growth would tend to be larger because it would include all of the growth relative to the firms' payroll a year earlier, whereas the payroll for the newly hired would reflect growth only since the policy took effect (which in this case was assumed to be March 2010). Net payroll growth is also boosted because it would reflect increases in the hours and wages of existing employees, who have higher average earnings than new employees.

CBO also estimates that the policy would add 3 to 9 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

In comparison with the effects of reducing employees' payroll taxes, the effects of reducing employers' payroll taxes are somewhat larger per dollar of forgone revenues. Reducing employers' payroll taxes for one year has an economic effect related to that of a temporary cut in sales taxes because a temporary reduction in prices (the first channel described in the section on reducing employers' payroll taxes) would encourage purchases while the reduction was in effect. The effects on spending, output, and employment through this channel are estimated to be somewhat larger than the corresponding effects of increases in take-home pay from reducing employees' payroll taxes.

Providing an Additional One-Time Social Security Payment. Income tax reductions and additional unemployment benefits would have small effects on senior citizens because many of them do not pay income taxes, and most are not in the labor force. One way to reach senior citizens is to provide direct payments. In 2009, for example, ARRA provided $250 in additional income to each senior citizen who received Social Security benefits in any month between November 2008 and January 2009 and to certain other retirees and disabled veterans.[11] This option would provide an additional one-time Social Security payment in 2010.

An additional payment of this sort in 2010 would increase demand to the extent that the recipients spent the additional income. Many of the elderly save at rates similar to those of the working-age population, suggesting that part of the additional income to seniors would not be spent (or at least not spent quickly) and part would. Hence, the option would probably have a moderate effect on demand and thus a moderate effect on output and employment.

CBO estimates that an additional Social Security payment in 2010 would raise output cumulatively between 2010 and 2015 by $0.30 to $0.90 per dollar of total budgetary cost and would add 3 to 9 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Allowing Full or Partial Expensing of Investment Costs. ARRA raised the maximum amount a firm can expense to $250,000 for equipment purchased in 2009. The amount that could be expensed phased out dollar for dollar for purchases above $800,000, so the provision targeted relatively small firms. ARRA also extended to the end of 2009 a provision first instituted in 2008 that allowed additional first-year depreciation of 50 percent for qualified investments. CBO analyzed a policy option to

11. Social Security beneficiaries received a cost-of-living adjustment in 2009 that was larger than usual because a run-up in oil prices boosted the consumer price index. The subsequent decline in oil prices pushed down the consumer price index. If the rules for Social Security benefits treated increases and decreases in prices symmetrically, the cost-of-living adjustment in 2010 would have been negative; however, the rules do not operate in that way, so beneficiaries received no cost-of-living adjustment in 2010.

provide further incentives to invest by extending both provisions of ARRA for one more year.

Full or partial expensing (sometimes called "bonus depreciation") of investment costs allows firms to realize the tax benefits of depreciation deductions more quickly, which provides a greater incentive for investment because a dollar of tax benefit this year is more valuable than a dollar of tax benefit in a future year. The effect of the incentive may be smaller when the economy is weak than when it is strong: Firms may be less likely to increase investment when they have idle capacity and when they are less confident about the future demand for their products and services. In addition, when the economy slows, more firms incur losses and pay no income tax; some of those firms therefore get less benefit from immediate tax deductions, although firms that paid taxes in previous years may be able to reclaim some of those taxes.

To the extent that temporarily reducing the after-tax price of investments accelerates the purchase of capital goods, that increased investment when the credit is available may be partially offset by a subsequent decrease when the credit expires. In addition, the policy would probably have the greatest effect on investment just before it expired at the end of 2010 (as firms accelerated equipment purchases from 2011), so much of the indirect effects on output and employment would spill over into 2011.

CBO estimates that allowing full or partial expensing would raise output cumulatively between 2010 and 2015 by $0.20 to $1.00 per dollar of total budgetary cost. CBO also estimates that the policy would add 2 to 9 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Policy Options with a Substantial Proportion of Impacts Beginning in 2011

Among the policy options considered in CBO's analysis, those that were estimated to have a substantial proportion of their impacts beginning in 2011 are investing in infrastructure, providing aid to states for purposes other than infrastructure, providing additional refundable tax credits for lower- and middle-income households in 2011, extending higher exemption amounts for the AMT in 2010, and reducing income taxes in 2011 (see Table 1 on page 11 and Figure 2 on page 13).

Investing in Infrastructure. ARRA appropriated about $60 billion for spending on water, transportation, and housing projects. CBO analyzed a policy option that would boost the demand for goods and services and thereby increase output and employment by providing additional increases in federal funding for infrastructure projects.

Infrastructure spending directly increases employment because workers are hired to undertake construction projects. It also adds to demand for goods and services through purchases of material and equipment and through additional spending by the extra workers who are hired; as with other policy options discussed in this analysis, that increase in demand would lead to further hiring. One drawback of this option is that infrastructure projects often involve considerable start-up lags. To be sure, some projects, such as highway repair and resurfacing, can be implemented relatively quickly. However, large-scale construction projects generally require years of planning and preparation; for example, building new transportation infrastructure that requires establishing new rights-of-way and developing and implementing alternative energy sources would probably have their biggest effects on output and employment after the recovery was well along. As a practical matter, the experience with ARRA suggests that fewer projects are "shovel ready" than one might expect: By the end of fiscal year 2009, outlays for infrastructure spending from ARRA made up less than 10 percent of the budget authority granted for infrastructure in that year. Moreover, given the substantial increase in infrastructure funding provided by ARRA, achieving significant increases in outlays above the amounts funded by ARRA would probably take even longer. Thus, most of the increases in output and employment from this option would probably occur after 2011.

CBO estimates that additional investments in infrastructure would raise output cumulatively between 2010 and 2015 by $0.50 to $1.20 per dollar of total budgetary cost and would add 2 to 4 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Providing Aid to States for Purposes Other Than Infrastructure. Many states have experienced a high degree of fiscal stress and are expected to have large budget gaps in the next few years. Eighteen states have budget gaps larger than 20 percent of general fund expenditures. Those budget gaps have occurred despite more than $200 billion provided to state governments by ARRA for purposes other than infrastructure. CBO analyzed a policy to further assist states by providing funding to state governments for a variety of purposes. Even if funding was intended for a specific activity, such as education or health care, CBO anticipates that the availability of those additional funds would both increase net state spending for that activity and affect other aspects of state budgets.

Without further aid from the federal government, many states would have to raise taxes or cut spending by more than they would if aid was provided. Such actions would dampen spending by those governments and by households in those states, and more state and private jobs would be lost. Under current policies, states will be taking such balancing actions on an ongoing basis, so federal aid that was provided promptly would probably have a significant effect on output and employment in 2010 and 2011. Such aid could lead to fewer layoffs, more pay raises, more government purchases of goods and services, increases in state safety-net programs, and fewer increases in state taxes; some might be saved for future use.

CBO estimates that providing aid to states for purposes other than infrastructure would raise output cumulatively between 2010 and 2015 by $0.40 to $1.10 per dollar of total budgetary cost. CBO also estimates that the policy would add 3 to 7 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Providing Additional Refundable Tax Credits for Lower- and Middle-Income Households in 2011. Some tax credits are refundable—that is, the government makes cash payments to people who do not have enough income to pay income taxes. ARRA contains several provisions that reduced taxes for individuals and families in 2009 and 2010 and that serve as examples of refundable credits that could be provided again in 2011. One such provision is the Making Work Pay credit, which provides a tax credit of up to $400 for individuals and up to $800 for married taxpayers filing joint returns; that credit is phased out as income exceeds $75,000 ($150,000 for joint filers). Another provision temporarily increased the earned income tax credit for taxpayers with three or more qualifying children and raised the threshold at which the amount of the credit begins to be reduced for married couples filing jointly. Yet another provision modified the existing Hope credit (a federal tax credit for education expenses of students meeting certain criteria) in 2009 and 2010 to make the credit partially refundable, providing education tax benefits to a larger group of taxpayers and allowing the credit to be claimed for four years of postsecondary education instead of two. CBO analyzed an option to extend those credits through 2011.

Refundable credits are often phased out when income increases above some amount and thus are effectively limited to lower- and middle-income households. Moreover, credits that are refundable provide a larger income boost to those households than do comparable credits that are not refundable, because lower-income households are more likely not to owe income tax. Therefore, providing additional refundable credits would increase after-tax income for households that are more likely to spend a greater share of the funds received. As a result, such credits would increase output and employment by more per dollar of budgetary cost than would cutting taxes for a broader set of taxpayers.

CBO estimates that providing additional refundable tax credits would raise output cumulatively between 2010 and 2015 by $0.30 to $0.90 per dollar of total budgetary cost. CBO also estimates that the policy would add 3 to 6 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Extending Higher Exemption Amounts for the Alternative Minimum Tax. The alternative minimum tax was originally intended to impose taxes on high-income individuals who used tax preferences to greatly reduce or eliminate their liability under the regular income tax. For most of its existence, the AMT has played a minor role in the tax system, accounting for less than 2 percent of revenues from the individual income tax and affecting fewer than 1 percent of taxpayers in any year before 2000. However, unlike the regular income tax, the AMT is not indexed for inflation. As a result, left unchanged, the AMT would affect significantly larger numbers of taxpayers over time, and lawmakers have intervened each year since 2001 to slow the expansion of the AMT and prevent it from affecting more taxpayers outside of the higher-income groups. At the expiration of each of those annual "patches," the exemptions would have reverted to their prior-law levels, so the prospective year-to-year increase in tax revenues if current law regarding the AMT was maintained has become larger each year. In 2010, under current law, the AMT will affect about 16 percent of taxpayers (up from less than 3 percent in 2009), who will, on average, pay $3,900 more in taxes than they would under the regular income tax system; nearly every married taxpayer filing jointly with income between $100,000 and $500,000 will owe some amount under the AMT. The option considered here would reduce taxes by making another adjustment to the amount of income that is exempt from the AMT during 2010 only.

The impact of this option on consumption is likely to be limited, because the AMT largely affects people in the upper half of the income distribution, and their consumption is unlikely to be constrained by their income in a given year. In addition, although the AMT extension would affect tax liability in 2010, most of its impact on consumption would probably occur in 2011. The effect would be delayed both because many taxpayers are allowed to pay their 2010 AMT liability in 2011 and because the increase in liability in 2010 would probably not be recognized immediately. In particular, taxpayers who have not previously paid the AMT may not know that they are becoming liable, and those previously liable for the AMT probably expect that another extension will be enacted; for both of those groups, the AMT liability under current law would not affect their consumption much until 2011, so changing the law would also not have much effect on their consumption until 2011.

CBO estimates that a one-year AMT patch would raise output cumulatively between 2010 and 2015 by $0.10 to $0.40 per dollar of total budgetary cost. CBO also estimates that the policy would add 1 to 4 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost.

Reducing Income Taxes in 2011. Various provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) will expire at the end of 2010, raising tax liabilities for most people. If policymakers wanted to avoid increasing taxes during a period of economic weakness, they could defer those increases as well as extend the higher exemption amounts for the AMT. Accordingly, CBO analyzed a policy that would defer, for one year, the scheduled 2011 income tax increases from the expiration of provisions in EGTRRA and JGTRRA and would increase the exemption amounts for the AMT in 2010 and 2011.

As compared with the one-year AMT patch, this option would convey a greater share of the tax reduction to households that have less income and that would therefore be more likely to spend a larger fraction of an increase in after-tax income. Still, only a fraction of the tax cut in this option would be received by those whose consumption is constrained by their current disposable income.

Deferring the scheduled increases in tax rates in 2011 would help some businesses as well as households. In particular, it would keep lower tax rates in place in that year for businesses that do not pay the corporate income tax (the pass-through entities such as sole proprietorships, partnerships, S corporations, and limited liability companies).

However, increasing the after-tax income of businesses typically does not create much incentive for them to hire more workers in order to produce more, because production depends principally on their ability to sell their products.

The economic effects of this option relative to those of the one-year AMT patch are influenced by two other factors. First, the effects would occur later, because the option would primarily reduce taxes in 2011 and much of the economic impact would not be felt until 2012. Second, because the economic effects would be delayed, more of them would occur in a period when CBO assumes that the Federal Reserve will begin to offset stimulative fiscal policy actions in order to avoid increasing the risk of excessive inflation. That response would reduce the overall boost to growth and employment from this option.

CBO estimates that a two-year AMT patch and one-year deferral of the EGTRRA and JGTRRA tax increases would raise output cumulatively between 2010 and 2015 by $0.10 to $0.40 per dollar of total budgetary cost. CBO also estimates that the policy would add 1 to 3 cumulative years of full-time-equivalent employment in 2010 and 2011 per million dollars of total budgetary cost. Although the effects of this policy per dollar of budgetary cost are smaller than the effects of extending ARRA's tax credits, the dollar amount of tax cuts under this option is substantially larger, so the total effects on output and employment also would be larger.

One variant on this option is to defer most of the tax increases in EGTRRA and JGTRRA for one year but allow the rate increases for the top brackets to go into effect. That approach would cost less than would deferring all of the scheduled tax increases, and it would be more cost-effective because the higher-income households that would be excluded would probably save a larger fraction of their increase in after-tax income. However, the difference relative to the option analyzed here would be small, because much of the remaining tax reduction would still go to higher-income taxpayers.

A related option is to permanently eliminate the scheduled tax increases in EGTRRA and JGTRRA. A permanent extension would have a bigger effect on demand in 2011 than would a temporary extension, because households that expected higher after-tax income in subsequent years would spend a larger share of the additional income they receive in 2011. However, a permanent extension would entail large revenue losses after the recovery is over, so its effects on output and employment in the next few years per dollar of total budgetary cost would be much lower than those of the one-year deferral analyzed here.