MONETARY POLICY AND THE STATE OF THE ECONOMY, PART II

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MONETARY POLICY AND THE STATE OF THE ECONOMY, PART II

Thursday, July 22, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 1:30 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Maloney, Watt, Hinojosa, McCarthy of New York, Miller of North Carolina, Scott, Cleaver, Ellison, Foster; Bachus, Paul, Hensarling, and Jenkins.

The CHAIRMAN. The committee will come to order.

I am pleased to continue a tradition we have started whereby the testimony of the Federal Reserve's Chairman is not the only words spoken on that day or two. And I am glad to see an acknowledgement from Professor Meltzer that no matter what people's views are substantively, the notion that the Fed should speak from Mount High, and that should be it, really doesn't make a great deal of sense. So, I appreciate these three distinguished economists joining us.

Obviously with the hearing we that we had today—we often try to have them on separate days to get a better membership, but yesterday, we were preempted by the signing ceremony. So we are now going to proceed. And I can tell you that these are monitored, even if they are not attended physically.

We will begin with Richard Koo, who is the chief economist of the Nomura Research Institute.

All testimony and supporting material that any of the witnesses want to insert in the record will, without objection, be made a part of the record.

We will begin with Mr. Koo.

STATEMENT OF RICHARD C. KOO, CHIEF ECONOMIST, THE NOMURA RESEARCH INSTITUTE, TOKYO

Mr. KOO. Thank you, Chairman Frank, and members of the committee. I really appreciate this opportunity to present my case that what the whole world has caught is the same Japanese disease that Japan had to struggle with for the last 15, 20 years.

And I was grateful that I was in this room when the morning session took place. All the debate that took place here actually took place in Japan 15, 20 years earlier. That was about zero interest rates, liquidity injections, quantitative easing, capital injections, guaranteeing bank liabilities, fiscal stimulus, large budget deficits, problems with rating agencies, and small companies not getting the funds.

We went through that debate in Japan 15 years earlier, and after going through this very difficult period, we came to the conclusion that this is a very different disease. It is a completely different disease compared to what we are used to. And in this disease, where the recession is caused by a bursting of a nationwide asset price bubble, financed with debt, when that bubble bursts, asset prices collapse, liabilities remain, and the private sector finds out their balance sheets are all underwater—or many of them are underwater. And when the balance sheets are underwater, if you have no income or revenue, of course you are out of business.

But if you still have some income or revenue or cash flow, then the right thing to do is to use that cash flow to pay down debt, because if you have a business, you don't want to tell your shareholders that well, we are bankrupt. We are out of business. Here is this piece of paper. You don't want to tell the bankers that it is a nonperforming loan. You don't want to tell your workers that they have no more jobs tomorrow.

So for all the stakeholders involved, the right thing to do is to use the cash flow to pay down debt. But when everybody does this all at the same time, we enter a very different world where the economy would be continuously losing demand until private sector balance sheets are repaired. And I see the same thing happening in this country.

There was a lot of discussion about corporate holding cash in this economy. I don't think they are just holding cash; they are paying down debt. And when this happens with zero interest rates, we enter a very different world. Because there is no name for this type of recession in economics, I call it balance sheet recession. And it happens in the following way: In the usual economy, if you have $1,000 of income, and I spent $900 myself and decide to save $100, the $900 is already someone else's income. The $100 that comes into the bank in the financial sector is lent to someone who can use it. That person then spends the money. That is $900 plus $100, and the economy moves forward. When there are too many borrowers, you raise interest rates. Some drop out. If too few, you bring rates down, and then someone will pick up the remaining sum, and that is how the economy moves forward.

But in the recession that we found ourselves in, in Japan 15 or 20 years ago, was that you bring rates down to zero, there are no borrowers because everybody is paying down debt. No one is borrowing money, even with a zero interest rate. And when that happens, when $900 is spent, $100 gets stuck in the banking system because there are no borrowers, even at a zero interest rate, then the economy shrinks to $900. That $900 is someone else's income. That person gets the money and decides, let us say, to save 10 percent. So $810 is spent, $90 goes into the banking system, and that $90 gets stuck. So if we do nothing about the situation, the economy will shrink from $1,000, $900, $810, $730 very, very quickly, even with a zero interest rate.

That is what happened in Japan, and that is exactly what happened during the Great Depression in the United States 80 years ago. Everybody was paying down debt. No one was borrowing money because their balance sheets were all underwater.

When you face a situation like this, the only way to keep the economy going is for the government to borrow the $100 and put that back into the income stream, because the government cannot tell the private sector not to repair its balance sheets. The private sector must repair its balance sheets. The private sector has no choice. So government has to then take the $100, put that back into the income stream, and then you have $900 plus $100 against the original income, $1,000. Then, the economy will move forward.

This government action will have to be kept in place for the entire period of private sector deleveraging because if you pull the plug at any moment when the private sector is still deleveraging, the economy will collapse very quickly. And we, in Japan, made that mistake in 1997 and in 2001. On both occasions, when the government pulled the plug, the economy collapsed; and the budget deficit, instead of decreasing, it actually increased massively. And it took us nearly 10 years to climb out of the hole.

So when the private sector is deleveraging, my advice to those countries suffering from this problem is to keep the government spending in there until private sector balance sheets are repaired, until the private sector is strong enough to move forward. And until that point, I am afraid government will have to be in there, because that will be the cheapest way to save the economy at the end of the day.

Our preliminary mistake, our premature fiscal consolidation in 1997 and 2001, prolonged the Japanese recession by at least 5 years, if not longer, and added massively to our budget deficit because the economy collapsed on both occasions, and we had to pull those economies out of that hole. So I would very much like to make sure that this economy, the most important one in the world, will not make the Japanese mistake of premature fiscal consolidation while the private sector is still deleveraging.

[The prepared statement of Mr. Koo can be found on page 28 of the appendix.]

The CHAIRMAN. Next, we have a familiar witness, and we appreciate his willingness from time to time to come meet with us. And if I read this correctly, Allan Meltzer is the holder of the eponymously named Allan Meltzer Chair, if I am reading that correctly. So we have Professor Allan Meltzer, who holds the Professor Allan Meltzer Chair at what is still the Tepper School of Business—that name has not yet been changed—at Carnegie Mellon University.

STATEMENT OF ALLAN H. MELTZER, THE ALLAN H. MELTZER UNIVERSITY PROFESSOR OF POLITICAL ECONOMY, TEPPER SCHOOL OF BUSINESS, CARNEGIE MELLON UNIVERSITY

Mr. MELTZER. Thank you Mr. Chairman, and Congressman Bachus. It is a pleasure to be here. I have been coming since the esteemed late Chairman Wright Patman, who hired me to work for the committee back in 1959. So I am an old friend of this committee.

The recession has ended, according to the statistical record, but unemployment remains high at between 9 and 10 percent, with long-term unemployment at the highest level since the series began in 1948. Much of the public does not see improvement. Many will not believe that the recession is over until they and others are back at work.

Why is this recovery slow and what can be done to increase growth and employment? Let us start with some of the problems. The fiscal stimulus helped very little. It didn't do nothing, but it didn't do much. And the best evidence that it didn't do much is the fact that the Administration is asking for a new fiscal stimulus, and many are urging that we do that. I think that is not what we need to do.

Since the Eisenhower Presidency in 1961, the Federal budget has been in deficit almost every year. The deficits have gotten larger and larger, and the reported deficits are dwarfed by the present value of promises for health care and retirement.

Uncertainty is the enemy of business investment and expansion, and what we have created is massive uncertainty. Here are some of the questions that businessmen worry about: What tax rate will apply in the future to income from investments made now? What new regulations will be imposed on businesses? How will existing and new regulations for pollution, financial services and health care be implemented, and what will they cost? What will employee health care cost? Will rules governing labor unions be changed to make unionization easier? How much will that add to production costs or increased outsourcing?

If employers have no idea about future costs, they are reluctant to hire additional workers. They satisfy increases in demand by asking current employees to work overtime.

Our current situation can be improved by reducing uncertainty and stimulating business investment. Here are some suggestions. Let me begin by saying that when Arthur Okun, the chairman of President Lyndon Johnson's Council of Economic Advisers, and a main architect of the Kennedy-Johnson tax program, analyzed the program after he left office, he concluded that the corporate tax cut which was part of the Kennedy-Johnson program was the most effective part of the program. Later work, including recent work, confirmed his conclusions.

What can be done? Declare a 3-year moratorium on new regulations, including labor market rules and the new financial restraints, unless each new rule is approved by a supermajority in Congress.

Develop and announced a precise, credible program of deficit reduction that specifies planned spending reductions and any tax increases.

Eliminate uncertainty about future tax rates and where the tax burden will increase by announcing the program now, a definite program.

Announce correct, believable costs of providing health care under the recently approved legislation. Recognize that many States are unable to pay additions to Medicaid. How much more will the government commit to the Medicaid program? How will these costs be paid?

Use the remaining unspent funds in the January 2009 stimulus program to reduce the corporate tax rate.

Reduce the risk of future inflation by eliminating a gradual program to reduce excess reserves in the banking system.

Some economists argue that the risk does not exist. The public doesn't believe them. Some economists actively urge more government spending and larger deficits. They neglect or denigrate concerns about the debt, the interest costs of servicing the debt, and the negative effect that large deficits and growing debt have on decisions to invest. Their arguments ignore the most important development in macroeconomics for the past 40 years: the careful integration of expectations about the future in dynamic economic models. A program that begins to lift uncertainty and reduce debt and deficits has a positive effect on private spending. It reduces uncertainty.

Recent efforts in Britain and in the euro area to reduce spending and deficits have been followed by currency appreciation there and other evidence of relief and more favorable expectations, knowing many governments are willing to act against future calamity.

Deflation has become a subject of much conversation. Deflation means a sustained decline in a broad-based price index. We do not suffer from deflation. Mention of deflation arouses memories of the Great Depression. That is a mistake. There have been 7 periods of deflation in the 97 years under the Federal Reserve Act. Some were large, 30 percent decline; some were small, 1 or 2 percent decline. Only one, 1929 to 1933, brought the economy close to disaster. Recovery from the others, most recently 1960–1961, looks like any other recovery.

We know that the 1929–1933 disaster was caused by inappropriate monetary policy. That policy reduced money growth by 50 percent. By 1933, prices had fallen less than 50 percent, so the expectation was prices will decline further.

That is nothing like the situation that we are in now. We have massive excess reserves. The banks that report their forecasts to The Economist magazine do not predict deflation anywhere except in Japan, and there by 0.1 percent. For any of the developed economic countries that they monitor, they expect prices to rise modestly. Their current forecast for the United States in 2011 is 1.5 percent.

Congress gave the Federal Reserve a dual mandate. It is inefficient and costly to concentrate on one objective at a time. That is what caused the great inflation of the 1970's. The Federal Reserve should not repeat that mistake as it is now doing. A small increase in interest rates would maintain negative real rates.

[The prepared statement of Mr. Meltzer can be found on page 42 of the appendix.]

The CHAIRMAN. We have a vote, but there are only two votes, so we are going to ask Mr. Mishel to speak, and we will be back within no more than 15 minutes. I appreciate the indulgence of our witnesses. We will now hear from Lawrence Mishel, the president of the Economic Policy Institute.

STATEMENT OF LAWRENCE MISHEL, PRESIDENT, THE ECONOMIC POLICY INSTITUTE

Mr. MISHEL. Thank you very much, Mr. Chairman, and Ranking Member Bachus, for this opportunity to address the committee. I welcome the opportunity to talk about the jobs situation, and it brings me no pleasure to report that I believe that the unemployment rate a year and a half from now will be very comparable to what it is today, and that we won't return to 5 percent unemployment for many years to come, perhaps 2015 or beyond.

I consider this an unacceptable outcome, and that means we should not accept it. I fear, however, that many of our elected leaders and the chattering class generally are implicitly accepting the unacceptable by doing very little to alter this future. We can do much better. We need to do much better. We can and need to pursue a vigorous jobs agenda to quickly lower unemployment and fill the huge jobs hole that has been created.

Let us talk about the job situation. Economic growth is scheduled to slow down, and it will unlikely do better than to absorb the natural growth of the labor force over the next year and a half. That means we will have roughly the 9.5 percent unemployment we have today and 1 out of 6 people underemployed; that is nearly 1 out of 10 unemployed, and 1 out of 6 underemployed. That means for minority workers, 1 out of 4 unemployed or underemployed. And over the course of a year, because there are flows in and out, I expect this year that we will have 1 out of 3 workers unemployed or underemployed at some point during the year, with that being around 40 to 45 percent for minorities. And we are likely to experience that again in 2011, and that means that we will have had around 2½ years of really horrific 9 percent to 10 percent unemployment, which is unacceptable.

Our problem is that we have a dramatic shortfall of demand for goods and services. We still have less final demand in the economy than we had before the recession, despite the fact that it is 2½ years later.

A lot of the risks are, in fact, that there will be further shortfalls in demand because of premature deficit reduction or even withdrawal of stimulus that is expected to pass; that the fact that the State and local governments could even have a tougher time than we now expect from austerity in Europe and from the declining wage growth, which gets worse and worse, which challenges the ability of households to increase their consumption.

Given the situation, it is necessary to do more to generate jobs, especially given the real risk of a double-dip recession. I am not saying there is going to be a double dip, but there is a risk. If we get there, we will be in a bad place without ammunition.

Deficits: In order to create jobs, we are going to have to raise the deficit in the short run. I wrote an op-ed with David Walker of the Peterson Foundation in February arguing that, in fact, the immediate priority needs to be jobs. That requires a higher deficit. We have a deficit problem in the future. We need to address that, and we should. But we should not let the higher deficit problem in the medium and long term keep us from generating jobs in the short term. These are, in fact, complementary strategies. The first steps towards getting the deficit down is surely to create jobs and create more taxpayers.

How are we going to generate these jobs? First of all, it is going to be the responsibility of Congress. The Recovery Act was important. It created millions of jobs. I don't really know how people explain the fact that we were losing three-quarters of a million jobs a month early last year, and now we are creating jobs. If not for the Stimulus Act, except for the inventory cycle, I don't think I have heard many explanations of why that occurred.

The fact that we haven't yet gotten to a place that we want to be, I think reflects how awful the place was before this Stimulus Act even took effect. In March 2009, we had an 8.6 percent unemployment rate, we had already lost more than 4 percent of our employment base—that is more of a loss of jobs than we even suffered in the 1980's recession—and we were still declining rapidly. It takes an awful lot to both stop a decline and to make up a lot of ground so that people feel prosperous.

How can we create jobs? I think there are the kinds of things that have been going on. We need to provide support for the unemployed. We need to provide relief to the States for both health and education. I think we need robust support for infrastructure, school modernization and transportation investments. I think we need to do something like the Miller bill to create local jobs throughout the country.

Let me just end by saying a few things about the recent debate we have had over unemployment insurance, which I felt was quite misguided. CBO, many economists believe that is the most effective thing you can do to stimulate the economy. It not only helps people, but it actually generates jobs. The reason is you are giving money to people who are desperate, and they are going to spend the money. So extending and expanding unemployment insurance is a "twofer." It helps people. It creates jobs.

We have calculated, using CBO parameters and the stimulus multiplier from economy.com, that the unemployment insurance system was providing around 1.7 million full-time equivalent jobs in early 2010. Now what happened? The bill that was passed is going to make sure that there is going to be more jobs and provide help for people in the last half of the year. But removed from that was $25 per week in benefits, COBRA subsidies, and other things, so that, in fact, the unemployment insurance system will be supporting fewer jobs in the last half of the year than in the first half.

Now, given the fact that when you do something that stimulates the economy, the Treasury gets back a lot of revenue and has to spend less, jobs created through unemployment insurance only cost 37,000 jobs. I thought that was a pretty good deal. I am sorry people didn't take it up.

[The prepared statement of Mr. Mishel can be found on page 46 of the appendix.]

The CHAIRMAN. We will recess and be back. There are only two votes. So we will say maybe another 10 minutes on the first vote. We will vote very quickly and then come back. We thank you for your patience.

[recess]

The CHAIRMAN. We will reconvene. I am going to ask my questions, and then I have to go to another meeting. The gentleman from North Carolina will preside, the chair of the subcommittee.

For all three of the witnesses, we have some agreement that the statistics show that things were on an upward path starting last year. I read from the Republican Budget Committee summary that said that after a long and deep recession, things began to get better in the second half of 2009, and that the credit markets and the financial institutions were getting more normal, that the economy was starting to get back. And then they said by the early part of 2010, by 2010, they said, most economists saw a modest recovery. And then they said, but a new crisis threatens that.

So my question is, what could that new crisis be? It is probably my question to you, Mr. Meltzer. You talk about uncertainty, but I don't understand why there would be more uncertainty today than there was a year ago, 3 years ago, or 5 years ago. In fact, to some extent we have passed some legislation that may have diminished it. During the period of transition from Clinton to Bush or from Bush to Obama, there was clearly uncertainty about public policies. One Administration with a very different view replaces another, and that happens in a democracy.

So I guess it is a combined question. What happened in April or May of this year? The Fed's estimate goes from more optimistic in April than it is today. The Republican Budget Committee comment that I talked about said things were going well in 2010, but now a new crisis threatens. What is the new crisis, and when did it arise?

Mr. Meltzer, let me start with you and ask each of you to talk about it for a minute or so.

Mr. MELTZER. I think it grew gradually. It didn't come one day; it came slowly over time. People became—the stimulus didn't seem to be doing much. It made people a bit nervous about why not. The programs for control of health were expensive, and you don't know what it costs to hire an employee. So as legislation began to come through—I don't say the legislation is wrong or bad or—

The CHAIRMAN. But let me ask you this, Mr. Meltzer, because, again, the Republican Study Committee, the Budget Committee says, things are going well in the second half of 2009, and there was a moderate recovery under way, and then it ran into a problem.

Mr. MELTZER. It is still under way.

The CHAIRMAN. But the health care bill—questions about—the things you have just explained were constant. So how did things start to get better despite them, and then they got worse because of them?

Mr. MELTZER. There is a heck of a lot of stimulus. My friend Professor Mishel says, well, what could possibly account for it? We have $1 trillion worth of excess reserves in the banking system. There has been a heck of a lot of monetary stimulus. The Fed bought $1 trillion worth of mortgages to hold the mortgage rate down. The government had a program for stimulating housing. It was actually a program I recommended at one time. So those were things which were helping.

There were things which were hurting; and the thing which was hurting was, in my opinion, pervasive growing—

The CHAIRMAN. All right. I appreciate that. But again, the timing still puzzles me. I don't see an explanation of why they suddenly emerged. But let me ask Mr. Koo and then Mr. Mishel to each address that.

Mr. KOO. My idea of the situation is that once the bubble burst, the economy began to weaken because of all these balance sheet problems that I mentioned. But we had one accident in between, which was, in my view, totally unnecessary, and that was the Lehman shock. The fact that Lehman Brothers was allowed to fail when so many other financial institutions had the same problem at the same time, that caused a massive panic, which was, in my view, totally unnecessary.

The CHAIRMAN. But I am talking about after that. Then, again, the argument was, we began to recover from that in a number of ways, and that somehow sometime around this spring, April or May, it stalled out—or it didn't stall out, but it slowed down. Lehman in 2008 couldn't explain April of 2010.

Mr. KOO. Without Lehman, the economy would have went this way; with Lehman, the economy went that way. And then with massive monetary stimulus and all the other actions taken by the Federal Reserve, Treasury, and all the other governments around the world, we were able to bring it back. But all the problems on the balance sheets are still with us.

The CHAIRMAN. Mr. Mishel?

Mr. MISHEL. My view is this is just a boldfaced political argument against the policy activism of the Obama Administration and Congress. You don't have to go very far to explain the lack in investment or the lack of hiring. It has to do with the fact that there is no demand, that we have plenty of excess capacity. If you track investment compared to capacity over the history—

The CHAIRMAN. Thank you. My time has expired.

The gentleman from Alabama.

Mr. MISHEL. Let me try very briefly.

The CHAIRMAN. I am sorry. If you want it to come out of your time, okay. It is great. We are going to have votes.

The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman.

Mr. Koo, you talked about the Great Depression, and you said some of what is happening now is similar to what happened in the Great Depression when people stop spending.

Mr. KOO. Stop borrowing.

Mr. BACHUS. Stop borrowing and spending.

During the Great Depression, the ratio of household debt to disposable personal income was in the 30 to 40 percent range. Currently, that ratio is above 120 percent. So, that is quite a difference. People have much more debt today, 3 or 4 times as much debt as they did then. So one of the reasons that they may not be borrowing money is because they simply can't afford to pay any more debt. Would you agree?

Mr. KOO. Yes. And when that process is going on, we are in a very different world, because these people would be minimizing debt instead of maximizing profits. And that is why we have to be super careful with this disease compared with ordinary recessions.

Mr. BACHUS. And I can understand when people have trouble paying back what they owe, they are not going to borrow, or they are not going to spend a lot. I think that is true of individuals today. For businesses, however, I think it is a totally different picture. They are sitting on record amounts of cash, and yet they are not hiring, and they are not investing.

I have to believe that Professor Meltzer is correct when he says that is obviously based on uncertainty. There has to be an amount of uncertainty or a lack of confidence. Otherwise, normally the business judgment is not to sit on cash; it is to invest it or to hire people. So what has changed? Because companies are not hiring, and they are not investing.

Mr. KOO. No. I think business is also very afraid whether they will be in demand in the future or not. As Jack Welch said in one of those TV programs that right now with so much monetary stimulus, so much fiscal stimulus, this is where we are. Just imagine what is going to happen next year when both of them may be gone. Then the economy will be much weaker, and you will look very stupid investing at this moment.

Industrial production is still at the level of 2004, meaning there are excess capacities everywhere, and you see so many workers unemployed. If I were running one of those businesses myself, I think I would be very careful going forward as well.

Mr. BACHUS. But isn't a part of that, that they don't know what the government—I hear people say, I don't know what the government is going to do. I even have one of my children who keeps saying, I am thinking about buying a house, but I am going to wait and see what the government—if they will—they didn't because of the tax credit. And then they kept saying, do you think it will be—there are just a lot of government mandates. There are a lot of new government regulations. Professor Meltzer said they don't know what tax rate they are going to pay. They don't know whether—and Chairman Bernanke today said we may start up some new lending programs. We might start borrowing. We could borrow loans, we could borrow bonds. And it appears as if people are making decisions not based on sound business judgment or commercial decisions or economic decisions. They are really trying to figure out what the government is going to do. And there is a certain amount of hesitation because of it and what Mr. Meltzer said.

In fairness to Mr. Mishel, there is a lot of uncertainty out there, right?

Mr. MISHEL. Yes. There is always economic uncertainty. I guess the question is, when some straightforward economic explanation explains something, why go to an unusual thing like uncertainty? And the usual explanation is what Richard Koo was saying, is that there are not good prospects for growth. There is very slow growth in demand. People have a lot of excess capacity. They do have more cash. They had $1.2 trillion of cash before the recession; they have more cash now. That is what happens in a recession. When you have a lot of excess capacity, there is no need to be spending the money on building new factories or building new facilities.

Mr. BACHUS. All right. Let me just end with this. What do each of you think? Do you believe that the tax cuts that expire—that if taxes increase at the start of the year, that will further constrict the economy?

Mr. WATT. [presiding] The gentleman's time has expired.

Mr. BACHUS. Could they answer the question?

Mr. WATT. You didn't finish the question before your time expired.

The gentlelady from New York, Mrs. McCarthy, is recognized for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. I am sorry that I was detained and wasn't here to hear your testimony, though we did go through the testimony when we received it.

I guess the question I have is actually for all three of you. This morning, listening to Chairman Bernanke's testimony, highlighted very important factors that could jeopardize economic growth: bank lending; employment rates; the housing market; and retail commercial activity. We have taken many legislative steps here in Congress to move those areas mentioned in the Chairman's testimony towards positive development; however, some feel that the tax cuts alone are the solution.

In reading your testimonies, I know there is even confusion here—or not confusion, but difference of opinions. So I guess—probably to continue on some thoughts of the questions already—that I would like to hear your thoughts and views on the success of the measures currently enacted as well as any future measures we should be thinking about. Mr. Koo, could you start?

Mr. KOO. I have argued that this is a very special type of recession that happens only after the bursting of a nationwide debt financed bubble as the asset prices collapsing, liabilities remaining, private sector balance sheets underwater. And in this type of recession, I believe the government will have to be in there spending to keep the GDP from falling so that people have income to repair their balance sheets. This action will have to be maintained until private sector balance sheets are repaired, and then you reverse course. Once the private sector is ready to borrow money, healthy again, then the government must reduce its deficit and at that time as quickly as possible.

But we are still in the entrance part of this recession with all these people repairing their balance sheets. So I would hope that government will maintain fiscal stimulus, and that, of course, different types of fiscal stimulus—there are the tax cuts, and there is government spending. Tax cuts, I am afraid, are not very efficient. It is far better than nothing, but it is still inefficient in the sense that when people are trying to repair their balance sheets, and they get the tax cut, they use that to pay down debt, which means it doesn't add to the demand in the economy. So if the government spends the money directly, that will add more demand to the economy for the same amount of budget deficit. But if you cannot get people to agree on spending, then I will say at least keep the tax cuts from expiring because that is still better than nothing.

Mrs. MCCARTHY OF NEW YORK. Mr. Meltzer?

Mr. MELTZER. Yes. I listed in my testimony about five things that you can do. I say quite explicitly that I don't expect you are going to do them.

But let me say, as I agree with Mr. Mishel, uncertainty is always there, but there are different degrees. And right now, it is enormous. Businessmen do not have an idea of what it is going to cost them to hire another worker. That is why they don't hire another worker.

So you could do a lot without doing anything fiscally or monetarily by simply saying, we are going to end all new regulations for the next 3 to 5 years unless Congress, by a supermajority, decides it is absolutely essential for the country. That would remove a great burden hanging over people, because they don't know what health care is going to cost, they don't know what financial services are going to cost, they don't know what cap-and-trade is going to do or if there is going to be cap-and-trade.

If you are sitting there trying to decide on an investment, and you are sitting on all this cash, you are not concerned about the things that they are talking about. You are not concerned about what is going to happen the next quarter. That investment is going to have to pay off over 3 to 5 more years. That is what you are worried about. What is it going to be like? You don't know. If you don't know, the sensible thing to do is wait. Put your money in government bonds, earn 3 percent, and wait to see how it settles down.

So what you could do that would be helpful would be announce a program of dealing with the deficit. Remove that uncertainty. Tell them what tax rates are you going to be facing 5 or 10 years from now, because you are not going to solve the deficit problem in a year or a week or a day; it is going to take years. Therefore, tell people what the environment is you are going to be working in, and that will help them a great deal to decide what is feasible and what isn't. That begins to work against the deficit, but it doesn't do draconian measures immediately.

Add to that a reduction in corporate tax rates. Tell businessmen, look, we are going to make it profitable, more profitable for you to invest. This country has an enormous international debt. To service that debt, it has to export. In order to export, it has to invest. So let us get started making investments.

Mr. WATT. The gentlelady's time has expired.

The gentleman from Texas.

Dr. PAUL. I thank the chairman.

So far, I don't think our recovery has gone too well. As a matter of fact, I remain pessimistic, just as I remained pessimistic before the crisis hit, because it was easily anticipated that bubbles had formed and had to be corrected.

But we have invested with fiscal and monetary policy $3.7 trillion in the last 2 years. Unemployment has gone up. There have been 8.5 million jobs lost. And if you take the $3.7 trillion that we have spent, invested to try to preserve this economy, it turns out that we have invested about $435,000 per unemployed. You could have taken about one-fourth of that and given them each $100,000. They certainly would have been a lot better off. But instead, we are still thinking about tinkering on the edges, and taxes, and regulations, and what are we going to do with monetary policy.

But I have a question dealing with monetary policy for Dr. Meltzer. The 1930's have been well described by many of the monetarists explaining that there was the allowance of deflation, and that is why we stayed in the Depression too long. And those who have studied that have very much to say about policy today, and there is no shrinkage of the monetary base. It has been doubled, and more than 2 times as high, and things aren't working.

So what would you advise now on monetary policy? They are talking about even more quantitative easing, but is that necessarily going to do much good? Certainly, we prevented the deflation of the monetary base of the 1930's. But if anybody cared about M3 anymore, which we don't record, but we do record it in the private sector—M3 was growing at 18 percent at the beginning of this recession. It is decreasing at the rate of 6 percent right now. Real M3 now is down a little bit over the last 2 years, $100 billion. So that sounds to me like deflation, according to what the monetarists say.

And so what do you think quantitative easings—they are even talking about buying municipal bonds, which I suspect and I predict they will, because conditions are going to get bad. Is this really going to be it? Or have we exhausted all our effort with monetary policy by dealing with the monetary base?

Mr. MELTZER. As you well know, we have $1 trillion worth of excess reserves. People can create—banks can create all the money they want. Adding more excess reserves to that stock is not going to do anything positive for the country. As a matter of fact, the Federal Reserve does not have a serious program for getting rid of those excess reserves over time, and that is a risk that adds to the uncertainty.

People like me worry about the fact that they don't know how they are going to bring that sum down. There is no central bank anywhere in the world in a developed country that has more than half of its balance sheet in illiquid long-term securities. None. There has never been a Federal Reserve with $1 trillion worth of excess reserves measured in real terms or any terms you want.

So we don't suffer from a need for more monetary policy. We suffer from a need to reduce the uncertainty that hangs over, that is deterring businesses because they don't know what their costs are going to be in the future. They don't know the inflation rate.

The other day I had dinner with two of the shrewdest and most successful investors. I asked them, who do you think is buying U.S. Government bonds at 2.8, 2.9 percent? The answer they gave me is an answer I just don't like to believe. They said, basically, it came down to the greater fool theory. The greater fool theory can't work for everybody. There has to be a greater fool. So they think we will invest in 2.9 percent bonds, but we will get out of them in time. Maybe, maybe. Otherwise, we are out some losses.

Dr. PAUL. You suspect that the multiplier effect will kick in soon or never? Or does it depend on our fiscal policies and what we do in the Congress?

Mr. MELTZER. I believe it depends upon increasing—let me say, velocity is way down. I have a chart published. It comes out of my history of the Fed. It shows base velocity from 1919 annually through 2007. The current numbers are on that chart. That is, we have very low interest rates. We have very low base velocity. That is not terribly surprising. Maybe it is off a little bit, but it isn't off a great deal.

So what we need is the confidence to get investment up. That is what we need. And at the risk of repeating, you have to do things to give businessmen a belief that they know what their costs are going to be for the next 5 years.

Mr. WATT. The gentleman's time has expired.

Dr. PAUL. Thank you.

Mr. WATT. I will recognize myself for 5 minutes, although I don't expect to take 5 minutes.

Mr. MELTZER. I am sorry, Mr. Chairman.

Mr. WATT. I guess I am kind of struck by what there seems to be some consensus about, yet it took the Senate so long to act on. Mr. Mishel testified to something that I have heard over and over and over again, that unemployment benefits going to the people who really don't have any alternative but to spend it has a stimulative effect. Do you argue with that, Mr. Meltzer?

Mr. MELTZER. I am not against increasing unemployment—

Mr. WATT. I didn't ask you whether you were against it or not. I am just asking you whether as an economist, you argue with the stimulative effect of it.

Mr. MELTZER. There is a stimulative effect.

Mr. WATT. Do you disagree with that, Mr. Koo?

Mr. KOO. No.

Mr. WATT. I guess my frustration is that politics has taken over something that is so simple that partisanship and politics don't allow us to do even the most basic direct thing that is in the country's interest. I don't understand that. I guess you all didn't come to explain that to me. I will have to figure it out on my own.

I will yield back the balance of my time and recognize the gentleman from Texas for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

Unfortunately, I was on the Floor, and I missed the testimony. But I did want to come back, particularly to Dr. Meltzer, and be able to speak with you. I was able to read your testimony. Frankly, Dr. Paul asked the very first question that I really had, and that was, what tools are left in the monetary toolbox? I think the conclusion is, frankly, none. And that indeed, speaking of Fortune 500 CEOs speaking to small business people in rural east Texas, frankly the anecdotal evidence is overwhelming that we have a massive quantity of uncertainty about the future that is keeping jobs from being created in the economy. And certainly the suggestions you make, Dr. Meltzer, I look upon those favorably. I fear this Congress will not.

Let me ask you this question, Dr. Meltzer. I think recently we saw that the 2-year Treasury bond yield dipped below 3 percent, which on the one hand you may say we still continue to be the flight to safety, if you will, particularly when you look at what is happening in the euro zone. Perhaps that is a good thing. But on the flip side, we know that, according to the Federal Reserve, we have public companies sitting on roughly $2 trillion of cash and cash equivalents. I assume they have brought up a lot of these treasuries.

Given the massive amount of cash that corporate America is sitting on, is that another manifestation of the uncertainty? Is that also an investment? Is that also their flight to safety, in your opinion?

Mr. MELTZER. Three percent isn't terribly good for a corporation, but it is better than taking a loss. So that is what they do, they wait. And prudent people know, as they say, there is a time to hold and a time to fold. And this is the time to hold, and that is what they are doing. They would like to see a program from the Administration and the Congress that spoke to their problems, just as many of the people are waiting to buy houses would like to see a program from the Administration or Congress that spoke to their problems.

Mr. HENSARLING. I was looking to the gentleman from North Carolina, but he is no longer in the chair. I was on the Floor for much of the unemployment insurance debate. I didn't hear anybody on either side of the aisle debate the proposition or actually come out against an extension of unemployment insurance. What I thought I heard was people on my side of the aisle thought that it ought to be paid for today, preferably out of unused stimulus funds, unused TARP funds. The other side of the aisle did not concur in that opinion. That is the debate I thought I heard.

And as far as the stimulative effect, I think again about Milton Friedman's permanent income theory. I sense the stimulative effect is negligible. It is not why I support unemployment insurance. If so, why don't we just create more jobs by creating more unemployment checks? If it is such a good stimulative impact upon the economy, the logic gets rather circular.

So the reason to vote for unemployment insurance, in my humble opinion, is not because of any significant stimulative effect. And I certainly respectfully disagree with the Speaker of the House, who had a quote recently that seemed to be very much to the contrary.

Mr. MISHEL. Could we have a dialogue on that point?

Mr. HENSARLING. When I am done. I am sorry. I have limited time here. I have another question I wanted to ask.

Dr. Meltzer, I have been looking at some academic studies concerning fiscal stimulus, and recently there have been several articles written about it, including, I think, Professor Taylor at Stanford had written about that. I think a bit of that had ended up in The Wall Street Journal.

Mr. MELTZER. Even Ms. Romer has a study in The American Economic Review.

Mr. HENSARLING. That she does.

I understand that Frank Smith with the European Central Bank has said that the stimulus has had almost no impact. Professor Robert Barro of Harvard said, "When I attempted to estimate directly the multiplier associated with peacetime government purchases, I got a number insignificantly different from zero." The IMF uses their global integrated monetary and fiscal model, which says, "For every 1 percent increase in government purchases, you get a maximum of 70 basis points increase in GDP, and then it quickly fades out," which caused Professor Taylor of Stanford to say, "My analysis of government spending is that it had little to do with the turnaround in the economic activity."

Mrs. MCCARTHY OF NEW YORK. [presiding] The gentleman's time has expired.

Mr. HENSARLING. We will speak about these matters later.

Mrs. MCCARTHY OF NEW YORK. If the members could keep their questions short, so the witnesses can answer, that would be a great help.

Mr. Hinojosa?

Mr. HINOJOSA. Madam Chairwoman, I am going to pass. I yield back.

Mrs. MCCARTHY OF NEW YORK. I recognize the gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Madam Chairwoman.

This morning, Mr. Bernanke said that the housing market remains weak with the overhang of vacant and foreclosed homes weighing on home prices and construction. That seemed to be the kind of understatement that you would have expected from his predecessor. In 2005, housing starts were 2,068,000; last year, there were 554,000. Some have said that 2 million was way too many, that was part of the bubble. But from 1996 through 2002 or so, new housing starts were at 1.5 million to 1.6 million, and the estimate this year is that it is going to come in less than last year.

That seems to be an enormous burden on the economy. That is a huge employer. Home building has been 16 percent of our GDP, and if it is a quarter of what it has been, it is hard to imagine how we are going to come out of the recession in a very strong way. And usually it is housing that has led us out of downturns in the past.

There is some debate about what the problem is. Some have said we just have too many houses for our population. Others have said that it is really tied to the recession; that demand is down because of recessionary forces, the liquidity trap; that people aren't buying houses because nobody is buying the stuff that their employer is making, so their wages are down, or they are unemployed.

And there is also the foreclosure crisis that continues to push down home values, which continues to be a huge disincentive to building new houses. There is a large number of houses that are foreclosed or destined for foreclosure that are either in the inventory or part of the shadow inventory.

Mr. Mishel, what is your sense of what the demand is for housing now? If we got the economy functioning halfway normally, how many new housing starts could we expect in a year? And how much of this is because of foreclosure? How much of this is because of recessionary factors?

Mr. MISHEL. I don't fashion myself as a housing expert, but I will offer what I can, which is I think we are still in the aftermath of the bursting of the housing bubble, and the prices haven't yet fully dropped to sort of reach the equilibrium. So there is not a lot of incentive to build more houses.

The problem in the housing sector, which is one reason why I don't think monetary policy is what got us the recovery from early 2009 to now, because one of the main reasons you would expect monetary policy to lead to growth would be through restoring durable goods and construction, and that really hasn't happened. Other than that, I don't want to venture any other advice.

Mr. MILLER OF NORTH CAROLINA. Mr. Koo, we had a raging debate in this country a year and a half ago about whether the biggest banks were solvent and what to do about them if they weren't. From our distance from Japan, one of the explanations given for Japan's lost decade, now apparently going on two lost decades, was that there were zombie corporations and particularly zombie banks that were really insolvent, but no one was quite willing to pull the trigger at taking them into receivership. So they continued not to function normally. They continued to hoard cash so they could remain solvent on paper.

And looking at the behavior of America's largest banks in the last year and a half, some of their behavior appears to be consistent with what is attributed to zombie banks. They are not lending normally. They are not making wholesome loans to people who are going to pay them back. They are emphasizing proprietary trading, which can kind of create a quicker profit when a bank is trying to get themselves back in the game. But most of all, their failure to make what appear to be economically sensible modifications of mortgages for people who can pay a mortgage on the house they are in, but not the one they have, for whatever reason.

Does it appear to you that American banks are behaving normally, or are they behaving the way the zombie banks in Japan behaved in the 1990's?

Mr. KOO. After the bursting of a major nationwide asset price bubble, banks are hit very badly as well, and that is what happened in Japan. That is what is happening in this country as well. Commercial real estate prices in Japan fell 87 percent from the peak. And just imagine Washington, D.C., down 87 percent. What kind of banking system do you think you would have left?

That is the challenge we faced in Japan. And when all the banks have the same problem at the same time, we have to go slowly. There is no way we can go quickly, because if they tried to sell the nonperforming loans, there won't be any buyers. Asset prices would collapse even further, and that makes the situation far worse.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

I remind the members that if you keep your questions shorter, you can actually get some answers.

Mr. Scott from Georgia.

Mr. SCOTT. Okay. Let us talk about jobs. And I asked Chairman Bernanke this morning about jobs. We are not doing enough in that area. What more can we do, from each of your perspectives? And cannot the Federal Government be utilized more effectively in helping to retain jobs? We have many cities, many municipalities who are losing jobs because they can't afford to keep people working. Could we not be more helpful in assisting to make sure money gets down?

The whole issue of getting this economy back on track is—the principle applies the same, whether you are dealing with the top of the economy or the bottom of it. Now, we responded to the top of this economy. We threw a bunch of money up at Wall Street, $700 billion—actually it has been over $1.5 trillion if you count the bailouts and all of that—without hesitation almost. But when it comes down to the basic bottom third of the economy, where the workers are concentrated, all of a sudden there is a different approach to this. We have to do monetary policy. We have to throw it up to the big eagles and hope that enough crumbs will fall down to the sparrows to eat. There is just not that same deal. And I mentioned to him, during the Depression we learned from that, and that is the way we got out of that Depression, by creating a massive influx of capital flow into that lower part.

We are a country of mass consumption, not a country of rich people going and buying a car. We are a country based upon a bunch of people, a lot of people going and buying cars, buying stuff. And if we get that money down at that lower level where the impact is the most, they spend it. They put it back. They turn out the other jobs.

So my point is, how are we going to get to that point of getting the same energy that we had in responding to Wall Street to respond to this serious problem of job loss?

My final point, and I will leave time for you to answer, as the chairman said. I will leave time for questions. But I had to get all this out. We are at a rate now that is so bad, that in order for us just to keep up with the population growth, we have to create 150,000 jobs every month. Just to even start the curve going back down and bringing the unemployment down, we have to keep it at least 250,000 a month. That ought to be the centerpiece of our plan. I believe we have to put that money down to do it. So what do you suggest we do with job creation?

Mr. MELTZER. Who are you asking?

Mr. SCOTT. I want to get each of your opinions.

Mr. MISHEL. He filibustered a bit. I will just say I very much agree with your analysis of the problem, and that we need a very vigorous job policy, and I think it will take actual—it is going to take some government spending, some more spending, some more deficits. The actual deficits we will have to undertake will be a short-term nature for a year or two, add a very small bit of debt that will be an enormous benefit to the Nation. We are going to borrow it at cheap rates, and we are going to create jobs and income for a lot of people. We should do things like the Miller jobs bill to help local governments. We need that State relief. My friend is also an incubator of that bill. We need State relief in the form of FMAP, and we need to work on the education part. We need a very vigorous infrastructure program, including school modernization. We need to start that right now.

Mr. MELTZER. You can't just stop there. Because these people are not blind and they are not stupid. And when they see you increasing their spending, they are going to say, who is going to pay for it? How is it going to be paid? You have to take that into account. Mr. Mishel does not want to take that into account. But your constituents, the market people do.

I share your view that we did much too much for the bankers. You just had the opportunity to end "too-big-to-fail." You didn't take it. That was a mistake.

Mr. SCOTT. Mr. Koo?

Mr. KOO. I think the demand has to be there for us before job creation can happen, and I think it would be a good idea for people in this room to tell the public that this is a different disease. If we do nothing about the situation, the economy will contract very, very quickly because everybody is still leveraging. When everybody is still leveraging and interest rates are zero, you know the private sector is very sick, and the public sector has to come in to keep the demand from falling. Once the private sector balance sheets are repaired and deleveraging is over, then you promise the people that then we will fix our balance sheets—the government will fix the balance sheets.

Mr. MELTZER. Why should they believe you?

Mr. SCOTT. Is that what you meant by balance sheet recession?

Mr. KOO. Yes, that is correct.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

Mr. Cleaver from Missouri.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Excuse me, gentlemen, it is my time. It is my time. Thank you.

Mr. Koo, Mr. Mishel—Mr. Koo, you mentioned in your opening comments in your testimony today, you quoted Paul Krugman, Nobel Laureate. Mr. Krugman, at the beginning of this crisis, or the response to it, suggested that we needed a $1 trillion stimulus for a variety of reasons, including the fact that a trillion dollars sounds like it might have been too much for the public to consume, but the President lowered it down to $840 billion.

So the first question for either of you is: Do you agree with Mr. Krugman's analysis? And, if so, do you think that we still have time—my concern is about the contraction of the economy, doing nothing. Do we have time to put things in place, particularly jobs, that could prevent that? First, though, was Mr. Krugman correct?

Mr. KOO. Mr. Krugman is correct about lack of demand. And he is saying we have to do something to make sure that demand doesn't fall. But Mr. Krugman doesn't seem to offer why the demand is so weak, even with zero interest rates, even with all the work you have down in this town. And I am offering that piece in my argument by saying that because private sector balance sheets are in such a sad shape, they are in need of help because the private sector cannot stop paying down debt. They have to repair their balance sheets or their credit rating goes down, their credibility goes down, and everything just gets worse and worse and worse.

So, the private sector has no choice. They have to repair their balance sheets. But when everybody does that all at the same time, we fall into a fallacy of composition, with the economy weakening very, very continuously. That is why I think the government has to be in there, to keep that from happening. And it can be done.

As I indicated earlier, Japan experienced an 87 percent decline in asset prices nationwide, and the wealth we lost in Japan was over 3 years' worth of GDP. The amount of wealth the United States lost during the Great Depression was just 1 year's worth of 1929 GDP. We lost 3 years' worth of 1989 GDP. But Japan was still able to keep the GDP from falling. Unemployment never went higher than 5.5 percent because of the fiscal stimulus to keep the economy from falling. That allowed the private sector to repair the balance sheets. It took us 15 years because we made a few mistakes—premature fiscal consolidation twice, which then lengthened the recession by very many years, I am afraid. But at the end of the day, private sector balance sheets are repaired in Japan and then people are ready to talk about reducing the budget deficit. Of course, the whole world caught the Japanese disease and that is why Japan is still struggling.

Mr. CLEAVER. Mr. Mishel?

Mr. MISHEL. I think Dr. Krugman was correct in that the economy required a larger stimulus than we got. I actually give the stimulus package very high grades because I think it utilizes about as many vehicles as we actually had to put money into the economy as were available. It could have been somewhat bigger and it could have been less oriented toward some of these tax cuts, especially the AMT relief. But I think it was a lot.

I think it is responsible for a lot of the forward movement in the economy we have had, and I find it dispiriting that—an unwillingness to go forward to provide employer assistance to the economy, because I think that is what it needs, and I find the complacency of Mr. Bernanke this morning quite disturbing to say that we are going to expect unemployment to drop essentially 1 percent over a 12-month period in the next 2, 2½ years, to be an unacceptable outcome for the economy that requires emergency action.

Mr. CLEAVER. Mr. Meltzer, if we don't extend TANF, Temporary Assistance for Needy Families, by September 30th, the end of the fiscal year, on October 1st, we will have an additional 200,000 people out of work. What do you think that will do psychologically to the same corporate leaders that you have been talking about who are afraid to hire?

Mr. MELTZER. It won't do anything good, for sure. But let me just say where I disagree with Mr. Koo. He talks about the Japanese case. I am sure he knows a lot about the Japanese case. But American corporations have billions of dollars of cash on their balance sheet. They are not suffering from debt deflation. They pay back their debts, many of them, and they are holding on to cash.

Mr. CLEAVER. Yes, that is a fact.

Mr. MELTZER. So they don't suffer from the problem that he is talking about.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

Mr. MISHEL. It wouldn't be good for business. We wouldn't like losing all those customers. We need to support TANF renewal.

Mrs. MCCARTHY OF NEW YORK. Mr. Ellison from Minnesota.

Mr. ELLISON. Let me thank the gentlelady for this hearing and thank all three witnesses for their comments.

I guess my first question is this: In the Congress and in the country, we are having this raging debate. On the Republican side, they are saying the debt, the deficit, no more spending unless it is accounted for. On our side of the fence we are saying, look, in the absence of private sector investment and expenditure, the public sector has to jump in and do something.

Who is right?

Mr. MISHEL. The answer is I think we need the public sector to step in because the private sector looks like it won't be for a while when it needs public sector expenditure. The reason why having unemployment insurance that is paid for doesn't make sense is because you are putting spending into the economy with one hand and taking it out with the other. So I think that is a very different policy.

I look forward to talking to Mr. Bachus about the tax cuts. I want to understand why tax cuts are seen as important if it is not really about the same kind of factor as putting money into the economy. So I don't know what the logic is, why tax increase hurts, but putting money into the economy is not good. These seem to be two things that are about demand.

Mr. ELLISON. Mr. Meltzer, do you want to take a whack at this?

Mr. MELTZER. I like your question, but I don't think it is an either/or case. I am not against the public sector. But most of the jobs that we are going to create, certainly permanent jobs, good jobs, are going to be in the private sector. So what can the public sector do that will help the private sector, encourage them to create more jobs? Do things which encourage them to be less uncertain. Put a moratorium on regulation for 3 to 5 years. Tell them something about what the health care costs are going to be. Announce a program for dealing with the deficits. Not cut the deficits tomorrow, but announce a program about how you are going to do that.

Mr. ELLISON. What do you think about the President's Deficit Reduction Commission? Is that a step in that direction?

Mr. MELTZER. It is if the Congress is willing to pay—will be willing to pay attention to it. But they will recommend things that are not costly in terms of dollars. They will say, extend the date on which you can get Social Security. We did that in the Greenspan Commission. We need to do it again. You have to do something about health care funding. But you have to make these things explicit. Businessmen are not stupid. But they like to know what their costs are going to be. And you; that is; the Administration, this Administration, more than most, has deprived them of that information. And they are waiting.

Mr. ELLISON. Mr. Koo?

Mr. KOO. At this juncture, I must say government has to be involved and in a sustainable way with a substantial amount until private sector balance sheets are repaired. I am not always for fiscal stimulus. I started my career at the New York Fed. I believe the monetary policy, all the market stuff. Occasionally, once in every several decades, the private sector does go crazy, and that is called a bubble. And once the bubble bursts, I am afraid there is this long period where they will have to do their balance sheets repair. And when the private sector is in that mode, the public sector must come in.

Mr. ELLISON. Now let me say I agree with you and Mr. Mishel, but I also find myself agreeing with Mr. Meltzer a little bit because they are not necessarily inconsistent. Fiscal stimulus and trying to give some—I am not sure I agree with his specific proposals for giving some certainty to the business community, but giving some predictability I think does have some merit. I am here to learn. What do you all think about that?

Mr. KOO. I fully agree with Mr. Meltzer's point that certainty is important. But having a big demand, I think, when the demand is so deficient at the moment, is equally important, if not more so.

Mr. ELLISON. Let me say that, am I right about this, that first quarter profits this year were up—after-tax profits were up 43 percent. Is that right?

Mr. MISHEL. In fact, corporate profits in the first quarter were higher than they were before the recession began. So the only recovery we have seen is for corporate profits.

Mr. ELLISON. Here is the $64,000 question. Why don't they use that money they have to hire some people?

Mr. MISHEL. It is a question about the cash you are sitting on. They had made a lot of profits. The reason they are not using the money to invest is because they don't expect to be able to make a lot of profitable sales. And if they can produce goods and services with the workers they have now and the capacities they have now, there is no reason to expand their capacity. So it is a shortfall in demand. It is just that simple. And there is no reason to stretch for these other explanations.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

Mr. ELLISON. That was fast.

Mrs. MCCARTHY OF NEW YORK. It goes fast.

Mr. Foster from Illinois.

Mr. FOSTER. Thank you, Madam Chairwoman. Just one comment about why businesses are not reexpanding. As a former businessman, when you have gone through layoffs, it is such a searing experience that you will do anything to protect yourself against the possibility of having to repeat that quickly. I think a big part of that is just psychological. And one of the joys of economics is that it is not as predictable as physics.

One of the things I wanted to ask your opinions on is part of the balance across the paradox of thrift that we have to get through with consumers is the balance between spending resuming and savings resuming. The numbers that I saw in this book that we just got today from Chairman Bernanke show that actual personal consumption has—consumer spending has now exceeded pre-crisis levels by a small amount for the first time, which I regard as a very good sign, and that similarly the savings has increased. It now just looks like for the last year been averaging some number about 4 to 5 percent, which is significantly above where it was in the bubble years.

And I was wondering if you feel that is a reasonable balance point for consumer behavior or whether we are still out of balance, that consumers are spending too much, saving too much. Or is that pretty healthy behavior?

Mr. Koo?

Mr. KOO. I think consumers were shell-shocked after the so-called Lehman crisis because the whole economy collapsed and then everybody thought they would be losing jobs left and right. But that was countered very strongly by what the Federal Reserve has done, Treasury, everybody. According to the IMF, the amount of money the governments in the world threw in was something like $8.9 trillion. If you threw in $8.9 trillion to a problem, which is basically due to a policy mistake of allowing Lehman to fail, then people say, oh, we don't have to worry about so much after all. So they are coming back, which is good. That is the V-shaped recovery we saw from March of 2009 to the present period.

But whether we can extend this going forward, I am a little more skeptical, because all the balance sheet problems in the private sector, the consumers are still with us. And house prices are not recovering back to the bubble levels. They are still falling. And so these people will still have to worry about their balance sheets.

Many of them will continue to deleverage. And if that is the case, just because we recovered to this point doesn't mean we can stay here or that this recovery will continue. I think we have to be very vigilant.

Mr. FOSTER. I am very struck by your testimony from earlier in the year—I guess it was the snowed-out testimony—where you had drawn a curve that looks remarkably like the curve of household net worth that shows the $17.5 trillion drop in the 18 months to maybe the first quarter of 2009, followed by the approximately $5 trillion rapid recovery in household net worth and a much slower recovery since then, which seems like you had called that almost perfectly almost a year ago.

If we could go to Mr. Meltzer, whether consumer behavior seems appropriate or out of balance?

Mr. MELTZER. Consumers are uncertain about what the future outlook for jobs is going to be. So as long as they are uncertain about the future outlook for jobs, they are not going to spend for durables, for houses, in the rates at which we have become accustomed.

Now, as a country, we have a major problem, many problems, but one is that we owe the foreigners—the Japanese and the Chinese—billions and trillions of dollars' worth of debt. To service that debt, we have to export. That is the only way we are going to be able to service that debt. So we have to become a big exporter. And that means we have to invest more.

So I believe that what we are seeing is a gradual transition in that direction toward more investment, and less growth and consumption. That is going to be a hard adjustment for Americans who have gotten used to very rapid growth of consumption, and it is going to be hard as the devil on the rest of the world, which has gotten used to the idea they can make their economies grow by selling consumer goods to us. But that is an adjustment that has to be made.

So I would like to see much more emphasis on getting investment up, because that is where our future has to be.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

Mr. Green from Texas.

Mr. GREEN. Thank you, Madam Chairwoman. I thank the witnesses for appearing today. I have but one area of concern that I would like to address very briefly. We have three, perhaps many more, but three significant factors that impact unemployment: fiscal policy; regulation; and global demand. And what I would like to do—and perhaps, Mr. Meltzer, you would be the ideal person to move into this because you were just talking about global demand to a certain extent. I would like to know to what extent is global demand impacting the unemployment. Is it the most significant of the factors? Is it having have very little impact? To what extent is global demand impacting unemployment?

And, Mr. Meltzer, you indicated that we needed to get more exports moving so that we can pay off debt. Accepting that as a basic premise, will you start, please, by explaining to us to what extent you believe global demand is having on our unemployment within our country?

Mr. MELTZER. I can't give you a quantitative estimate. I am sorry. It is certainly a factor. If it were higher, especially from Europe, it would be—but our principal markets have been in the past Latin America. Latin America is doing well and we are exporting a lot to Latin America. But the quantitative impact in dividing it up between what is causing what, I am sorry, I can't say.

Mr. GREEN. I understand. I am sorry that this was not a question I submitted to you so that you might review and find studies. But, in your opinion—and I will ask the other two witnesses to respond—but in your opinion, Mr. Meltzer, would I be able to find studies that have looked into this? Do you believe that someone has tried to quantify this?

Mr. MELTZER. I am sure that people have tried to quantify it.

Mr. GREEN. Okay. Whether they have or not may be debatable, all right.

Let's start with Mr. Koo, please.

Mr. KOO. Of the three, I am sure global demand is a factor. Given this type of recession, what I call balance sheet recession, is happening in so many parts of the world at the same time, this is going to continue to be a challenge in that if the United States tries to export, everybody else has the same problem. Everybody wants to export at the same time. So I don't know how much mileage we can get out of global demand, because everybody is in the same boat at the same time.

The U.K. is now talking about increasing exports, Germans are talking about increasing exports. Everybody is talking about increasing exports. It is not going to happen. So I think at the end of the day, given that everybody has the same problem at the same time, I think we all have to put in the necessary fiscal stimulus to keep our GDP from falling, because otherwise, if everybody tries to export their way out, we fall into the 1930's type so-called competitive devaluation world, which will not be in the interest of anybody.

Mr. GREEN. Thank you.

Yes, sir?

Mr. MISHEL. If I interpret your question as what is our trade position and how has that changed and how has that affected our economic growth, one would say, I think, so far we actually are increasing our exports faster than our imports were increasing. But I think that recently has flipped and that, moving forward, imports are going to grow faster and that will actually be a drain on the recovery moving forward. Part of that has to do with exchange rate problems we have with China and other countries.

I just want to echo the fact that the hope that somehow exports are going to lead us out would only be true if we could export to Mars or the Moon because there is no one on this planet who is going to buy in sufficient quantity that will allow us to fuel a recovery.

Mr. MELTZER. We have to export or we are going to default on the debt. It is not pay back the debt, it is just pay the interest on the debt.

Mr. GREEN. If I may, Mr. Meltzer, because my time is about to expire. How would you address the premise that this is a common solution seen by many, all trying to implement it at the same time?

Mr. MELTZER. We are the inventive and productivity leader of the world, and the iPhone is selling all over the world. We have to have more iPhones. We get that by investment. We are an ingenious people with a free and flexible market. That is a great advantage.

Mr. MISHEL. Too bad the iPhones are not made here.

Mr. GREEN. Mr. Koo, your response as well?

Mr. MELTZER. Some are made here.

Mr. GREEN. Let me hear from Mr. Koo.

Mr. KOO. I believe the United States must export its way out. So in that sense, I am not against Professor Meltzer. I actually worked very hard in Japan trying to bring U.S. products in. I worked with Walter Mondale and Ambassador Armacost trying to open the Japanese market. I did a lot in that regard. But this is a very special moment. When all of the other countries have the same problem that we do, all in balance sheet recession, no one wants to increase fiscal stimulus, everybody wants to export, and when everybody has this problem at the same time, I think addressing the global imbalance problem should be put aside a little bit.

Mrs. MCCARTHY OF NEW YORK. The gentleman's time has expired.

Mr. GREEN. My time has expired, Mr. Meltzer. Thank you very much, Madam Chairwoman.

Mrs. MCCARTHY OF NEW YORK. All time has expired. The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

I thank the gentlemen for appearing before this committee. We thank you for the information that you have given us.

This hearing is closed.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

A P P E N D I X

July 22, 2010

<u>How to Avoid a Third Depression</u>
Testimony before the Committee on Financial Services
U.S. House of Representatives

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July 22, 2010

Nobel Laureate Paul Krugman argued in his recent essay, "The Third Depression," that "recessions are common; depressions are rare," adding that "both the U.S. and Europe are well on their way toward Japan-style deflationary traps." Remarkable similarities between house price movements in the U.S. this time and in Japan 15 years ago as shown in Exhibit 1 suggest that the two countries have indeed contracted a similar disease. The post-1990 Japanese experience, however, also demonstrated that ordinary recessions and depressions are actually two different diseases requiring totally different treatments.

<u>The key driver of depression</u>

The key difference between an ordinary recession and those that can lead to a depression is that in the latter, a large portion of the private sector is actually *minimizing debt* instead of maximizing profits following the bursting of a nation-wide asset price bubble. When a debt-financed bubble bursts, asset prices collapse while liabilities remain, leaving millions of private sector balance sheets underwater. In order to regain their financial health and credit ratings, households and businesses in the private sector are forced to repair their balance sheets by increasing savings or paying down debt, thus reducing aggregate demand.

The first casualty of this shift to debt minimization is monetary policy, the traditional remedy for recessions, because people with negative equity are not interested in increasing borrowing at any interest rate. Nor will there be many lenders for those with impaired balance sheets, especially when the lenders themselves have balance sheet problems. There is no reason why bringing back inflation or inflation targeting should work, either, because people are paying down debt in response to the fall in *asset* prices, not consumer prices.

More importantly, when the private sector de-leverages in spite of zero interest rates, the economy enters a deflationary spiral because, in the absence of people borrowing and spending money, the economy *continuously* loses demand equal to the sum of savings and net debt repayments. This process will continue until either private sector balance sheets are repaired, or the private sector has become too poor (=depression) to save any money.

To see this, consider a world where a household has an income of $1,000 and a saving rate of 10 percent. This household would then spend $900 and save $100. In the usual or textbook world, the saved $100 will be taken up by the financial sector and lent to a borrower who can best use the money. When that borrower spends the $100, the aggregate expenditure totals $1,000 ($900 plus $100) against the original income of $1,000, and the economy moves on. When demand for the saved $100 is insufficient, interest rates are lowered, which usually prompts some borrowers to take up the remaining sum. When the demand is too large, interest rates are raised, which prompts some borrowers to drop out.

In the world where the private sector is minimizing debt, however, there will be no borrowers for the saved $100 even with zero interest rates, leaving the economy with only $900 of expenditure. That $900 is someone's income, and if that person saves 10 percent, only $810 will be spent. But since repairing balance sheets after the bursting of a major bubble typically takes many years (it took 15 years in Japan), the saved $90 will go unborrowed again, and the economy will shrink to $810, and to $730, and so on.

This is exactly what happened during the Great Depression, where everybody was paying down debt and nobody was borrowing money. From 1929 to 1933, the U.S. lost 46 percent of its GDP due mostly to this debt-repayment-induced deflationary spiral.

The significance of Japanese experience

Japan faced the same challenge following the bursting of its bubble in 1990, when it lost wealth equivalent to three years worth of GDP on shares and real estate alone (the U.S. lost wealth equivalent to one year's worth of 1929 GDP during the Depression), and net debt repayment in the corporate sector shot up to more than 6 percent of GDP a year (Exhibit 2) on top of household savings of over 4 percent of GDP, all with interest rates at zero percent. In other words, Japan could have lost 10 percent of GDP every year, just as the US did during the Great Depression.

Japan managed to avoid the depression, however, because the government borrowed and spent the aforementioned $100 every year, thereby keeping the economy's expenditure at $1,000 ($900 household spending plus $100 government spending). In spite of nationwide commercial real estate prices falling 87 percent from their peak, Japan managed to keep its GDP above the bubble peak throughout the post-1990 era (Exhibit 3). Its unemployment rate never went beyond 5.5 percent, either. Private sector balance sheets were also repaired by 2005.

Although this fiscal action increased government debt by 460 trillion yen or 92 percent of GDP during the 1990-2005 period, the amount of GDP this fiscal action managed to sustain compared with a depression scenario was over 2,000 trillion yen, making it a huge bargain. Because the private sector was deleveraging, the government's fiscal actions did not lead to crowding out, inflation, or skyrocketing interest rates.

Since there is no name in the economics literature for an economic contraction triggered by private sector deleveraging or debt minimization, I called it a "*balance sheet recession*" to distinguish it from ordinary recessions. Balance sheet recessions are certainly rare, just as nationwide debt-financed bubbles are rare, and a depression is the ultimate form of an untreated balance sheet recession.

The world in balance sheet recession

Today the U.S., the U.K., Spain, Portugal, and Italy (but not Greece) are in serious balance sheet recessions with massive private sector deleveraging, even with near-zero interest rates. The Federal Reserve's Senior Loan Officer Opinion Survey indicates that demand for funds from businesses in the U.S. is still falling even with zero interest rates (Exhibit 4), and the banks have raised lending standards to very restrictive levels (Exhibit 5).

With disappearing borrowers and reluctant lenders, it is no wonder that,

after nearly two years of zero interest rates and massive liquidity injections, industrial production is still at the level of 2004, and the unemployment rate is almost in double digits.

Moreover, in all of the above countries, increases in private sector savings (including debt repayments) during the last two years have exceeded increases in government borrowings, which suggest that governments are not doing enough (Exhibit 6). Yet policymakers in many of these countries, spooked by what happened to Greece, have made strong pushes to cut budget deficits as quickly as possible. Unfortunately, the proponents of fiscal consolidation are only looking at increases in the deficit ((B) in Exhibit 6) while ignoring an even bigger increase in private sector savings ((A) in Exhibit 6). Removing government support in the midst of private sector deleveraging will repeat the Japanese mistake of premature fiscal consolidation in 1997 and 2001, which in both cases triggered a deflationary spiral and *increased* the deficit (Exhibit 7). In fact, Japan would have come out of its balance sheet recession much faster and at a significantly lower cost than the 460 trillion yen noted above if it did not implement austerity measures on those two occasions. The U.S. made the same mistake of premature fiscal consolidation in 1937, with equally devastating results.

There is actually no reason why a government should face financing problems during a balance sheet recession. This is because the amount of money it must borrow and spend in order to avert a deflationary spiral is exactly equal to the un-invested savings in the private sector (the $100 mentioned above) that is sitting somewhere in the financial system. With very few viable borrowers left in the private sector, fund managers in financial institutions should be more than happy to lend to the government, the last borrower standing. Although talk of "bond market vigilantes" is often invoked by deficit hawks pushing for fiscal consolidation, the fact that the 10-year bond yield in the U.S. today is only 3 percent—an unthinkably low yield given a fiscal deficit of over ten percent of GDP—suggests that bond market participants are aware of the nature of balance sheet recessions.

In Japan, where the private sector has grown extremely averse to borrowing after its bitter experience of paying down debt for over a decade, the 10-year bond is yielding less than 1.3 percent even with government debt of nearly 200 percent of GDP. The same aversion to borrowing by the U.S. private sector following its devastating experience of paying down debt during the Great Depression kept interest rates unusually low for thirty years, until 1959 (Exhibit 8).

Fiscal policy determines the effectiveness of monetary policy

It should be noted that fiscal stimulus is also needed to make monetary policy work during a balance sheet recession. This is because the money supply, which consists mostly of bank deposits, contracts when the private sector draws down bank deposits to repay debt. Although the central bank can inject liquidity into the banking system, it will be hard-pressed to reverse the shrinkage of bank deposits when there are no borrowers and the money multiplier is zero or negative at the margin. During the Great Depression, the U.S. money supply shrank by nearly 30 percent mostly for this reason (Exhibit 9).

Post-1990 Japan managed to keep its money supply from falling in spite of private sector deleveraging because government borrowing took the place of private sector borrowing and kept banks' assets from contracting. This is shown in Exhibit 10. The post-1933 U.S. money supply also stopped shrinking and started growing because the Roosevelt Administration began borrowing money for its New Deal programs, as shown in Exhibit 9. Fiscal stimulus is therefore essential in keeping both GDP and the money supply from contracting during a balance sheet recession.

Ending the panic was the easy part; rebuilding balance sheets is the hard part

Some people have become more optimistic or even complacent after seeing certain economic and market indicators improve from their trough in March 2009. The stock market, for example, has gone up nearly 60 percent during this period. This "recovery," however, is largely limited to a recovery from the policy mistake of allowing Lehman Brothers to fail. The collapse of Lehman sparked a global panic to "safety" that was far more severe than what would have been suggested by balance sheet problems alone. This panic-driven part of the collapse had to be countered with all the policy tools that could be mobilized, and the Federal Reserve, together with governments and central banks around the world, contributed some 8.9 trillion dollars in liquidity and guarantees for this purpose.

Since the panic was caused by the mistake of not safeguarding the liabilities of a major financial institution when so many institutions had similar problems, the panic dissipated when the mistake was corrected. That was the V-shaped recovery observed in some quarters since the spring of 2009.

Although the panic has subsided, all the balance sheet problems that existed before the Lehman shock are still in place. These problems are likely to slow down the recovery or smother it altogether unless the government moves to offset the deflationary pressure coming from private sector deleveraging. In other words, the recovery so far was the easy part ((B) in Exhibit 11). The hard work of repairing millions of impaired private sector balance sheets is just beginning ((A) in Exhibit 11).

Conclusion

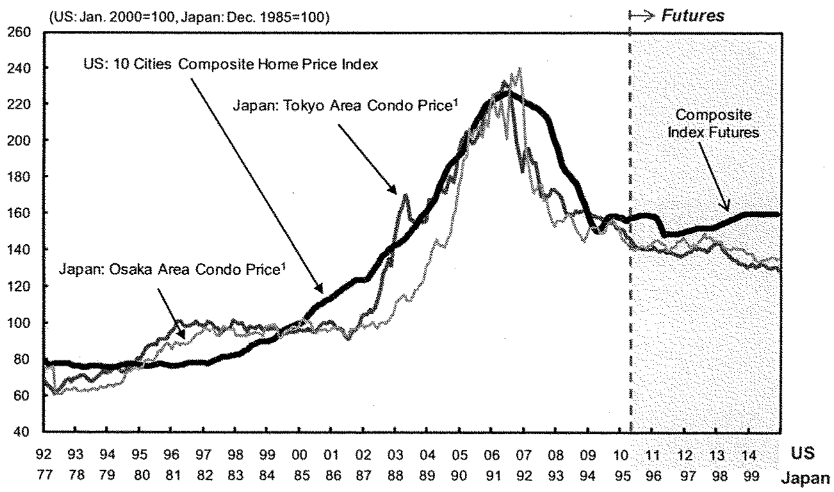
It is laudable for policy makers to shun fiscal profligacy and aim for self-reliance on the part of the private sector. But every several decades, the private sector looses its self-control in a bubble and incurs heavy financial damage when the bubble bursts. That forces the private sector to pay down debt even with interest rates at zero, triggering a deflationary spiral. At such times and at such times *only*, the government must borrow and spend the excess savings in the private sector, not only because monetary policy is useless but also because the government cannot tell the private sector *not* to repair its balance sheet.

Although anyone can push for fiscal consolidation by advocating higher taxes and lower spending, whether such efforts actually succeed in reducing the budget deficit is another matter entirely. When the private sector is both willing and able to borrow money, fiscal consolidation efforts by the government will result in a smaller deficit and higher growth as resources are released to the more efficient private sector. But once every several decades, when the financial health of the private sector is impaired and in need of treatment, a premature withdrawal of that treatment will both increase the deficit and weaken the economy. Key differences between the textbook world and the world of balance sheet recessions are summarized in Exhibit 12.

With massive private sector deleveraging still going on in the U.S. and in many other countries around the world in spite of historically low interest rates, this is no time to embark on fiscal consolidation. It is ill-advised for these countries to try to halve their deficits by 2013 as proposed at the recent G-20 Summit in Toronto. Such consolidation must wait until it is certain the private sector has finished deleveraging and is healthy enough to borrow and spend the savings left unborrowed as a result of the government's austerity measures.

As for the accumulated public debt, there should be plenty of time to pay it down because the next balance sheet recession of this magnitude is likely to be generations away. It will be generations away because those of us who learned a bitter lesson in the present episode will not make the same mistake again. That means the next bubble and balance sheet recession of such magnitude will happen only after those of us who remember this one are no longer here.

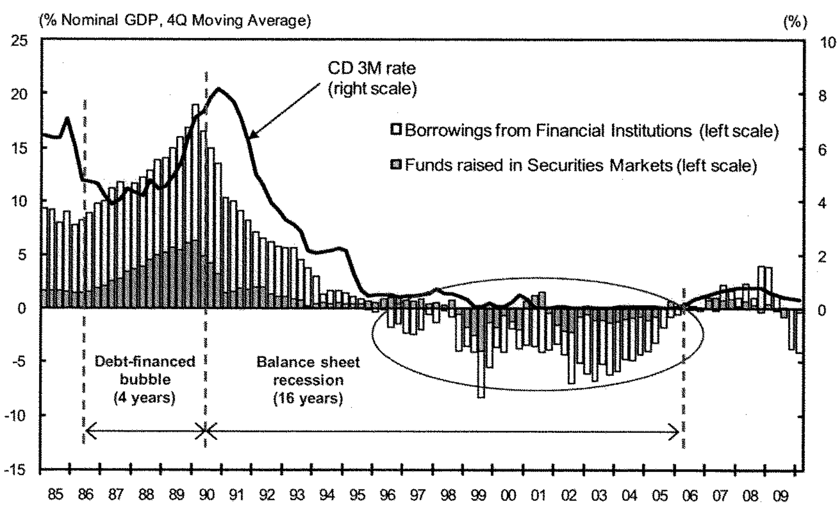
Exhibit 1. US Housing Prices Are Moving along the Japanese Experience



Note: per m², 5-month moving average
Sources: Bloomberg, Real Estate Economic Institute, Japan, S&P, S&P/Case-Shiller® Home Price Indices, as of Jul. 15, 2010

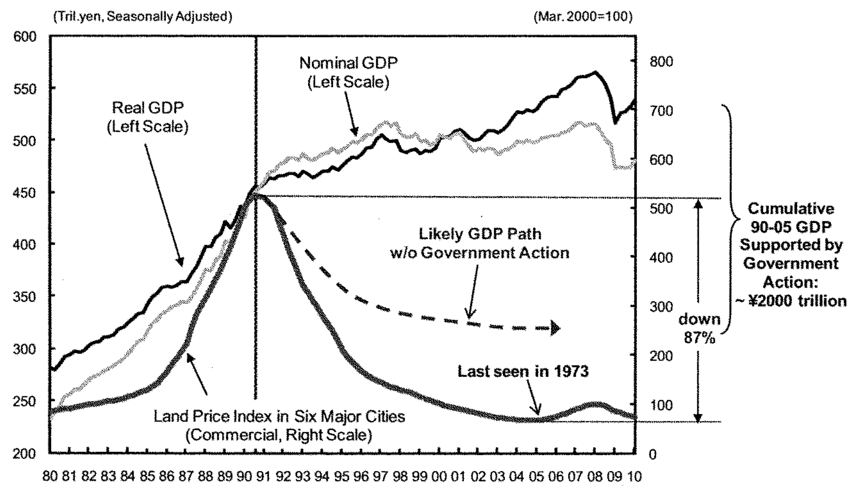
Exhibit 2. Japan's De-leveraging with Zero Interest Rates Lasted for 10 Years

Funds Raised by Non-Financial Corporate Sector



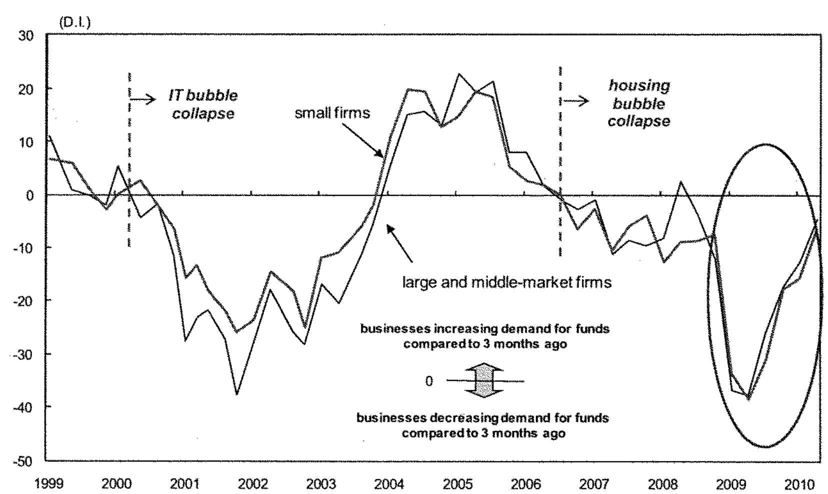
Sources: Bank of Japan, Cabinet Office, Japan

Exhibit 3. Japan's GDP Grew despite Massive Loss of Wealth and Private Sector De-leveraging



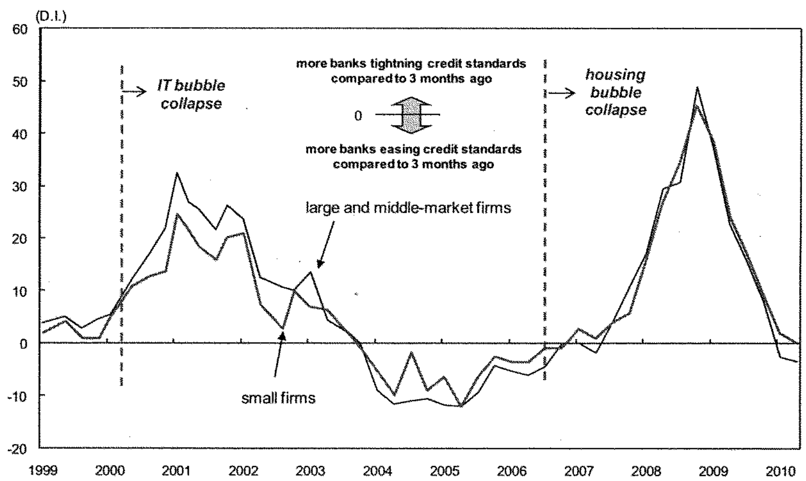
Sources: Cabinet Office, Japan Real Estate Institute

Exhibit 4. Demand for Funds from US Businesses Is Still Falling



Source: Nomura Research Institute, based on FRB, *Senior Loan Officer Opinion Survey on Bank Lending Practices*.
Note: D.I. are calculated from the answers to the question, "Apart from normal seasonal variation, how has demand for C&I loans changed over the past three months?"
D.I. = ("Substantially stronger" + "Moderately stronger"× 0.5) - ("Moderately weaker"× 0.5 + "Substantially weaker")

Exhibit 5. US Banks Have finally Stopped Tightening Lending Standards



Source: Nomura Research Institute, based on FRB, *Senior Loan Officer Opinion Survey on Bank Lending Practices*.
Note: D.I. are calculated from the answers to the question, "Over the past three months, how have your bank's credit standards for approving applications for C&I loans or credit lines changed?"
D.I. = ("Tightened considerably" + "Tightened somewhat"× 0.5) - ("Eased somewhat"× 0.5 + "Eased considerably")

Exhibit 6. Too Much Attention on Deficits (B),
Too Little Attention on Private Savings (A)

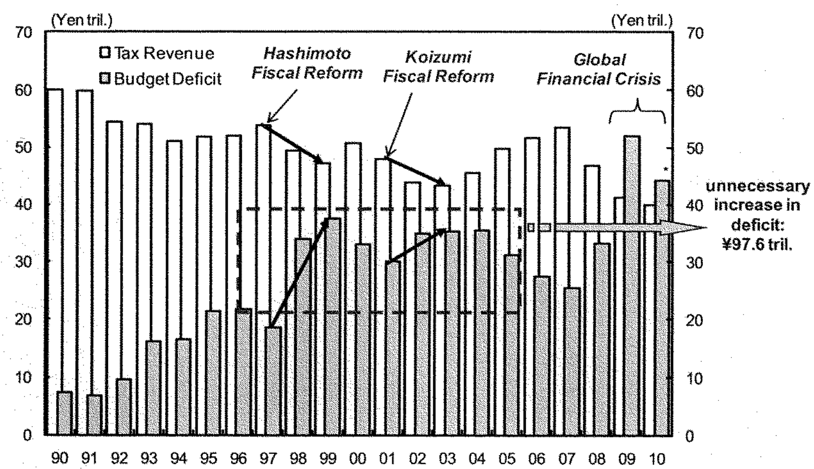
Countries in Balance Sheet Recession

(indicated as % of GDP)

	Changes in Private Savings (A)[1,2]	Changes in Government Deficits (B)[1]	Deflationary Gap (A-B)
Spain	+18.34%	+13.09%	+5.25
US[3]	+12.05% ~ +5.33%	+8.43%	+3.62 ~ -3.10
UK	+10.28%	+8.75%	+1.53
Portugal	+7.42%	+6.55%	+0.87
Japan	+5.95%	+4.71%	+1.24
Italy	+4.18%	+2.53%	+1.65
Greece[4]	+3.24%	+5.76%	-2.52

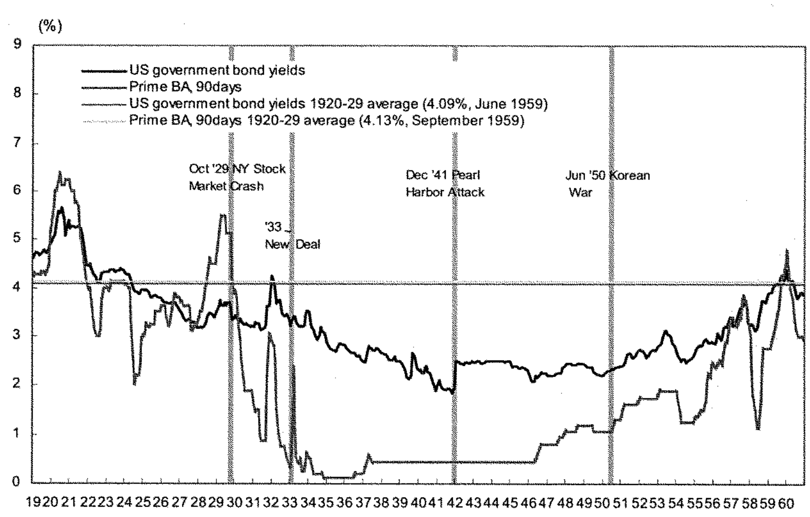
Notes: 1. Measured from the recent trough of private sector savings: Spain (2007), US (2006), UK (2007), Portugal (2008), Japan (2008), Italy (2008), Greece (2008).
2. Include debt repayments.
3. Huge range exists in private savings data because of problems with the US Flow of Funds statistics since 2008. Economic and market indicators suggest that the 12% figure is closer to the truth than the 5% figure.
4. NOT in balance sheet recession. Included for comparison purposes only.
Source: Nomura Resarch Institute, from respective countries' flow of funds data

Exhibit 7. Premature Fiscal Reforms in 1997 and 2001 Weakened Economy, Reduced Tax Revenue and Increased Deficit



Source: Ministry of Finance, Japan
*: estimated by MOF

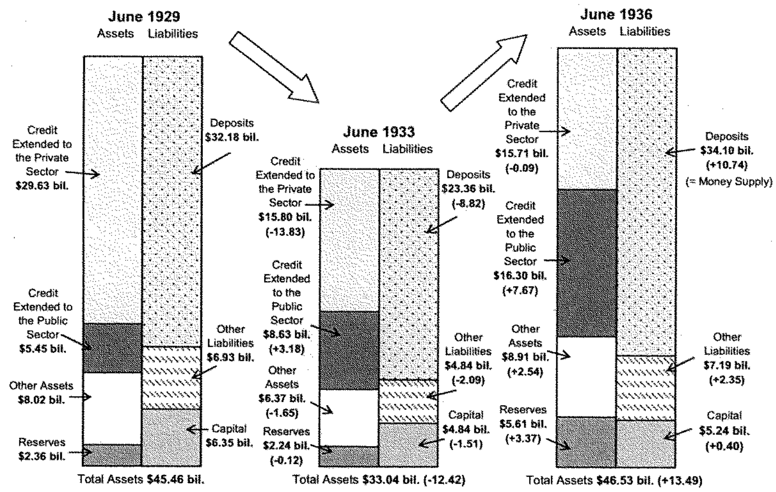
Exhibit 8. The Exit Problem: Debt Rejection Syndrome US Took 30 Years to Normalize Interest Rate after 1929



Source: FRB, *Banking and Monetary Statistics 1914-1970 Vol.1*, pp.450-451 and 468-471, Vol.2, pp.674-676 and 720-727

Exhibit 9. Post-1933 US Money Supply Growth Was also Made Possible by Government Borrowings

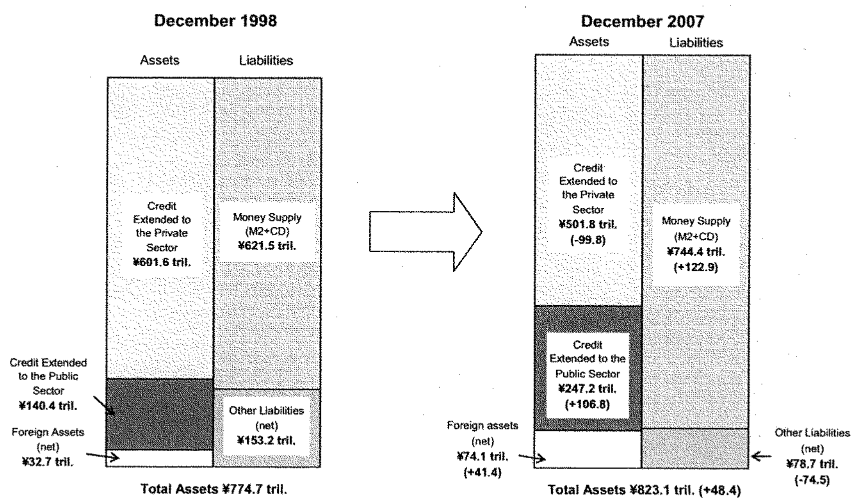
Balance Sheets of All Member Banks



Source: Board of Governors of the Federal Reserve System (1976) *Banking and Monetary Statistics 1914-1941* pp.72-79

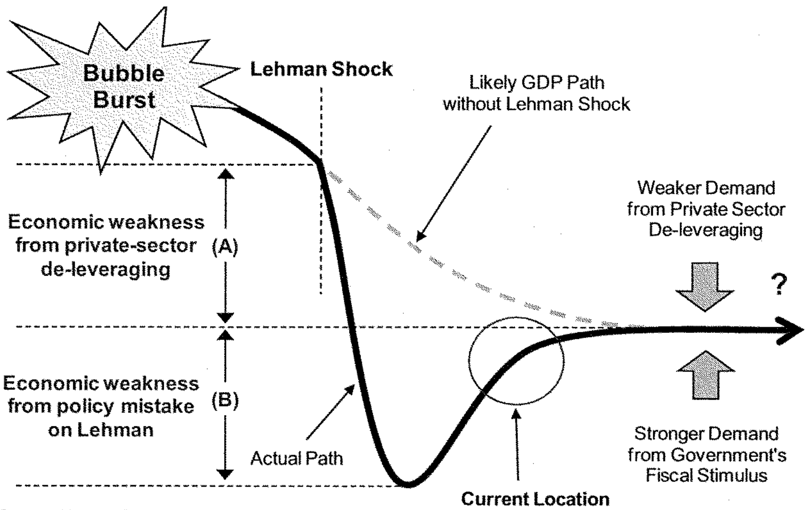
Exhibit 10. Japan's Money Supply Has Been Kept Up by Government Borrowings

Balance Sheets of Banks in Japan



Source: Bank of Japan "Monetary Survey"

Exhibit 11. Short and Long Term Trends of Global Economy



Source: Nomura Research Institute

Exhibit 12. Contrast Between Profit Maximization and Debt Minimization

Private sector behavior		***Profit Maximization***	***Debt Minimization***
1) Phenomenon		Textbook economy	Balance sheet recession
2) Fundamental driver		Adam Smith's "invisible hand"	Fallacy of composition
3) Corporate financial condition		Assets > Liabilities	Assets < Liabilities
4) Outcome		Greatest good for greatest number	Depression if left unattended
5) Monetary policy		Effective	Ineffective (liquidity trap)
6) Fiscal policy		Counterproductive (crowding-out)	Effective
7) Prices		Inflationary	Deflationary
8) Interest rates		Normal	Very low
9) Savings		Virtue	Vice (paradox of thrift)
10) Remedy for Banking Crisis	a) Localized	Quick NPL disposal Pursue accountability	Normal NPL disposal Pursue accountability
	b) Systemic	Slow NPL disposal Fat spread	Slow NPL disposal Capital injection

Source: Richard Koo, *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession Updated*, John Wiley & Sons, Singapore, 2009, p.176

Richard C. Koo

Mr. Richard C. Koo is the Chief Economist of Nomura Research Institute, with responsibilities to provide independent economic and market analysis to Nomura Securities, the leading securities house in Japan, and its clients. Before joining Nomura in 1984, Mr. Koo, a US citizen, was an economist with the Federal Reserve Bank of New York (1981-84). Prior to that, he was a Doctoral Fellow of the Board of Governors of the Federal Reserve System (1979-81). In addition to conducting financial market research, he has also advised several Japanese prime ministers on how best to deal with Japan's economic and banking problems.

In addition to being one of the first non-Japanese to participate in the making of Japan's 5-year economic plan, he is also the only non-Japanese member of the Defense Strategy Study Conference of the Japan Ministry of Defense.

Author of many books on Japanese economy, his latest book "The Holy Grail of Macroeconomics - Lessons from Japan's Great Recession" (John Wiley & Sons, 2008) has been translated into and sold in four different languages.

Mr. Koo holds BAs in Political Science and Economics from the University of California at Berkeley (1976), and MA in Economics from the Johns Hopkins University (1979). From 1998 to 2010, Mr. Koo was a visiting professor at Waseda University in Tokyo.

In financial circles, Mr. Koo was ranked 1st among over 100 economists covering Japan in the Nikkei Financial Ranking for 1995, 1996 and 1997, and by the Institutional Investor magazine for 1998. He was also ranked 1st by Nikkei Newsletter on Bond and Money for 1998, 1999 and 2000. He was awarded the Abramson Award by the National Association for Business Economics, Washington D.C. for the year 2001. Mr. Koo, a native of Kobe, Japan, is married with two children.

What Do We Do Now?

By: Allan H. Meltzer, Tepper School

Carnegie Mellon University and

The American Enterprise Institute

Testimony, House Financial Services Committee, July 22, 2010

The recession has ended according to the statistical record. But unemployment remains high at between 9 and 10% with long-term unemployment at the highest level since the series began in 1948. Much of the public does not see improvement. Many will not believe the recession is over until they and others are back at work.

Why is this recovery slow, and what can be done to increase growth and employment? Let's start with some of the problems.

The fiscal stimulus helped very little. Economists have known for decades that temporary tax cuts have little effect. The Carter and the first Bush administrations provided additional evidence. Transferring large sums to state governments gave temporary relief to the states but shifted deficits from states to the federal government. Keeping teachers employed for a year helped some teachers for a year, but it does not do much for the unemployed production or service worker. And the teachers spend the year worrying about next year. That's not an outcome that leads to much new spending. Net effect on the economy is close to zero. And the states' problems remain. Most of the stimulus spending went to these programs and did very little for the mass of unemployed.

At issue is not whether the stimulus did some good. It is whether the government's policy and actions were well designed to restore stable growth with low inflation. Pressure for more stimulus makes clear that previous actions have not done what is needed.

Since the end of the Eisenhower presidency in 1961, the federal budget has been in deficit almost every year. The deficits have gotten larger and larger. And the reported deficits are dwarfed by the present value of promises for healthcare and retirement. Most everyone now agrees that our fiscal position is unsustainable. Unlike Japan, we do not finance the deficits with domestic saving; we borrow massively abroad. To service that debt to foreigners we must export more and import less. Americans have enjoyed a high consumption growth rate for many years. They must learn to live with a smaller consumption growth rate. Production must be used for exports, and imports must shrink. This can have a major effect on countries that grew by selling to us.

Uncertainty is the enemy of business investment and expansion. The future is always uncertain, but the administration has added greatly to the costly and unforeseeable future. Here is a short list, admittedly incomplete.

1) What tax rate will apply in future to income from investments made now?
2) What new regulations will be imposed on businesses?
3) How will existing and new regulations for pollution, financial services, and healthcare be implemented and what will they cost?
4) What will employee health care cost?
5) Will rules governing labor unions be changed to make unionization easier? How much will that add to production costs or increased outsourcing?

If employers have no idea about future costs, they are reluctant to hire additional workers. They satisfy increases in demand by asking current employees to work overtime.

What can be done?

Our current situation can be improved by reducing uncertainty and stimulating business investment. I emphasize investment because the United States must invest more to produce exports. Past experience suggests that reducing the corporate tax rate is an effective stimulus to investment. Arthur Okun, Chairman of President Lyndon Johnson's Council of Economic Advisers and a main architect of the Kennedy-Johnson tax program, analyzed the components after he left office. He concluded that the corporate tax cut was the most effective part of the program. Later work confirmed his conclusion.

Declare a three to five year moratorium on new regulations, including labor market rules and the new financial restraints, unless each new rule is approved by a super majority in Congress.

Develop and announce a precise, credible program of deficit reduction that specifies planned spending reductions and tax increases. Eliminate uncertainty about future tax rates and where the tax burden will increase by announcing the program now.

Announce correct, believable costs of providing health care under the recently approved legislation. Recognize that many states are unable to pay for additions to Medicaid. How much more will the federal government commit to this program? How will these costs be paid?

Use the remaining, unspent funds in the January 2009 stimulus program to reduce the corporate tax rate.

Reduce the risk of future inflation by implementing a gradual program to reduce the excess reserves in the banking system. Some economists argue that the risk does not exist. They point to the interest rate on longer-term Treasury bonds as evidence of diminished inflationary expectations. I believe this interpretation is wrong. Low interest rates on Treasury bonds indicate the uncertainty and fear that exists currently. Investors pay for safety by holding Treasuries and gold.

I recognize that my proposed program is not about to be implemented. You should recognize that high uncertainty about the future will continue and that sooner or later you must act on many of these issues. Growth will be slow and unemployment will remain far outside the range considered full employment if you delay.

Some economists actively urge more government spending and larger deficits. They neglect or denigrate concerns about the debt, the interest cost of servicing the debt, and the negative effect that large deficits and growing debt have on decisions to invest. Their arguments ignore the most important development in macroeconomics for the past 40 years—the careful integration of expectations about the future in dynamic economic models. A program that begins to lift uncertainty and reduce debt and deficits has a positive effect on private spending.

Recent efforts in Britain and in the euro area to reduce spending and deficits have been followed by currency appreciation there and other evidence of relief and more favorable expectations knowing that many governments are willing to act against future calamity. The United States must do the same. The longer we wait, the harder it will be to make an orderly transition. Start by curtailing new regulation and by implementing a program of current and future spending cuts and corporate tax reduction to increase current investment. Everyone knows that current deficits are unsustainable. A credible multi-year program that starts to reduce deficits will remove a major uncertainty.

Deflation

Deflation is a sustained decline in a broad-based price index. We do not suffer from deflation, and it is essential to separate a decline in some commodity price that has a large weight in the consumer price index, such as oil or gasoline, from a general decline in prices. Gasoline prices fell 39 % at an annual rate in the most recent three months. That drags down the increase in the consumer price index, but that's not deflation. A first lesson in elementary economics distinguishes between inflation or deflation and large changes in individual prices. We should not base policy on that error. We have in the past when the Federal Reserve in the 1970s attempted to offset large increase in the oil price. The result was deep recession.

Mention of deflation arouses memories of the Great Depression. That's another mistake. There have been 7 periods of deflation in the 97 years under the Federal Reserve Act. Some were large, 30% decline; some were small, 1 or 2% decline. Only one, 1929-33 brought the country close to disaster. Recovery from the others, most recently 1960-61, looks like any other recovery.

We know now that the 1929-33 disaster was caused by inappropriate monetary policy. That policy reduced money growth by 50%. By 1933, prices had fallen much less than 50%, so the correct expectation was a further deflation. Devaluing the dollar in 1934 brought an end to deflation by inducing sustained massive increases in gold that restored growth in the monetary aggregates and revived the economy.

Current monetary policy is very different from 1929-33. Businesses hold large cash balances. The banking system has over $ 1 trillion of excess reserves. We do not need more monetary stimulus. We need programs that get the banks to increase lending and businesses and consumers to increase spending. Reducing uncertainty and restoring confidence is the place to start.

The banks that report their forecasts to the Economist magazine do not predict deflation, except in Japan, for any of the developed countries that they monitor. Their current forecast for the United States in 2011 is 1.5 percent.

Congress gave the Federal Reserve a dual mandate. It is inefficient and costly to concentrate on one objective at a time. That's what caused the Great Inflation of the 1970s. The Federal Reserve should not repeat that mistake. A small increase in interest rates would maintain negative real rates.

EPI TESTIMONY

TESTIMONY GIVEN BY

Lawrence Mishel, Ph.D.
President
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IN A HEARING BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

"Monetary Policy and the State of the Economy"

Thursday, July 22, 2010
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Thank you, Chairman Frank, ranking member Bachus, and members of the committee for the opportunity to testify today. I am Lawrence Mishel, president of the Economic Policy Institute.

I have three messages for you today:

1. The nation's current jobs crisis is severe and there will be continued high unemployment—perhaps as high as current unemployment—through the end of 2011. This is an unacceptable outcome, and we should not and need not accept it. Many localities and particular demographic groups, particularly the workforce in minority communities, can expect under current forecasts to be living in depression conditions for several years to come. Therefore, it is incumbent upon Congress to act on a scale that will produce millions of jobs in order to put unemployment on a steep downward path.

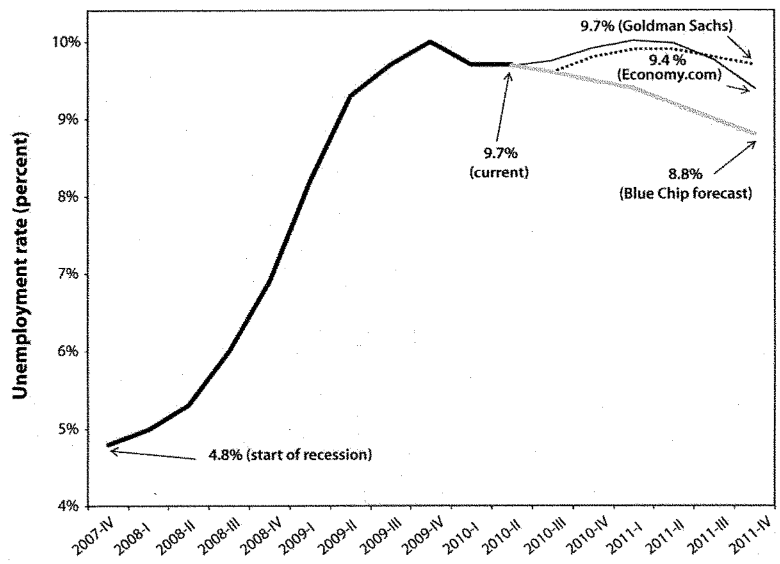
2. The only viable solution to this problem is an array of large and effective federal jobs initiatives, beginning with continued support for the unemployed, relief to state and local governments, direct job creation as provided in the Local Jobs for America Act and a commitment to a sizeable and ongoing program of public investment.

3. Deficit spending for the next few years under these circumstances is not just unavoidable, it is desirable. The main reason we have a large deficit is that we have a large recession that has reduced revenues and temporarily raised certain expenditures. Further efforts to generate jobs require spending to boost overall demand for goods and services, and any effort to offset that spending in the near term will only lessen the boost to demand. Therefore, the best policy approach is to provide some offsets that take effect in several years, such as the institution of a financial transactions tax, or to have no offsets at all. It should be noted that spending on items such as unemployment insurance will generate jobs and income and generate extra revenue and reduced expenditures as a result: the net impact on the debt is just 40% of the actual sticker price of the legislation.

THE JOBS CRISIS IS SEVERE AND THERE IS NO END IN SIGHT

The United States is undergoing the worst economic downturn in 70 years, and the damage and suffering it is causing will last many years beyond the official end of the recession. There are a few signs of hope: with the help of the Recovery Act, economic activity and employment are rising, although slowly; with federal assistance the auto industry has survived a near-death experience; and there is even a little growth in manufacturing employment. But we still have enormous problems. It is likely that unemployment will rise again before the year ends, and CBO forecasts that unemployment will average 9.5% next year, a rate historically associated with severe economic crisis. At the end of next year it is likely that the unemployment rate will be comparable to what we have now. As **Figure 1** shows, the Blue Chip forecast is for unemployment at 8.8% at the end of 2011. Some forecasters with strong track records—Goldman Sachs and Economy.com—suggest unemployment will be from 9.4 to 9.7% at the end of next year. Recall that unemployment started rising from its low level of 4.4% in the spring of 2007, reached above 9.0% in May 2009, and has stayed there ever since. Therefore, if unemployment remains above 9.0% at the end of 2011 it will have remained on that high plateau for over two and a half years (after having steadily risen for two years before that). Note that unemployment never exceeded even 8.0% in the last two recessions. The problem is that even though we have had economic growth since mid-2009, it has not been rapid enough to absorb all of the new entrants to the labor force as the population expands (roughly 100,000-125,000 per month) or employ any significant portion of the unemployed. That appears to be the case going forward through the end of 2011 as well.

Unemployment rate projections



As you know, the current unemployment rate of 9.5% understates the extent of the distress in the labor market. Many workers are underemployed, including many working at part-time jobs though wanting a full-time job and some who have given up on looking for work and thus are not even counted in the official unemployment statistics. There were 25.8 million Americans underemployed in June—that is 16.5% of the labor force. The recession is even more severe among minority workers, with unemployment of 15.4% and 12.4%, respectively, for black and Hispanic workers. The Economic Policy Institute calculates that underemployment among minority workers is now roughly 24%. All the figures I am citing describe the number affected in a particular month. However, since there are flows into and out of unemployment each month, there are many more people affected over the course of a year. In 2010, I expect that roughly a third of the workforce and more than 40% of minority workers will be unemployed or underemployed at some point during the year. This experience will be repeated in 2011 as well under current projections. Last, the deep recession is also damaging those who remain employed, as wage growth descends to historically low levels and benefits are cut. Even actual cuts to wages themselves are becoming widespread.

There are still five jobless workers for every job opening—proof by itself that there is nothing most of the unemployed can do to find a job. Businesses aren't hiring because, as the Council of Economic Advisers has noted, there is still a huge shortfall in demand. The jobs just aren't there to absorb new workers and bring the needed reductions in unemployment. Even though job openings have increased lately, they still remain one-third below the number being generated on average in 2007 before the recession (during 2007, even with those job openings, unemployment rose throughout the year).

The result is record levels of long-term unemployment. In June, nearly half (45.5%) of all unemployed workers had been unemployed for over six months. That translates into 6.8 million long-term unemployed workers, by far the highest level since the Great Depression—the previous high was 26% in June 1983. Roughly one-fourth of the unemployed, 3.7 million workers, have been unemployed for more than a year.

We are now 7.5 million jobs below where we were when the recession started. And that enormous loss doesn't tell the whole story: because the population is growing all the time, we need to add jobs every month just to keep the unemployment rate from rising. Over the two years and six months since the recession began in December 2007, we needed to have *added* around 3.1 million jobs simply to keep up with population growth. The job shortage in the labor market is thus roughly 10.6 million jobs. To put this all in perspective, consider the following: in the boom of the late 1990s, the fastest year of employment growth was 2.6% in 1998. If we somehow achieve that extremely strong level of growth, month after month, from today onward, we would still not get unemployment rates down to pre-recession levels (5.0% in December 2007) until January 2015. Unfortunately, as of today no policy has been enacted that would allow us even to hope for that rate of job creation in the coming years.

The challenges ahead are well known and easy to specify. First, if the deficit reduction that is needed in the medium term is started prematurely—meaning this year or next—it will weaken the recovery. We recommend that deficit reduction, other than that occurring from a healing economy producing more jobs, more revenue, and less emergency spending, not begin until the economy achieves 6.0% or lower unemployment for at least six months. This would assure that there is sufficient momentum toward reaching full employment before undertaking deficit reduction that will offset some of the growth. Second, state and local governments as they move their budgets into balance could lay off hundreds of thousands of their employees and lead to an equal number of employment losses in the private sector. The combination of program cutbacks and revenue increases (which will lessen overall demand) undertaken by state and local governments will act as an 'anti-stimulus'. It is likely that there will be substantial employment reductions in the next six months as a consequence. Our research indicates that as many private sector as public sector jobs will be lost. This is because state and local governments provide many services through private firms, such as hospitals and nursing homes, but also because laid off public employees will curtail their spending in the private sector.

Third, the fiscal austerity being proposed in Europe will slow growth there and lessen our ability to export to them. Fourth, the economy is still wrestling with the substantial lost wealth from the housing and stock market crashes, the urge of households to deleverage—boost their savings rate and pay down debt—and a depressed construction sector. Final demand is still, as of the first quarter of 2010, more than 1% below the pre-recession level. Of course, we should have expected demand to grow by 2.5% to 3.0% each year. Thus, demand is still substantially reduced, unfortunately growing slowly now and in the foreseeable future. This shortfall in demand is the main impediment to growth and why the challenges to future demand growth just discussed—deficit reduction here and abroad, and cutbacks by state and local governments—are so dangerous.

Last, the poor performance of wage growth, which normally drives the growth in demand from consumers, will limit future demand growth. At this point wages are growing at a minimal rate and below the rate of inflation. This is despite a very fast growth of productivity. These trends have led to much higher profits, which aren't being reinvested because of a lack of growing sales opportunities, in other words, a lack of demand. Profits have, in fact, bounced back to their pre-recession levels. Federal policy should focus on reducing unemployment and lessening the downward pressure on wages so we can have household consumption growth contribute to higher levels of demand and overall growth.

JOB CREATION REQUIRES MORE FEDERAL INTERVENTION

Obviously, what the economy and the unemployed need is job creation, and Congress has to take responsibility for creating it. Some policy makers may be getting tired of having to deal with job creation and unemployment, but it is surely true that American families are even more tired of having to endure extreme labor market distress with no real end in sight. Because so much wealth—$12 trillion—was lost in the twin financial disasters of the housing market and the stock market crashes, consumer purchasing power and demand for goods and services have been greatly reduced. Consumer demand is further reduced because 15 million workers are unemployed and surviving either on unemployment benefits that are a fraction of their previous income, or no benefits at all. Another 9 million workers have part-time jobs—with part-time incomes—even though they want full-time jobs. This reduced demand discourages business investment: why add extra employees or new equipment if consumers can't buy what you produce? To maintain or increase their profits, businesses have been increasing productivity, squeezing more out of their existing workforce while resisting additional hiring. This has allowed corporate profits to return to the levels prevailing before the recession, but it has not allowed for income growth for most workers or for rapid job generation.

To break this cycle, Congress should: (1) Continue providing support for the unemployed, including restoring the extra weekly supplement and the COBRA subsidies that were not included in the recently passed legislation; (2) Provide relief to the states both for health and education, continuing the provisions included in the Recovery Act; (3) Provide robust support for infrastructure, including school modernization, and transportation investments that can fuel job growth going forward; and (4) Pass the Local Jobs for America Act, H.R. 4812, which Rep. George Miller has introduced in the House, along with 165 co-sponsors. Economic forecasters have been assuming the extension of the UI/COBRA program and fiscal relief to the states in their forecasts, so failure to do so means that the unemployment horizon will be more severe than I have already described. With the difficulty of enacting such measures, specifically unemployment insurance and state relief, forecasters have now begun to revise downward their estimates of economic growth and revise upward their estimates of unemployment.

If Congress does not want to accept the unacceptable, then it will need to enact the Miller bill and other measures to generate jobs. The Miller bill, for example, would distribute $100 billion in grants to state and local governments over the next two years to retain public safety and education employees, create new local government jobs, and help local non-profits create hundreds of thousands of jobs doing work that would improve their communities—everything from environmental clean-up to child care. The funds would be distributed by formula to every major jurisdiction based on unemployment and poverty to ensure that the areas that need help the most get the most help. Scores of organizations, led by the National League of Cities and the U.S. Conference of Mayors, have called on Congress to enact this legislation, which builds on a long history of successful public service job creation efforts dating back to the New Deal, but also including the Nixon Administration's Emergency Employment Act of 1971.

THE DEFICIT IS NOT A REASON TO FAIL TO ACT

The initiatives I have outlined above necessitate increased spending or lower revenue over the next couple of years, and thus they will add to the federal debt in the short run. While we do face longer-term budgetary challenges, we cannot be paralyzed into inaction—deficits are both necessary and appropriate with unemployment at current levels.

In fact, the best way to get our fiscal house in order is to ensure we have a vibrant, growing economy and enough jobs and taxpayers so that we as a nation can start to address the long-term budget. In other words, a major job creation initiative is complementary to any strategy for addressing our future fiscal imbalances.

Experts agree deficits are appropriate and desirable in recessions.

During times of economic contraction and/or high unemployment, deficits will naturally increase. As incomes and profits fall, tax revenues will decline as a share of the economy. Greater unemployment and lower wages will increase spending on a variety of social supports, including unemployment insurance and Medicaid. These "automatic" reactions to recessions imply that deficits will increase. Furthermore, policies enacted specifically to combat recession (through, e.g., infrastructure spending or tax cuts) will have an impact on the deficit as well, at least for the time-limited existence of such efforts.

Textbook economics as well as expert opinion are in agreement that deficits that arise from both the automatic reactions as well as from deliberate, counter-cyclical policy changes are appropriate and desirable to reduce the size and duration of the recession. See examples below for illustrations from experts who are thought to be "deficit hawks":

David Walker, President and CEO of the Peter G. Peterson Foundation: "I think it's very important to separate the short term from the structural. It's understandable to run deficits when you have a recession, a depression, or unprecedented financial services and housing-type of challenges and crises that we've had. That's not what I'm concerned about."[1]

Gene Steuerle, Senior Fellow, The Urban Institute, and co-director of the Urban-Brookings Tax Policy Center: "Contrary to much debate, getting the long-term budget in order does not require avoiding stimulus in bad times; it only means reasonable reductions in those levels in good times."[2]

Greg Mankiw, Harvard Professor and Former Chairman of the Council of Economic Advisors under George W. Bush: "It is a textbook principle of prudent fiscal policy that deficits are an appropriate response in times of war and recession."[3]

Isabel Sawhill, Senior Fellow, Brookings: "It is important to stimulate the economy now and not worry about the deficits needed to do this, but we should simultaneously be enacting legislation that will gradually phase in spending cuts and revenue increases over the next decade."[4]

Concord Coalition: "It may be appropriate for government to spend more than it taxes during downturns in the business cycle. The Concord Coalition has always recognized the importance of fiscal stimulus, so long as the stimulus is timely, targeted, and temporary."[5]

In fact, David Walker, president of the Peterson Foundation and a well-known deficit hawk, wrote an op-ed with me in February arguing that our short-term deficits should not be the focus of concern: rather, it is the longer-term structural deficits that we need to address. We argued that job creation is the immediate priority and that this will necessarily mean higher deficits in the short term. Since measures taken now to generate jobs have very little effect on our long-term imbalances, one should not invoke worries about future deficits as a reason to avoid creating jobs now. In fact, these are complementary strategies, creating jobs and more taxpayers now is the way to move the fiscal situation to a healthier place. In testimony before the Deficit Commission, Walker argued that deficit reduction should wait until unemployment falls below 7%, close to my recommendation that the target be 6% for six months.

A Potent Example of Job Creation and Helping the Victims of the Recession: the macro-economy of unemployment insurance.

The debate over the renewal of unemployment insurance was rather misguided from my perspective. While there is variation in "bang-for-the-buck" estimates of different types of stimulus spending, among economists there is a generally accepted hierarchy of the economic benefits of various stimulus provisions. CBO and other analysts base their GDP and unemployment projections on the fact that, aside from food stamps, government spending on extending unemployment insurance provides the greatest economic benefit to the economy of any form of stimulus spending. In other words, extending and expanding unemployment insurance benefits are among the most efficient things the government can do to generate jobs. The reason extending unemployment insurance is such good stimulus is that it gets money to people who are the most likely to have depleted their savings and thus tend to have no choice but to quickly spend essentially every dollar they receive on necessities found in their local economy. In other words, virtually every dollar spent on extending unemployment insurance benefits goes directly, and immediately, toward the purchase of local goods and services, providing an extremely efficient demand boost. Not only is extending and expanding UI benefits the right thing to do for the people hurt most by this economic downturn, it is also excellent economic policy.

We have estimated that the expansion of unemployment compensation since 2007, both the receipt of regular benefits during the first 26 weeks and the special extensions of weeks and extra weekly benefits, supported an additional 1.7 million full-time equivalent jobs in early 2010 that would not have been there otherwise. This helped offset the employment decline during the recession. This program has not only been effective at helping people and generating jobs, it has also done so at a bargain price. The ultimate impact of the accumulated debt is only 40% of the "sticker price" because the jobs and output generated by the spending bring in revenue and lessen the need for other safety net expenditures, such as Medicaid and food stamps. The result is that the spending creates jobs for the meager cost of about $37,000 per job. Unfortunately, the recent legislation excluded two provisions—COBRA subsidies and the weekly supplement to benefits—which provided about 300,000 jobs in early 2010. The result is that the renewal of the unemployment compensation program will provide more jobs than would be there otherwise, but fewer jobs than were being provided in early 2010. The cutbacks in the program, which were enacted for symbolic purposes to appear fiscally responsible, have in fact cost us jobs that could have been provided at a very reasonable cost.

Conclusion

Thank you very much for the opportunity to offer my perspective on the job challenges ahead and what can be done to address those challenges.

Endnotes

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