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THE ECONOMIC OUTLOOK

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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THE ECONOMIC OUTLOOK

THURSDAY, OCTOBER 22, 2009

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

The committee met, pursuant to call, at 10:04 a.m., in Room 210, Cannon House Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

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

Senators present: Klobuchar, Brownback, and DeMint.

Staff present: Paul Chen, Gail Cohen, Nan Gibson, Colleen Healy, Andrew Wilson, Lydia Mashburn, Jeff Schlagenhauf, Ted Boll, and Robert Quinn.

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

Chair Maloney. I would like to call the meeting to order. Meetings should start on time, even though it is a very difficult time and many people are involved in votes and activities in other committees. And I know other members are on their way. I welcome my colleague, Mr. Hinchey.

I most of all want to welcome Dr. Christina Romer, the President's Chair of the Council of Economic Advisers, and thank her very much for her hard work and her testimony today. The Council of Economic Advisers and the Joint Economic Committee were both created by the Employment Act of 1946 and share an important history of providing the White House and Congress with analysis of economic conditions and economic policy.

Our hearing today is on the economic outlook. The current Administration took office only 9 short months ago. And 9 months ago we have to remember that the economy was facing the worst economic crisis since the Great Depression, with GDP falling at its fastest rate in almost three decades. In January alone, 741,000 jobs were lost, but job losses of about 600,000 or more per month had started in November of 2008. Those punishing job losses continued for 5 straight months. However, thanks to President Obama and to the American Recovery and Reinvestment Act, we are finally seeing some signs of recovery. For example, the $35 billion obligation to states so far for education has saved 250,000 jobs for teachers in our nation's schools.

However, I am deeply concerned about the state of the labor market, as I have been since the start of this recession. GDP growth is of little comfort to the millions who have lost their jobs.

The unemployment rate is at an unacceptably high 9.8 percent. I am particularly interested in Dr. Romer's outlook on the labor market and additional measures that may be needed to boost job creation.

As the economy recovers, we must continue our commitment to the unemployed to ensure that working class Americans are not once again left out of the economic recovery, as they were under the Bush Administration. People are losing their unemployment benefits at alarming rates. In my home state of New York, close to half of the unemployed are losing their state unemployment benefits; and the same story can be told in states around the country. That is why I encourage the members of the Senate to follow the House in passing a bill that extends unemployment benefits.

As the 2001 recession subsided, the average American family was left behind. Job creation and median family income never recovered to the levels experienced during the Clinton Administration. We must do more to ensure that as we recover from this recession we do not see a repeat of the dismal job record of the Bush Administration, and this is a chart on that. One statistic I find striking is that, for every job opening, there are six Americans applying for that one job opening.

[The chart titled "The Bush Economy Slowest Job Growth of Any Administration in over 75 Years" appears in the Submissions for the Record on page 34.]

Despite this fact, the Recovery Act is working. In fact, it is softening the impact of the recession on workers. According to a report that the Council of Economic Advisers released last month, the Recovery Act reduced average monthly job losses by 169,000 in the second quarter of this year. In addition, the U.S. economy had 1 million more jobs in August because of the Recovery Act.

The report also notes that the Recovery Act has contributed significantly to economic growth. Using the latest GDP numbers, the Recovery Act raised GDP growth by 2.6 percentage points in the second quarter. In the third quarter, analysts expect an even larger, greater boost.

Next week, we will hold a hearing where the Bureau of Economic Analysis will report advanced estimates of GDP for the third quarter; and I am optimistic that the numbers will show that the bold actions taken by Congress and the Obama Administration are turning our economy around.

The Administration and Congress continue efforts to help create jobs. Just yesterday, the Administration announced a series of proposals to help small businesses, including tax relief to small businesses and promoting access to credit.

Dr. Romer, we thank you for your testimony; and I look forward to working with you as the committee continues our focus on fixing the economy, helping struggling families, and, above all, putting people back to work. Thank you for being here.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 35.]

I recognize my colleague, Mr. Brady, for 5 minutes.

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

Representative Brady. Thank you, Madam Chairwoman. I am pleased to join you in welcoming Chairwoman Romer before the committee this morning.

There are some encouraging signs that the recession may be nearing its trough. Commercial paper and corporate bond markets are functioning. The stock market is up. Housing prices may be stabilizing. Industrial production edged up 2.8 percent during the last 3 months. Job losses continue but are slowing.

In the October survey of economists, *The Wall Street Journal* forecasts that real GDP will grow at an annualized rate of 3.1 percent during the third quarter. Even if this forecast proves correct, the U.S. economy still suffers from many fundamental problems. In September, payroll jobs fell by 263,000, while the unemployment rate rose to 9.8 percent. The same *Wall Street Journal* survey also forecasts that the unemployment rate will rise to 10 percent by December.

Commercial real estate prices continue to fall. Because of the collapse of the market for commercial mortgage-backed securities, many property owners cannot rollover performing commercial mortgage loans at maturity. Regional and community banks are likely to suffer large losses on their commercial mortgage loan portfolios that may impair their ability to supply credit to families and small businesses.

I am concerned that any growth in the second half of this year may prove transient; and, consequently, the unemployment rate may continue to increase well into 2010.

Those in Washington should not kid themselves. A jobless recovery is no recovery for American workers. During the last 4 months of 2008, the Federal Reserve injected more than $1.3 trillion of liquidity into the U.S. economy. With the traditional lag between monetary actions and their effects becoming apparent in the real economy, this liquidity injection last fall supported real GDP in the second quarter and should boost real growth in the second half of this year.

Compared to the Federal Reserve's $1.3 trillion adrenaline shot, President Obama's stimulus spending pales. As of this month, only $173 billion, or 22 percent of the program's total, has been spent. To the view of many, too slowly, too wastefully, and too unfocused on jobs. Like the hunter in the party who takes credit for every bird that falls, stimulus promoters should be wary of taking credit for the results of unprecedented Fed actions that are casting a far greater influence over the economy's performance.

[The chart titled "Federal Reserve v. Obama Stimulus Spending: Who Did More to Strengthen the Economy?" appears in the Submissions for the Record on page 36.]

But neither liquidity injections nor fiscal stimulus can create a sustained expansion. As the chief executive and co-chief investment officer of Pimco noted, these government interventions are unsustainable sugar highs. If the United States is to avoid slipping back into a W-shaped recession, the private sector must once again become the driver of economic growth.

It is unclear how this handoff will occur. The balance sheets of U.S. families remain damaged from the collapse of housing prices and the excessive debts accumulated during the bubble years. The growth of personal consumption is likely to remain constrained. The large inventory of foreclosed homes is likely to dampen housing investment. Therefore, a sustained expansion must depend upon business investment and net exports.

Here is a major concern going forward. Entrepreneurs and business leaders make investment decisions based on their expectations of risks and return. Government policies affect these perceptions. Unfortunately, the Obama Administration and congressional Democrats have simultaneously dampened the expected returns and increased the risks associated with new business investment through their actions and inactions.

Higher income tax rates, higher taxes on capital gains and dividends are set to begin in 2011. The White House and Congress are proposing job-killing energy and international tax increases that will drive investment and jobs offshore. Congress has not acted in a timely manner to extend the research and development tax credit and the home buyers tax credit, as well as an increase in the net operating loss carryback period from 2 to 5 years.

Uncertainty about cap-and-trade and health care legislation further depressed business investment. Firms fear the additional energy costs associated with what many term the cap-and-tax bill that passed the House this summer and are unsure what the Senate may do. The various trillion dollar health care bills leave firms, especially small businesses in my district, confused and concerned about additional taxes and regulatory burdens; and, as a result, many companies in my district and around the country are delaying important investment decisions and the job creation that goes with it.

In short, the government's uncertainty and interference is quickly turning a rescue operation into an anchor around the private sector's neck.

With U.S. consumer spending lagging, a key opportunity at recovery lies in selling American goods and services overseas to recovering markets. Yet America is sitting on the sidelines while other nations are aggressively shaping these new markets.

The Doha round of negotiations remain stalled. Congress has not acted upon three completed trade agreements with Colombia, Panama, and South Korea, while competing countries reach agreements that leave American companies and farmers at a severe competitive disadvantage.

The United States is on an unsustainable fiscal course. According to the CBO, projected Federal deficits will swell, publicly held Federal debt from 40 percent of GDP at the end of the last fiscal year to nearly 70 percent at the end of fiscal year 2019. And this CBO projection is before adding new health care benefits and other costly initiatives. Moreover, the CBO projects that the growth of existing entitlement programs will drive Federal deficits and debt even higher over the long term.

Instead of resolving these imbalances and consequently protecting both beneficiaries and taxpayers, President Obama and con-

gressional Democrats are seeking to create new entitlement programs that would further damage our fiscal position.

Finally, the United States could face the risk of a dollar crisis in the future. Recent history in Asia and Latin America——

I would just finish with this, Madam Chairman. There is much to be concerned about in America's economy, and today is no time to be taking false credit for economic indicators.

I would yield back.

[The prepared statement of Representative Kevin Brady appears in the Submissions for the Record on page 37.]

Chair Maloney. Okay. The Chair recognizes Mr. Hinchey.

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

Representative Hinchey. Thank you very much, Madam Chairman.

Dr. Romer, thank you very much. Thank you for being here. Thank you for the leadership that you provide, and thank you very much for the positive directions in which the economy is now moving. And those positive directions are primarily based on the Economic and Recovery Act and the way in which that Economic and Recovery Act is being put into play.

And, as we know, the vast majority of it is still not in play. Only about 25 or 30 percent of it has actually been out there, and there is a lot more to come. We know how badly that is needed. We can see it very clearly and then speculate about it on the basis of this little chart that is up here, how during the previous Administration we not only experienced no growth, we actually saw the beginning of a serious decline in this economy.

And one of the main reasons for a decline in the economy is the failure of Administrations to invest in our own country. We saw huge amounts of spending outside the United States, of course, in the Bush Administration. On a monthly average, it was something in the neighborhood of between 10 and $12 billion a month spent in Iraq as a result of that illegal, illicit invasion of that country and how that was costing us so much money and degrading the economy here internally within the United States.

So the Investment and Recovery Act, so-called stimulus bill, is critically important. We need to keep moving on it in a very positive and forward way; and, as a consequence of that, we will see the economy continue to grow.

However, there are other aspects of the economic circumstances that we are facing that really need to be addressed as well. One of the things that we are confronting right now is the fact that we see a concentration of wealth in the hands of fewer and fewer people, more dramatically so than we have seen probably since the 1930s. And the concentration of wealth in the hands of a few multibillionaires and multimillionaires means that there is less money in the hands of blue and white collar working Americans.

Now, we know that the blue and white collar working Americans drive the gross domestic product; and without their ability to function effectively and have money, raise their families, deal with all of those issues, then the general economy suffers dramatically. And it will continue to suffer dramatically unless we are able to change

the circumstances that were created during the Bush Administration with regard to the way in which the tax system in this country has been put together.

One of the others aspects of this, of course, was the repeal of the Glass-Steagall Act by the Republican majority here in the Congress of the United States and, unfortunately, signed by the Clinton Administration, the Gramm-Leach-Bliley bill; and this is something that really needs to be addressed. Once again we are seeing huge banking operations, like Goldman Sachs, for example, bringing in very substantial amounts of money but also beginning to engage in the kinds of very complicated investments that were engaged in prior to the collapse of this economy and which stimulated that collapse.

So we are going to have to pay a lot of attention to that situation and focus our attention on the consequences of the repeal of that Glass-Steagall Act and on doing something to bring back some set of circumstances that are going to bring the banking system of America back into a rational position so that they are functioning not just in the benefit of a handful of people at the upper levels of those huge banks but also the way the banking system is supposed to operate, in the best interests of the general economy and the people of this country. So all of these things are critically important.

We thank you very much for all the leadership that you are providing, the positive things that you have done. We are very grateful to President Obama for the changes that he has made in the short time that he has been in office and the way in which he has reversed these economic circumstances from a deep decline to a situation now where it is being much more effectively managed and it is beginning to grow.

So, Dr. Romer, thank you very much for being with us; and we are looking forward to hearing your testimony and your response to questions. Thank you very much, ma'am.

Chair Maloney. Thank you very much.

Senator Brownback.

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

Senator Brownback. Thank you very much. Thank you, Chairman Maloney.

There we go. I had to give the button a little extra push.

Thank you for holding this hearing.

Let me first express my heartfelt condolences to your incredible loss. It was just stunning. I just don't know what to say other than you have been in my prayers and my thoughts.

Chair Maloney. Thank you.

Senator Brownback. Thank you, Dr. Romer, for being here today. I look forward to the testimony.

I have got a lot of questions on this. I hope you have got answers. Because I think there are a lot of questions to be asked.

I was not favorable towards the stimulus. I saw it as a government stimulus, not an economic stimulus; and it just seems to me that the numbers have, unfortunately, borne that out.

I want to clip through a couple of charts just if I can with you about what has happened in several key areas: Heavy and civil engineering construction, average monthly job loss pre-stimulus, I see 6,200; post-stimulus, 11,800. State and local government educational services average monthly job loss, pre-stimulus 6,000; 19.3 post-stimulus. Stimulus savings in creating jobs results from targeted sectors March to September——

I mean, you are looking at the total job loss in these categories; and it just doesn't seem like to me it has worked.

Now, I have been one on—for instance, Cash for Clunkers, I thought when the money came out of the stimulus program I thought that actually stimulated something. But that was $3 billion of the $750 billion. And if we are doing that with that piece of it, what is happening with the rest of it?

We have got numbers coming in from my state on spending versus job creation during that same period of time. It hasn't been particularly favorable. I am hopeful of having those before the end of the hearing.

But my point in saying all of that to you is that I think we did end up getting a government stimulus, and it hasn't created jobs. And you know the job numbers like anybody else and the job loss. And while we may have some green shoots showing up out there, people sure aren't going to feel like there is anything of a recovery until we start seeing job recovery taking place and that continues to happen in a very aggressive, high fashion and looks through the end of this year.

And, finally, I would hope you could address for us some the growing deficit and looking like the debt is going to be equal to GDP here in a short period of time. It seems to me that we are on the exact same path that the Japanese took in their lost decade of running up huge government debts, of not stimulating growth, and at the end of the decade having this massive debt that they wouldn't be allowed to join the EU if they had asked because they had too much debt, that we are on the same trajectory and building massive government projects that aren't creating the jobs and the growth in the economy.

This just seems to me that we have learned this lesson globally, and I would hope we would get back to an economic stimulus and not a government stimulus, and you can respond to some of those thoughts. Thank you.

Thank you, Chairman.

Chair Maloney. Thank you very much.

The Chair recognizes Mr. Cummings for 3 minutes. Then we will be followed by Mr. Paul and then Dr. Romer.

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

Representative Cummings. Thank you very much, Madam Chair.

I just want to start off by saying, let's root for the home team. Let's root for the home team. I get to a point where I see people with no insurance, people losing their jobs, people losing their savings, people losing opportunity, losing their companies—we have got to root for the home team.

Ms. Romer, I thank you for what you have done and what the President is trying to do. I am not coming here saying that all is rosy. We did not start with a rosy picture. And we have come a long, long way. And we need to all admit that, and we need to support this President. He is the President of the United States of America.

Let me go back and remind my colleagues that approximately 16 percent of this money was for tax breaks. We seem to forget that. We seem to also forget that 22 percent, approximately, was to assist states. Almost every single state has had phenomenal problems, almost every one of them, even those who act like they don't want to take the money.

We have kept people employed. We kept people serving other people. I know it has happened in my state. I know it has happened in South Carolina, where my parents are from. I know it has happened all over the place.

I know it has happened in Texas. I heard the governor of Texas complaining, but he was able to balance his budget with $12.1 billion, while he was complaining, with stimulus money. Duh?

So, you know, at some point I think—and is the recovery slow? Yeah, it is slow. But just a week or two ago we had the Bureau of Labor Statistics here, and they explained to us that it is going to be a slow process, that the jobs are not going to come just like that overnight. We have come a long way.

And I am not going to sit here and blame Bush or anybody. What I do know is that I have got people in my district who do not have a job, who don't have a job. And some kind of way——

And then I have seen others. We had Mr. LaHood, Secretary LaHood come in, and just a wonderful gentleman. The head of Transportation came into the Transportation Committee, which I am a senior member of. He came in a few weeks ago and said, you know what? After our friends on the other side of the aisle were complaining about a stimulus package, he said, let me tell you something. It is working. He said, when I travel throughout this country, I see people that told me just a few weeks ago they were drawing unemployment, and now they are working. That is what LaHood said, Secretary LaHood.

So, again, you know, we say that we are this great country, that we can accomplish anything. But then when it comes to this kind of thing we say, oh, the sky is falling. We will never get through. Well, we will get through. This is America, the greatest country in the world.

And I thank you, Madam Chair, for your indulgence.

Chair Maloney. Thank you for your statement.

Mr. Paul is recognized for 3 minutes, and then we are going to Dr. Romer.

OPENING STATEMENT OF THE HONORABLE RON PAUL, A U.S. REPRESENTATIVE FROM TEXAS

Representative Paul. Thank you, Madam Chair. Welcome, Dr. Romer.

I appreciate this opportunity to attend this hearing. I am sorry I have to leave shortly to do some votes, but I did want to make a couple points, and maybe you can follow up on this later on.

In the several years that I have been here, I have never met anybody that is not for a sound economy. Everybody is for the economy. Everybody debates the issues and what we should do. We have a Federal Reserve that dictates the money supply and what the interest rates should be, and they want a sound economy. Then the Congress writes the regulations. We have the regulating agencies that are supposed to give us a sound economy, and yet we have probably real unemployment close to 20 percent and still a lot of problems.

Although I find everybody wants a sound economy, nobody talks about a sound dollar. And I know you are interested and have worked in the monetary field. But we don't talk about what sound money is, and I don't know how you can have a sound economy without a sound dollar.

As a matter of fact, we talk too often about a weak dollar. We allow the Fed to devalue the dollar by printing too much money to accommodate the Congress. At the same time, we say, well, the Secretary of the Treasury has the job of maintaining a strong dollar at the same time the dollar keeps going down. And this has a lot to do with our imbalance of payments and all the problems that we face.

But a lot of people say, hey, this is great. A weak dollar is good for exports. You know, if you look at it from an individual level and you are a saver, who wants a weak dollar? Who wants to have their dollar lose their purchasing power? And yet we actually say, yeah, we should.

And I hear comments that come across and say, well, it is okay to have a weaker dollar as long as it is orderly. Well, if a weak dollar is bad, if it goes down and suddenly you are orderly, you are still hurt and you are penalized. But there should be no place in economics that argues the case that it is good to have a weakening dollar and see your purchasing power dried up. So my concern is that we don't talk about the value of money.

On the books still and the Constitution says that there is a definition for a dollar in terms of a weight of something that governments can't create, of precious metals. But, at the same time, under the law, the law says a Federal Reserve note is legal tender, and everybody has to obey all the laws doing it because a Federal Reserve note is a dollar.

But you ask them what is a dollar? Oh, we don't know what a dollar is. But there is nothing on the books that says the Federal Reserve note is a dollar.

This is like building a building with a measuring rod that constantly changes. I cannot see how you can ever have a sound economy without a sound dollar and getting back to defining what a dollar really is. Our Founders knew about this. They advised us. We have ignored it, and we are in a mess.

I yield back.

Chair Maloney. Thank you very much.

Now I would like to introduce Dr. Romer. She is the Chair of the Council of Economic Advisers. Prior to joining the Obama Administration, she was a professor of economics at the University of California, Berkeley; and before teaching at Berkeley, she taught economics and public affairs at Princeton University. Until her nomi-

nation, she was co-director of the Program on Monetary Economics at the National Bureau of Economic Research and served as vice-president of the American Economic Association, where she was also a member of the Executive Committee. She is also a fellow of the American Academy of Arts and Sciences.

She is known for her research on the causes and recovery of the Great Depression and on the role that fiscal and monetary policy played in the country's economic recovery. Her most recent work, with her husband David Romer, also an economist, shows the impact of tax policy, a report she did on government and economic growth.

Chair Romer is the recipient of a John Simon Guggenheim Memorial Foundation Fellowship, an Alfred P. Sloan Research Fellowship, the National Science Foundation Presidential Young Investigator Award, and the Distinguished Teaching Award at Berkeley. She received her Ph.D. from MIT.

Thank you so much for being here. We look forward to your remarks; and I apologize that some members of this committee will be going in and out for votes, including myself. Thank you so much for being here and for your many contributions.

Dr. Romer is recognized for as much time as she may consume.

STATEMENT OF THE HONORABLE CHRISTINA ROMER, CHAIR, COUNCIL OF ECONOMIC ADVISERS, WASHINGTON, DC

Dr. Romer. Thank you.

Chairwoman Maloney, Ranking Members Brady and Brownback and members of the committee, it is an honor to be with you today.

There is no question that the past year has been one of enormous challenges for the American economy. The recession that began in December of 2007 has been the worst that this country has faced since the Great Depression. The suffering that it has brought to American workers and their families has been terrible, and the toll that it has taken on American businesses has been great across the spectrum.

In my testimony this morning, I want to discuss the economic crisis and the efficacy of the policy response. I also want to talk about the outlook for the U.S. economy and describe what I see as the key risks to the forecast. And, finally, I want to discuss some of the policy challenges that are likely to face us going forward.

Let me start by talking about the shocks that hit our economy in this recession, and I think one way of describing the severity of the crisis that we faced that I find striking is to observe that the shocks that hit the U.S. economy last fall by almost any measure were larger than those that precipitated the Great Depression.

So this first figure shows you just some measures that economists use of the shocks hitting the system, and it compares them. The dark blue bars are what happened in the late 1920s; the light blue bars are the most recent episode.

So that first sign, a key causal factor in both downturns, was a decline in household wealth that lowered consumer spending. Now, in 1929, household wealth fell 3 percent. In 2008, it fell 17 percent, more than five times the decline in 1929.

Another factor creating uncertainty and restraining spending in both periods was volatility in financial markets. The variance of

daily stock returns is shown there in the middle column; and what you see is that that variance, measured using the S&P stock index, was more than one-third larger in the current episode than in the last 4 months of 1929.

Now, if falling and volatile asset prices were important in both 1929 and 2008, the defining feature of the crisis in both cases was a full-fledged financial panic; and one frequently cited indicator of the depth of the panic in September of 2008, if you remember, was the skyrocketing of credit spreads. Well, one spread that we can actually analyze going all the way back to the 1920s is that between the Moody's AAA and BAA bonds. Well, in the fall of 1929, the spread barely moved at all. By December of 1930, after we have had the first wave of banking panics, it had risen some 87 basis points, as you see. In contrast, this spread rose 187 basis points between August and December of last year.

Well, the result of these shocks, as we all know, was a rapidly contracting economy. Real GDP fell at a 5.4 percent annual rate in the fourth quarter of 2008 and at a 6.4 percent rate in the first quarter of 2009. Employment, which had been falling by less than 150,000 jobs per month before September, fell by an average of 622,000 jobs per month from October to March.

What kept the American economy from heading into a second Great Depression in 2008 and 2009 was the strong and timely policy response. The Federal Reserve, as has already been mentioned, began cutting interest rates in late 2007; and by December of 2008 it had brought its target for the Federal funds rate essentially to zero. As credit market after credit market froze or evaporated, the Federal Reserve created many new programs to fill the gap and maintain the flow of credit.

Now, Congress' approval of the—I think it is fair to say—not-always-popular TARP program was another crucial step. Creating a program that could be used to shore up the capital position of banks and take troubled assets off banks' balance sheets has proven both necessary and valuable. Similarly, Congress's willingness to release the second tranche of TARP funds last January gave the new Administration the tools that it needed to further contain the damage and to start repairing the financial system.

Now, a key piece of the policy response, again, as has already been described, was the American Recovery and Reinvestment Act of 2009. And in a report issued on September 10th, the Council of Economic Advisers provided estimates of the effect of the ARRA on GDP and employment. What this table shows you is our estimates of the impact of the Recovery Act on real GDP growth in the second and third quarters of 2009, along with estimates from a number of government and private forecasters.

Well, what these estimates suggest is that the Recovery Act added 2 to 3 percentage points to real GDP growth in the second quarter and three to four percentage points to growth in the third quarter. This implies that much of the modification of the decline in GDP growth in the second quarter and the anticipated rise in the third quarter is directly attributable to the Recovery Act.

Now, this next table shows the Council of Economic Advisers' estimates of the effect of the Recovery Act on employment relative to what otherwise would have occurred without the Act, again in the

second and third quarters of 2009 and again along with the estimates from a number of other forecasters. What these estimates indicate is that, as of August, the Recovery Act had raised employment relative to the baseline by between 600,000 and 1.5 million jobs.

All right, well, the other thing I wanted to talk about this morning is the economic outlook. Because of the unprecedented policy response, the economic outlook has improved markedly in recent months.

This next figure shows you the growth rate of real GDP since the end of 2007. Together, the light blue lines are the Blue Chip consensus forecast for GDP growth from 2009 quarter three through the end of 2010. The path of actual GDP growth emphasizes just how severe the current recession has been. Equally notable is the improvement of GDP performance in the second quarter of this year. Though still declining, the moderation in the rate of decline was the second largest improvement in real GDP growth in 25 years. The Blue Chip forecast shows that GDP growth is anticipated to be positive in the third quarter and each subsequent quarter through the end of 2010.

There is a substantial range of uncertainty around any forecast. However, if GDP growth for the third quarter is indeed positive, as anticipated, this would be strong evidence that economic recovery is under way.

This next picture shows the quarterly behavior of the unemployment rate, beginning with the business cycle peak in 2007 quarter four; and it again continues with the Blue Chip forecast. Consistent with the recent cyclical pattern, the unemployment rate is predicted to continue rising for two quarters following the resumption of GDP growth. Whether this happens and how high the unemployment rate eventually rises will obviously depend on the strength of the GDP rebound.

Leaving aside timing issues, the unemployment rate typically falls when GDP growth exceeds its normal rate of roughly 2.5 percent per year and rises when GDP growth falls short of this rate. With predicted growth right around 2.5 percent for most of the next year and a half, movements in the unemployment rate either up or down are likely to be small. As a result, unemployment is likely to remain at its severely elevated level.

This figure shows the quarterly average of the monthly change in payroll employment. The enormous declines over the last four quarters are graphic evidence of how horrible this recession has been for American workers.

Now, because the Blue Chip forecast does not exist for employment, we continue the graph here with a survey of consensus forecasts from the Survey of Professional Forecasters. These forecasts suggest that payroll employment loss will slow substantially in the fourth quarter of this year and that payroll employment will likely turn positive in the first quarter of next year. Importantly, as you can see from these numbers, employment growth is expected to be quite low, below about 100,000 per month through the end of the forecast in the third quarter of 2010.

All right, well, all forecasts are subject to substantial margins of error; and the errors are often particularly large at times like the

present, when the economy is near an inflection point. For this reason, I think it is important to consider the risks to the forecast.

First, there are reasons to think that GDP growth could be either weaker or stronger than the consensus forecast. On the weaker side, one concern is the leveling out of fiscal stimulus.

Fiscal stimulus has its greatest impact on growth around the quarters when it is increasing the most strongly. When spending and tax cuts reach their maximum and level off, the contribution to growth returns to roughly zero. Now, this does not mean that the stimulus is no longer having an effect. Rather, it means that the effect is to keep GDP growth above the level that it would have been in the absence of stimulus but not to raise growth further.

Most analysts predict that the fiscal stimulus will have its greatest impact on growth in the second and third quarters of 2009; and, by mid-2010, fiscal stimulus will likely be contributing little to further growth.

Related to this, continued tightness in credit markets is a concern. Quantity measures of lending and issues of corporate debt remain low, and small business owners in particular report significant credit tightness. On the other hand, as has been mentioned, credit spreads are down dramatically from the fall of 2008, suggesting some easing of conditions. While tight credit market conditions are a factor that could hamper recovery of private sector demand and tamp down further GDP growth.

On the positive side, surveys of consumer and business confidence have risen substantially in recent months; and the stock marked has increased as well. For example, the Conference Board's CEO Confidence Survey and the Business Roundtable's CEO Economic Outlook Survey show that business leaders have become more optimistic in both the second and third quarters of this year. The S&P 500 has increased some 62 percent from its low point in March.

If such measures continue to rise strongly, private demand could rise more strongly than anticipated, which would raise GDP growth. Now, typically, risks to the GDP growth would translate into risks to the forecast for employment and unemployment. If GDP growth falls substantially short of 2.5 percent per year, the unemployment rate would likely continue to rise and employment to decline. If GDP rises strongly, labor market indicators could improve more quickly. In addition, one has to worry about separate risks to the employment forecast.

So this figure shows you productivity growth going back to 1988. What you see is that—and the gray bars are recession periods. And what you see is that in the recoveries from the last two recessions productivity has risen strongly. This, together with slow GDP growth, resulted in unusually weak labor market improvement for several quarters following the business cycle troughs in the last two recessions.

Now, in the current recession productivity has increased substantially. If GDP growth comes in as expected in the third quarter, the rise in productivity will be particularly large. A continuation of this behavior could lead to weaker than expected employment gains and possibly continued job loss.

On the other hand, because productivity has risen substantially during the recession, it is possible that firms have pushed the productivity of current workers about as far as possible. In this case, GDP growth gains could translate particularly strongly into employment increases.

Now, while it is natural to focus most closely on real economic variables such as GDP and employment, much recent discussion has focused on the possibility of inflation. Some have expressed concern that the unprecedented monetary actions taken by the Federal Reserve and the similarly unprecedented fiscal actions taken by the Congress and the Administration have created conditions likely to result in inflation. Such concerns in my opinion are unwarranted in the near and medium term.

Historically for the United States, the main determinant of movements in inflation is the relationship between output and the economy's productive capacity, with additional influences from oil price movements and other supply disturbances. When output and employment are high relative to the economy's comfortable capacity, inflation rises, as it did in the late 1960s and the late 1970s. When output and production and employment are low relative to capacity, inflation falls, as it usually does during and after recessions.

Economic theory and evidence suggests that there is a relationship between monetary expansion or budget deficits and inflation, but it operates through the demand for goods. Rapid money growth and large budget deficits lead to inflation when they fuel growth in demand beyond the economy's normal capacity. Well, the behavior of inflation so far over this recession and forecasts of it going forward fit with this view.

This last figure shows inflation measures using both the Consumer Price Index, which is highly influenced by the behavior of food and energy prices, and the GDP Price Index, which is less influenced by those volatile components. What the figure shows is that both measures of inflation have fallen over the course of this recession.

Furthermore, measures of expected inflation, whether from professional forecasters, as shown in the dashed lines in the picture, surveys of consumers, or inferences based on interest rates on inflation-protected securities all show that expectations of inflation remain subdued.

All right, well, likely economic conditions I think present policymakers with many challenges going forward. First, the switch from decline to growth may lead to calls for the end to rescue operations. As the immediate crisis fades, there may be a tendency to wish to return to more normal policy positions. Such a premature end to stimulus would be misguided. The forecasts that I have described are largely predicated on continued fiscal ease and the Federal Reserve's announced policies that, quote, economic conditions are likely to warrant exceptionally low levels of the Federal funds rate for an extended period. Excessive moves towards fiscal policy tightening could lead to a return to output decline and a reacceleration of job losses. The current policies that have generated a dramatic turnaround in the economy need to be seen through to their completion.

A second challenge, as has been mentioned, that we face is clearly the budget deficit. The final numbers just released shows that in fiscal 2009, the deficit reached $1.4 trillion, or about 10 percent of GDP. The mid-session review released in August predicted a similarly large deficit in 2010 and substantial structural deficits even once the recession is over and the economy is fully recovered.

Such long-term deficits are unacceptable, and they need to be dealt with. Over the long run, sustained deficits crowd out private investment and reduce long-run growth.

Given the current precarious state of the economy, substantial near-term spending cuts or tax increases to reduce the deficit would threaten the recovery. However, the current efforts for health insurance reform present a critical opportunity to improve the long-run fiscal situation dramatically. Health reform that is at least revenue neutral in the short run and that genuinely slows the growth rate of costs in the long run is a crucial precondition for reducing the long-run budget deficit.

A third policy challenge that we face is the likelihood that labor market conditions will remain painfully weak through 2010. The suffering and potential permanent damage that a sustained period of high unemployment will bring is likely to spur calls for further action to stimulate employment growth and cushion the effects of unemployment.

As policymakers consider the options, rigorous evaluation of alternatives must be conducted. Particularly in the context of large budget deficits, the efficacy of different options must be considered. Whether expiring programs are continued or new programs are instituted should be decided on the basis of their efficacy in putting people back to work and in improving the future strength of the economy.

Well, as I described, the last year has been one of extreme challenge and aggressive policy response. That many analysts believe the low point of the recess session has been reached is perhaps the most concise evidence that the policies are working. A recession that showed no signs of ending last January appears to be firmly entering the recovery phase.

Unfortunately, despite this dramatic turnaround, the U.S. economy still faces many challenges. We enter the fourth quarter of 2009 with the unemployment rate nearing 10 percent and likely to remain severely elevated. The Congress and the Administration will need to continue their excellent record of policy coordination to not just start the process of recovery but to finally finish it.

Thank you.

[The prepared statement of Christina D. Romer appears in the Submissions for the Record on page 39.]

Representative Hinchey [presiding]. Dr. Romer, thank you very much. Thanks for that very comprehensive presentation of the situation that we are confronting, and we appreciate the opportunity now to ask you a few questions.

I just wanted to start briefly and talk about a few obvious things. One, of course, is the Economic Investment and Recovery Act and the way in which that money has been outlaid so far.

If you look at the way in which the money has been put out and made available and then attach to it the additional funding that

has been obligated but not yet put out, we are looking at something in the neighborhood of $280 billion out of the $787 billion. So we are talking about a fraction, small percentage of the available funding. Can you give us some indication of what you think of the way in which the effectiveness of the outcome of that spending, and what you anticipate to be the way in which the remaining funding will be allocated and for what specifically as much as possible? As much specifically for which it will be allocated?

Dr. Romer. Absolutely. You do point out that I think the Office of the Vice President that has been in charge of the Administration side of getting the money out the door has done a remarkable job in getting the money obligated, outlaid. I think you were also the one—or perhaps Mr. Cummings was pointing out that a tremendous fraction of what has already occurred are the tax cuts. That was one of the first things that we could get out the door.

Another thing that was very fast was the state fiscal relief. I think both of those have been incredibly important. We hear from the state governments over and over how crucial a lifeline that state fiscal relief has been.

We know the other thing that has gotten out quickly is a lot of the money to cushion the impact of the recession for those directly hurt. The increases in unemployment compensation, for example, have been absolutely important.

You know, our analysis, as I suggested, does indicate that it has been incredibly effective. In the report that we put out in September, we looked at various pieces of it. We looked, for example, at the state and local—the state fiscal relief and found that that showed evidence that it was very much working, it was affecting employment at the state level.

We also have done an analysis, as was mentioned, of the Cash for Clunkers program, which we think was something that was added or sort of a rearrangement of some of those Recovery Act funds that we think did add significantly to growth in the third quarter of this year. So absolutely we think that it has been important.

I think, going forward, one of the things that we can look forward to—and I described what had gotten out quickly, the tax cuts, the state fiscal relief. What is coming out sort of next is a lot more of the direct government investment. And that is important because we do think that the direct government investment has a bigger bang for the buck in terms of employment and GDP growth. And so that is one of the reasons why, even though levels of quarterly spending and tax cuts are kind of up or reaching their maximum level, the composition we think is moving towards something that is going to be even more effective.

Representative Hinchey. Well, thank you very much.

The additional spending of this money, the very important amount that is still pending is going to be critically important. You talked about that. And we hope and pray that that is going to be handled effectively.

One of the weaknesses of this Investment and Recovery Act has been the way in which it was engaged here in the Congress to try to get enough support from a variety of other people. I think it could have been much more effective if it had been specifically

adopted to the kinds of spending that we need to create additional jobs. That is the most important thing.

Now, one of the things that we have in the context of this economy, which has been negative for some time, is investment outside of this country; and I am wondering to what extent your recommendations or others may be focused on this particular issue. How are we going to reduce the investments that are engaged in outside of this country? How are we going to change the tax rates that are in play so that the taxes that are owed are actually going to be paid internally here to deal with the circumstances that we are confronting? And how that would bring about the creation of a substantial number of jobs in this country.

Dr. Romer. No, you are absolutely right. When we think about what generates growth, what generates job creation, investment is incredibly important. I mean, one of the things that—the Recovery Act did two things that I think are so important, right? Obviously, it did public investment. So rebuilding our roads and bridges, putting in some very forward-looking investments in health information technology, in broadband, in the smart electrical grid. All of those are things that increase our productivity over time but also increase jobs right now as we put those into place.

But we also had in the Act incentives for private investment, right? So a lot of the tax treatment of investment, of research and development investment. We think those are incredibly important, again, for encouraging firms to do the investments right here and for creating the jobs right here.

Also, the Recovery Act just had unprecedented incentives for investments in particular areas like alternative energy and weatherization and those kind of things, which again we think are likely to be job creators and a direction that our country needs to go.

So I couldn't agree with you more that fostering investment is both good in the short term for job creation but is one of those fundamental things that it is a win-win because it makes us richer in the future.

Representative Hinchey. Well, thank you very much. I appreciate what you are saying. Perhaps we might be able to work closely with you and with the way in which the Vice President is operating this to engage in this more specifically and perhaps, in the context of that, more effectively. In any case, Dr. Romer, thank you very much for everything you have done.

I would like now to recognize Mr. Brady.

Representative Brady. Thank you, Mr. Chairman.

Dr. Romer, while I respectfully disagree with your economic analysis, I am always appreciative of how open you are and how accessible you are to this committee. So thank you for being here today.

You know, I believe the stimulus benefits are widely exaggerated. Forty-nine out of fifty states have lost jobs since the stimulus took effect. The unemployment rate is far above the 8 percent we were all promised it would be. When you look at this chart, this is the comparison to the White House promises on what would occur with the stimulus. And you can't—it can't be claimed that the economy is worse than anticipated, because at the time we warned from this panel that the economic projections of the Administration were far too rosy. And these exaggerations I think have become es-

pecially clear when compared to the Fed's actions that show, whether you agree with their unprecedented actions or not—and there is wide disagreement—I think economists widely agree that the Fed's monetary actions have been far more influential on this economy than the stimulus.

[The chart was not available at the time of publication.]

But the negative impact of spending the money in the stimulus and this budget and the continuing appropriations which just blow through any notions of fiscal responsibility is the deficit. The deficit this year is nine times greater than when control of Congress moved from Republican to Democrat control; and it gets worse over the next decade, more dangerous.

Today, this morning, Moody's has warned the United States may lose its AAA credit rating unless the Federal Government significantly reduces its budget deficit below current forecasts over the medium term. Since Alexander Hamilton was Secretary of the Treasury, the U.S. Government has been the world's most creditworthy borrower. So the question is, what is President Obama's fiscal exit strategy to bring the budget into balance over the medium term?

Dr. Romer. All very good points. Let me actually respond to several of them.

First, your chart about the Federal Reserve—as I made very clear in my testimony, I am a big fan of their actions. I think in terms of the recovery, I am very happy to share credit, that I do believe actions the Federal Reserve took, especially last fall, were very important.

I think the important thing to keep in mind is, once the Fed had gotten interest rates basically down to zero, that is when they lose a fair amount of their ability to affect the economy; and that is precisely because the Fed, we felt, was out of firepower, that we thought it was incredibly important to augment that with the other tool that we have, which is fiscal policy.

The second thing is to talk about your graph about where we are versus where we had predicted. I will be the first to admit that I didn't have a crystal ball back in December and in January. I think it is actually very misleading to say that because the unemployment rate is higher than we predicted that is a sign that fiscal stimulus isn't working.

I used an analogy back in August that if you go to a doctor with a strep throat and he gives you medicine and the next day, maybe even after you have taken the first pill, your fever spikes, you don't say, ah, see, the medicine didn't work. Right? You probably say, my goodness, I was sicker than my doctor and I thought; and it is very good that we got to the doctor and started taking the medicine. And I feel that is exactly the situation that we are in.

The third thing about the budget deficit, I agree it is large and it is a problem. I think we need to keep in mind why it is large now. It was large really for three reasons. One is simply the recession. We know that nothing is as bad for revenues as an unemployment rate approaching 10 percent. It is also high because of actions that were taken in the last 8 years that we did not pay for, things like the expansion in the prescription drug program, the wars, as has been described, and tax cuts.

And then, of course, there is—so, anyway, so we certainly—and then there are the actions—the unprecedented actions that we have had to take to try to get us out of the recession. And the important point there is, you know, as big as the fiscal stimulus sounds or as big as the TARP money sounds, the truth is those are one-time programs. And when you look at what they are contributing to the budget deficit over the 10-year horizon, they are actually a very small fraction of it.

What are we going to do to get it under control?

Well, the first thing we have to do is get the economy recovered. And that is precisely why we have focused so thoroughly on putting people back to work, that that is good for people, it is good for the economy, and it is good for the budget deficit.

And then, as I mentioned, we are in the middle of probably the most important thing we could do on the deficit, which is to pass responsible health insurance reform that doesn't add a dime to the deficit, as the President said, and in fact over the longer run genuinely slows the growth rate of costs so that it improves the deficit.

Representative Brady. Thank you, Doctor.

As I turn it back to Chairman Hinchey, I ask, will the Administration be bringing a fiscal exit strategy to Congress this year?

Dr. Romer. Certainly, it is something—we are going to have to provide our 2011 budget. And in every year we have been thinking about, as we did last year, what is the path that we are on?

Again, I very much want to hesitate—I like your term of "exit strategy." I think the thing that worries me the most is when people talk about exits. Because in the situation that we are in, as I mentioned, I think a move to fiscal tightening while the unemployment rate is high and rising would be very bad for the economy. But, absolutely, we need to have a strategy going forward; and it is something that I am sure we will be working very closely with the Congress to put in place.

Representative Brady. Thank you, Dr. Romer. Yield back.

Representative Hinchey. Thank you, Dr. Romer.

Mr. Cummings.

Representative Cummings. Thank you very much, Dr. Romer, for your testimony.

I would like to talk to you about Social Security briefly. The latest Social Security Administration calculations show that the average individual monthly benefit is $1,012, which works out to about $12,744 annually. We saw the President endorse a flat $250 cost of living increase for Social Security retirees and beneficiaries. That works out to 1.96 percent on the average. And, you know, when you think about it, just the cost of medicine has gone up probably more than that. I just want to know your feelings on that and what is the thinking behind that. What do you see?

Dr. Romer. All right. Well, you surely know that Social Security benefits are indexed to inflation. And as the numbers that I showed you—maybe it would even help to put them back up. We see the Consumer Price Index there, and what had happened was it had certainly gone up substantially in 2008, and that is why Social Security benefits last year got a very hefty cost of living adjustment.

And then what you actually see is that the Consumer Price Index, which includes things like gasoline, it would have prescrip-

tion drugs in there, but on net has fallen dramatically. And that is why, the way the law is written, seniors would not get any cost of living increase. We don't—the law is written, when prices go down, we don't reduce benefits, obviously, but it would have caused for it to be flat.

The Administration's thought was that, given we were in a recession, given that we do know seniors are facing many special challenges, given how hard this recession has been for everyone, we thought a responsible way to deal with the fact that there was no cost of living increase called for by the law was to do an extension or a repeat of the one-time payment that we did last year, sort of the equivalent of the making work pay tax cut that we did last year for working families.

We think that that is a reasonable compromise. One of the reasons—so, anyway, we think that is both more fiscally responsible than putting, say, an ad hoc cost of living adjustment but a way of acknowledging that seniors are suffering—everyone is suffering—and a way of getting a little more spending going in the economy.

Representative Cummings. Do you think that Social Security should consider moving to a different type of index?

Dr. Romer. I think right now the law is certainly very clear. And there is always discussion of are there other price indices that might be more accurate, but that is certainly something that I am sure the Bureau of Labor Statistics could tell you much more than I.

Representative Cummings. Let's talk about unemployment benefits for a moment.

As we know, states have borrowed some $19 billion from the Federal Unemployment Trust Fund to finance benefits. Going out on a limb, do you think this borrowing has had a negative impact on state bonding ratings?

Dr. Romer. Well, certainly we know that state governments in general have been very hard hit by the recession; and many states, including my own of California, have had a very hard time with what is going on. I think it is part of a general problem, right?

So state revenues are down dramatically. State spending in general on programs to help deal with people suffering through the recession, that spending goes up. I think all of those things have contributed to the problems that they faced, and a piece of that would be what they are having to pay for unemployment insurance.

Representative Cummings. And conversely, I take it that you are of the belief that the whole state fiscal stabilization funds in the stimulus have had a very positive impact. Is that right?

Dr. Romer. Oh, absolutely no question.

Representative Cummings. And how do you determine that?

Dr. Romer. Well, so, actually, we did a very interesting study in our office. Because one of the problems that you have is states that were in more trouble tend to get more state fiscal relief, right? So there were rules put in place like if you had a higher unemployment rate. So it is a hard statistical exercise to figure out how state fiscal relief is affecting employment.

But what we did in our office is to look at, you know, a piece of the state fiscal relief was determined by just your FMAP, your

Medicaid matching rate and what it had been before the recession. And so that got some variation across states in how much money they got. And then we went and looked at, well, what had happened to their employment state by state? And we absolutely found that states that got a little bit more money were doing a little bit better on employment relative to otherwise. We thought that was very strong evidence.

And I will tell you it is on the CEA Web site if anyone wants to look at the study.

Representative Cummings. The new-hire tax credits, what is your feeling on those?

Dr. Romer. I think again, as I suggested, given how high the unemployment rate is, I know there is a lot of discussion in Congress, I know there is a lot of discussion within the Administration that do we need to do more; and, if we do more, what should it look like? An employment tax credit is something that the President had certainly talked about back in the campaign. I think it is one of the options that should certainly be on the table as something that might have a particularly large impact on employment. But you would be weighing that against more state fiscal relief, against what we might want to do on infrastructure, as was mentioned earlier, investment in the economy. So there are a range of things, but I think the important thing is that we talk about them and figure out which one has the biggest job bang for the buck.

Representative Cummings. Thank you, Mr. Chairman.

Representative Hinchey. Thank you, Mr. Cummings.

Mr. Brownback.

Senator Brownback. Thank you, Mr. Chairman.

Dr. Romer, I want to give you kind of some input from the field of what I am seeing and hearing people say. Kevin Brady and I obviously have great skepticism about the impact of the stimulus, and the numbers aren't what the Administration projected they would be. But I understand your position on it.

What I am getting from people as I am traveling around is they can't get credit. If you are a small business, a mid-sized business, you can't get credit. If there is anything associated with real estate in any fashion, you not only can't get credit, there is not a market if it is commercial real estate. So that people are just sitting on assets, and even banks are sitting on assets, that they don't put them on the market because they can't sell them. And if they did put them on the market, it would scare and mark down the entire region.

The biggest complaint I get is that people can't get credit, and anything that the Administration can do to get the credit to go towards small and mid-sized businesses—you have done a lot of work on getting it to big business, and I think some of that is reflective in the stock market's impact.

But if you look at syndicated borrowing numbers—I am sure you have—these numbers are a fifth of what they were during a normal time period. And this is where your mid- and certainly—mid- and some small businesses get money.

As I mentioned, too, to you, anything in commercial real estate is just dead. Even well-financed deals with a good percentage down, it is not happening. And it is certainly my belief that until

you fix that piece of it, you are not going to have much in the way of job creation. You may slow your job loss level, but you are not going to have much job creation, because, generally, your engine of job creation has been the small and mid-sized businesses.

And then, on top of it, the discussions here of these major policy initiatives, whether it be on health care or cap-and-trade, have a dramatic impact on people's willingness to take risk in such an unknown tax atmosphere. So I mean you have an intangible impact here that is not good either.

So that to the degree you can start to clear through your policy agenda and let people kind of get back to being normal and knowing what the environment is going to be, I think the cap-and-trade idea is one you ought to pull away from and say, in this economy, at this time, we are not going to do it. We are going to do things maybe like the renewable energy standard, we will do incremental, but we are not going to do these big dramatic things that have an impact of raising people's prices.

And the difficulty to project what your price is going to be in the future then just holds people back. And in an economy where we need to get things going, you are having the impact of stalling things when you have these huge policy debates and discussions.

The health care does it too. As people are trying to calculate, okay, what do I do? This? Do I do that? Is it going to have an effect? Is it not? And it stalls everything.

So the banks aren't lending, the people are scared to get out on it, syndicated borrowing is not happening, and the total of it is that you just get a very lethargic private sector in the economy. And as many jobs as the public sector may try to create or sustain, it is not long term sustainable because of the debt we are running up.

And you have noted your difficulty with the debt numbers. I mean, they are striking to you. They are certainly striking to me.

And you travel across Kansas, and people are just appalled by it. Because they just go, you know, these things have been building. And now it is up to nearly $12 trillion in debt, and we are looking at going to 100 percent of debt to GDP within a 5-year time period. That just is going to further strain credit, and it is going to raise interest rates. It is likely to lower the dollar, which will drive oil prices up and gasoline up, which I think was one of the key triggers of the recession in the first place, is gas prices getting so high. People didn't have any money left in their pocketbook.

So I would really urge you to look at those pieces of it. I know you are here to defend what has taken place to date. But as I am out traveling around, those are the things that I think are going to long term make this very lethargic and likely to just have this government bubble be a sustained decade like Japan had where you just don't get much happening outside of the government putting in money. And the government is not going to really cause much growth overall to take place.

So that is what I am hearing from a lot of people, and I am certain you are getting it from points. But I wanted you to hear what I get across Kansas.

Thank you, Mr. Chairman.

Representative Hinchey. Thank you, Mr. Brownback.

Dr. Romer. So let me—I mean, you make so many points. Let me try to respond to some.

One, I share—I mean, I share many of your points, especially, you know, in thinking about the role of the government and the government stimulus, right? The whole reason that we are here, the whole reason we did something like the American Recovery and Reinvestment Act was precisely because the private sector wasn't spending, right? We did see a dramatic decline in demand, you know, investment, consumer demand.

And I agree completely we are all working toward the place where that private sector demand comes back and the government doesn't need to be there. That is I think what we all want to happen. And the question is how and when we get to that place.

Your point on small businesses and credit is a message we get loud and clear as well, and I can't tell you how often the President gets—you know, he reads letters from people that write to him and, you know, we meet with him every day, and he said, what are we doing about small business credit?

And that is part of what—the event yesterday, where we announced two initiatives, one working with you all to try to up the SBA loan limits. We hear from our small businesses that there is a gap, that the current programs are missing the people that need the somewhat bigger loans, but they are not yet the really big companies.

The other is a program to get more capital into the small community banks. Because we do know the main people that do a lot of the lending to small businesses are the small local banks. And we have had, as you mentioned, important recovery measures for the big banks and trying to use some of the funds that we have. If small banks have a plan for doing more business lending, if we can get a way to get them more capital so that they are able to do that and grow their businesses, we think that would be a win.

The other thing, you mentioned the idea of we need to get credit flowing before we will get the private recovery, and to a degree that is true. But I think that the causation also goes the other way. The more we can get the economy going again, I think the better that is going to be for the health of all of our banks, the health of the financial system. And so it does go both directions.

And, in fact, I love one of the things that Secretary Geithner sometimes says. He says, I don't think the Recovery Act gets enough credit for the financial rescue, the sense that by buoying up demand by getting the economy growing again, by getting stock prices growing again, that has been very healthy for the financial system, for getting credit.

Again, it is still limited, but it is a lot less limited than it was 6 months ago.

And, finally, your point on uncertainty and the big policy initiatives, and it is a reason why we need to get moving. I hear this, for example, on financial regulatory reform. That, again, you know, we are putting in place I think some very important new rules of the road. The sooner we can do that, the more people know what the institutional framework they are going to be operating in.

Likewise, in health care, now this is one where I would think we would probably, if we are talking to the same small businesses,

they tell us that what they are worried about is the rising cost of health care and the difficulty that they are having providing health insurance for their workers. And one of the great strengths I see of all the bills that have been working their way through the House and the Senate is how focused they are on making it work for small businesses. The exempting businesses from the—small businesses from the pay or play, setting up an insurance exchange. Because we know small businesses pay something like 18 percent more for the same coverage that a big firm would pay. Setting up a small business tax credit to make it more affordable for them.

I think, again, the sooner we can do that and the sooner we are careful to make sure that anything we do on health care does protect and help small businesses I think we will get, as you mentioned, those engines of growth going again.

Senator Brownback. Senator DeMint may have a series of questions that he would like to submit for the record.

Representative Hinchey. Absolutely.

Senator Brownback. Thank you.

Representative Hinchey. Thank you very much.

Mr. Snyder.

Representative Snyder. Thank you, Mr. Chairman.

Dr. Romer, I have several questions I will ask quickly, if you will give quick answers.

Arkansas unemployment rate over the last 5 months has gone up from 7.0 to 7.2 to 7.4; and in the last 2 months it dropped to 7.1 and then most recently stayed at 7.1. Are we like the canary that shows that things are going in the right direction or—how should we interpret what seems to be a trend in the right direction?

Dr. Romer. I would love to interpret you as a canary.

I think one of the things that is important is we do know, just as there are measurement issues even with the national unemployment rate, when you get down to the state level they are even bigger. So one of the things I have learned in my short 9 months in the job is to not read too much into any one number and certainly into any one state's number. But certainly the fact that we are seeing a few states turning the right direction, I think that is wonderful. And, again, if we see at the end of next week that the GDP numbers for the third quarter are positive, as we had anticipated, that would be another sign in a very good direction.

Representative Snyder. My second question, again a parochial question, I think Arkansas has gotten on people's radar screen internationally in terms of international investment. We have had several international companies involved in wind power. That LM Glasfiber is now manufacturing windmill blades in Little Rock. Some Indian companies have gotten interested and made substantial investments in central Arkansas. Governor Beebe has been very aggressive the last several years about looking for opportunities for international investment.

We always think about our companies investing overseas, but it is working the other way. How important do you think international investment can potentially be as we see some areas around the world that are recovering faster than we are as a potential source of investment and job creation?

Dr. Romer. I think it certainly is important. I think it does get to some of the things that we have been talking about, how, in general, keeping our trade in both goods and services and in financial flows like investment. Working and operating and on a fair, level playing field I think is very important. So you have talked about the direct foreign investment, and that is—as we build factories here, that is great.

And we are also looking the other direction, of making sure we open up markets for our products overseas so that, if our firms that are already here produce, make sure that they have a place to sell. And, in that context, the recovery in the rest of the world is so important, right? As we see China and a lot of the Asian countries coming back, that is so important for making sure there is a market for our products, because net exports are something that can help to buoy up our demand and help us to grow.

Representative Snyder. And one specific message I don't want you to comment on. I hope you will take a message to the President we in Arkansas would love to see more opportunities to sell products in Cuba, and we don't understand why we haven't been more aggressive about that. We have got a lot of agricultural products we would like the good people of Cuba to eat.

I have a different take than Senator Brownback does on the energy policy. He suggests we pull back from doing big things with regard to what we are going to do about greenhouse gases. I don't understand how pulling back and not doing something somehow gives business predictability for the future.

Probably the best example of that is I am one of those people who strongly believes we need to expand nuclear power expansion and construction in this country. In Arkansas, Entergy, our big power company, they have a nuclear power plant in Arkansas. They want to expand nuclear power plants. They were a strong supporter, as were a lot of nuclear power companies, a strong supporter of the Waxman-Markey bill in the House. And I think the reason is because until we resolve this issue of what we are going to do about greenhouse gases, because of the incredible expense of nuclear power plants and how long it takes to recoup that money, they don't have the predictability.

So I take a different position than Senator Brownback. If anything, what is going on right now points out the need to resolve what we are doing as a Nation.

Would you comment on that specifically with regard to nuclear power?

Dr. Romer. Absolutely. When you think about cap-and-trade, right, so the discussion was how that was causing uncertainty. But, of course, your point is we have got a looming problem with both energy independence and with greenhouse gases and so there is inherently uncertainty. So I think what you are saying is getting to a point where we deal with this is going to provide certainty for everyone. So I think that that is absolutely true.

And the President has very much been of the view that, you know, at a time of economic crisis you can still be focusing on the more fundamental, longer-run problems.

And certainly, you know, nuclear energy is one of the ways that we can increase our energy independence, can get—and your point

that getting certainty, you know—and, again, that is going to be an issue as we think about how we—you know, I know certainly the Senate is going to be thinking about its own version of the Waxman-Markey or the cap-and-trade and energy bill and thinking about what can you do within that to get more certainty about, you know, the price of energy going forward exactly so that you do have the right incentives to make the big investments.

Because we want to not only do nuclear, but there is also so much we want to do in encouraging renewable energy of other kinds and those kind of investments also in just the technologies for energy conservation and new factories.

Representative Snyder. And natural gas is doing very well in Arkansas, too.

Thank you, Mr. Chairman.

Representative Hinchey. Mr. Snyder, thank you very much.

Mr. Hill.

Representative Hill. Thank you, Mr. Chairman; and, Dr. Romer, thank you for being here this morning.

My question will be brief. The projections that you have with the growth in GDP, are they based upon the fact that stimulus money will be spent or is it not based upon stimulus money being spent?

Dr. Romer. Well, the numbers that I showed you from the Blue Chip consensus forecast—it is a survey of about 50 professional forecasters—I am sure that they—so each one of them will have some assumption about what is going to happen to interest rates, what is going to happen to fiscal stimulus. And given the law that is there, they are all predicated upon the fiscal stimulus that at least has been passed stays and follows through in the path that say the Congressional Budget Office has projected.

Representative Hill. So if it would be taken away, then those growth percentages would not be realized.

Dr. Romer. Oh, you would see their forecasts plummet. I am certain of it.

Representative Hill. The one other question I have, there is talk among some Members of Congress—I am not one of them that are sounding the alarm bells, but there are several Members of Congress, and I have talked to some commercial real estate developers about this as well, that the second shoe that is going to be dropping that is going to drastically affect the economy is the collapse—or not collapse but foreclosures on commercial real estate loans that are being made and that many banks are going to go belly up because the commercial real estate developers are not going to be able to pay their loans. Have you got any thoughts that you can share with us about that?

Dr. Romer. It is something that we certainly hear as well, and I know that the Federal Reserve and the Treasury we are all concerned about what we do see happening in commercial real estate.

I think, as I understand it, part of the—or certainly one of the things that is somewhat different from what we went through, say, last fall, this is a more slower evolving problem, so it is one that we will have the time and the ability to deal with. But it is something that is looming there.

It is another—I mean, we have had, you know, when I say we faced challenges, right, this is not a normal recovery in the sense

a normal recession is caused, you know, in post-war history was tight monetary policy to get inflation down, and then there was an obvious way that you ended it. You just loosened monetary policy, interest rates came down, and the economy came bouncing back.

Where this started with interest rates low, we had a severe financial crisis, and that means coming out of this we have just got lots of things working against us. We know credit is still tight. We still have trouble in our banking system. We are—as you mentioned, the commercial real estate loans are going to be another thing that is going to be holding back how much banks want to lend and be something else we are fighting against.

So, in my mind, it just makes it clear how hard this is and how important it has been that we have taken the very aggressive actions that we have taken and that we are going to have to be vigilant and keep working at this.

Representative Hill. Thank you, Mr. Chairman.

Representative Hinchey. Thank you, Mr. Hill.

Senator Klobuchar.

Senator Klobuchar. Thank you very much, Mr. Chairman. Thank you, Dr. Romer.

In late September, you said that the recession—you said, to say the recession is over is a big difference than to say we are recovered. You said, I don't want the "mission accomplished" banner. We have so much more to do.

Could you talk about what you think, number one, is happening in terms of the Recovery Act—I think it was forecast to save 3.5 million jobs over 2 years—whether we are on track for that? And, secondly, what other tools that you may have in the economist toolbox that we could use?

Dr. Romer. Absolutely. So, no, I did—that statement that I made, I do think is important. Because when economists talk about the recession is over or if you look at the—I cite in my testimony, if you ask the Blue Chip consensus, 81 percent of them say the recession is over. What that means is you have hit the bottom and you have turned the corner. There is a huge difference between that and when you are back to something normal.

And just—you know, one of the ways that I described this is we have lost 7.2 million jobs since the business cycle peak back in December of 2007. Normally, we would have added about 100,000 jobs every month. So if you think about the job deficit, we are at probably over 9 million. So that says, even once you turn the corner, you have so much work to do.

In terms of the Recovery Act, it is—as all of our estimates suggest, it is on track. So, you know, that was a number that said, as of the end of 2010 we expected it to have raised employment relative to the baseline by about 3 and a half million. And it does look like we are going to meet that. So the one million that we saw at the end of August is very much on that trajectory.

The economist tool bag, we do still have tools, all right? So that is part of—you know, despite the high budget deficit, there is still—you know, I think as long as we have a credible plan for getting it under control over the long term, health care reform is going to be a big part of that. Announcing a sensible plan for once we are recovered of how we are going to rein in spending or deal with

revenues, that is all important for making sure we retain credibility, that everyone understands that the United States is the safest country to put your money in to buy their government debt.

But there are things you can do, whether it is more state fiscal relief, whether it is more investments in infrastructure, whether it is another tax cut, whether it is tax incentives for businesses to hire, all of those are things that I think should be looked at.

I know that the Federal Reserve is thinking about—they are always saying, what are the tools that we have? We are thinking about, in terms of homeowners and mortgages and foreclosures, what could we do to make that program work better so that we don't see a big rise in foreclosures pushing down house prices? All of those should be on the table and things we are thinking about.

Senator Klobuchar. Thank you. I do appreciate that. We have heard a lot of concerns in Minnesota with small businesses, that the President came out on that. I have been working with Senator Warner, Mark Warner, on this.

Because it seems that, while the Dow is doing fine now, or getting better, at least, there are some huge problems for small businesses not being able to share in that credit that is starting to get out there and our small community banks.

On the fiscal responsibility note, I went on a letter, nine of us did, to try to push for a process. I was on a bill a year ago with Senator Conrad to try to put a process, a bipartisan process together with suggestions on Social Security and other ways to bring down our deficit. And I think it is now more important than ever that we do that.

But my question in my remaining time here is about unemployment benefits. The House produced a bill that extended unemployment benefits, which is good, but it only included unemployment benefits for states that had 8.5 percent unemployment. Our concern on the Senate side, as someone so nicely put it in a letter a month ago to me, even though our state may have 8 percent unemployment, in my household it is 100 percent unemployment.

It is very difficult for me to explain to the people in northern Minnesota, where they border Wisconsin, why their unemployment benefits would be cut off and people just across the border—we have a lot of issues sometimes between Minnesota and Wisconsin, including Brett Favre, but to have to explain to them that we got Brett Favre but you don't have the unemployment benefits would be difficult.

So I just wonder if you had any views on the issue of trying to make sure we extend unemployment benefits across the line for all households and the need that we have for this despite the fact that we are seeing some glimmers of hope with the economy.

Dr. Romer. Yes. I mean, it absolutely goes to the big issue of, you know, even—your first question, even if we are starting to recover, we do know that there are still over 15 million people who are unemployed. We do know that there are people who are expiring their benefits. There is still just a tremendous amount of suffering and that the recovery back to normal levels of unemployment is unfortunately going to be, you know, something that takes a long period of time; and we have an obligation as a country to cushion that blow for people.

So, absolutely, I mean, one of the things, of course, we all know is how much the Recovery Act did on this front, right, the unprecedented increase in the size of payments, the length of payments, and completely appropriate given the suffering that was going on and given that we needed the aggregate demand stimulus. It was just a sensible program. I think it is one of the ones that Mark Zandi says has the biggest bang for the buck. Because you give people their unemployment check; they spend it. So that is incredibly important.

I think my main plea going forward is to think hard about what is—I mean, it is exactly your question. How do we devise this, right? What is the right length of extension? What is the size? I think all of that is something we should think about sort of as a coherent whole and figure out, you know, sort of what is the right thing to do.

I think it is true, you know, economists do sometimes worry about incentive effects. I think one of the main lessons is when the unemployment rate is 10 percent we are not really worried about people not getting a job if it were there, right, that it is very much—we know that people are looking as hard as they can, and we are trying to do the best that we can to make the jobs be there for them but for now cushioning the blow. So the details of how we deal with Wisconsin versus Minnesota and those, I think that is something we are going to be having to working about and working together and thinking about. But I will certainly take that back with me.

Senator Klobuchar. Thank you very much.

Yeah, look at the Senate bill. We like it.

Representative Hinchey. Senator, thank you very much.

Dr. Romer, I think just to emphasize something that you said in response to a question a little while ago, we have the National Federation of Independent Businesses, which sometimes makes correct analysis. This week they said that their survey found that it is not credit problems, but it is the lack of customers that is the biggest problem for small businesses. And we know that that is true. It is lack of customers. And we wonder if we shouldn't be focusing on increasing consumer spending. But how do you increase consumer spending other than by creating jobs?

A lot of the consumer spending has dropped off because consumers don't have money to spend, and they don't have money to spend because they have lost their jobs or people close to them have lost their jobs, people working with them have lost their jobs, and if they haven't lost their jobs, they are worried about the possibility of losing their jobs. That is one reason why we see some increase in private savings that have gone up across this country, because people are saying to themselves, I don't know what is going to be in this for me; I better take care of myself a little bit and start saving as much money as I can.

So that is part of the problem. Spending has gone down, and spending has gone down for those two reasons. People are worried about their future, and other people have just lost their jobs. They don't have any money to spend.

With that in mind, I can't help but focus on something that Paul Volcker has been saying; and he has got some attention in *The New*

York Times yesterday and in *The Wall Street Journal*. And one of the things that he is talking about is the commercial banks and how the commercial banks should be restricted to commercial banking so that in the context of commercial banking they could be exhilarating the economy and that they shouldn't be engaged in the Wall Street situation.

And, of course, that takes us back to the repeal of the Glass-Steagall Act, where banks that had their main focus of attention on commercial spending and commercial investments and job creation have stopped doing that. They stopped doing that just after 1999.

So what do you think about this? Isn't this something that we should deal with? Isn't there something that we should—some way in which we should focus attention on the huge amounts of money, trillions of dollars, that are in the hands of growing banks, including the specific banks that have come together and made themselves larger and increased the amount of money that they have?

But that amount of money is not being put out into investments. It is being put out into other operations which are designed to try to bring in as much money to them as possible not over the long term but quickly. And if that is the case, then we are facing the potential of another economic decline, another serious economic recession sometime over the course of the next several years.

What do you think?

Dr. Romer. Many points there.

First, your report from the NFIB about lending and what is holding back small business. I think the answer is probably a mixture. We do hear from them that they are having trouble getting credit. But we also hear the other side of, well, maybe they don't want to be expanding very much because they don't have the customers.

That is sort of why I think a multifaceted approach makes a lot of sense, the kind of measures we announced yesterday to try to get lending going more to small business. But all of the other things that we are doing exactly—the tax cuts, the UI extension—all of those things are things designed to get people back to work and buying things, a lot of those from small businesses. So I couldn't agree with you more that there is a mixture, and both of them need to be done.

The discussion—your discussion of Glass-Steagall and where we go from there and Paul Volcker, I think it all brings to the fore just how important regulatory reform is, right? We are in the middle. The President has said, and I feel so strongly, that we need to use the pain that we have been through to some good. And what we saw in the Great Depression, they had the good sense to take that horrible crisis and say at least out of this let's put in place a framework that makes us healthier going forward. And that is why we have the introduction of deposit insurance and the creation of the FDIC, so many of the laws about how our stock markets work, the Securities and Exchange Commission. So important.

We have seen that there are gaps in our regulatory framework. That is what we learned last fall and how important it is that we do a comprehensive fix, right? And that is really what is starting this process that is going on in the House and in the Senate. So incredibly important.

The particular form, whether, you know, as Paul Volcker would say, can we go back somewhat to the old-fashioned world where banks were one thing and, you know, investment banks or hedge funds were another thing or has somehow the world changed enough that they are kind of all—it is hard to draw the lines. I think that is something we will have to work out with the Congress.

I think the important thing is to make sure everybody is regulated, make sure everybody has good, strong capital requirements so that they have money on the line.

We hear so much talk about executive compensation and making sure that regulators work with the institutions they regulate to say, you know, do you have pay practices that are encouraging risky behavior? All of that is going to be part of coming up with a system that, you know, I hope will buy us another 80 years without a major financial crisis. I think that would be an important legacy for our children.

Representative Hinchey. Well, I perfectly agree with you; and I think that is exactly what we should be doing, trying to make sure that this economy is strong and stable for as long as possible and not going back to the way we were prior to the 1930s, when we had serious recessions and depressions every 10 or 15 years.

Dr. Romer. And financial crises.

Representative Hinchey. Yes, and an array of financial crises during that period of time. But the installation of those changes, which occurred in 1933, stabilized this economy for a long time; and it seems to me that this is something that we need to do.

Nevertheless, there is a resistance to that; and the resistance to that is coming largely from the big banks. And that resistance coming from the big banks is having some effect on some of the decision makers in the context of this set of circumstances that we are dealing with, and that may include even the way in which this Congress is working.

There is a very important bill that is coming out of the Financial Services Committee here in the House of Representatives, and we are hoping that that is going to do it in a way that is going to be effective. And I can't help but believe that the only way to make it effective is to enable different kinds of banks to be engaged in the kinds of things that they were initially set up to do and not enabling them to sort of manipulate the set of circumstances that they have available to them that is available for their own interests.

Now, that is just a human nature thing. That is just something that people are going to do unless there is some way to stop it. If you have the power and ability to do things, the main focus of attention is going on yourself; and that is true of the banks as well as it is of individuals.

So this is something we have got to deal with, and we have got to deal with it effectively. We know very well that this deep recession came about largely, almost exclusively, as a result of the repeal of that Glass-Steagall Act and the economic manipulation that came about immediately after that. Because so many people had been pushing for that for a long time, and they knew how effective

it was going to be, and they engaged in that effectiveness right away.

We have a big responsibility here not just to stabilize this economy over the course of the next few months or few years but to stabilize it, as you were saying, for at least the next 80 years; and I hope that that is something that we can do.

We have four minutes to vote. I just want to mention before closing that I wanted to return to a point that was made earlier about the special relations between the JEC and the CEA. It is so special, in fact, that Dr. Romer, the chairman, has asked our executive director, Nan Gibson, to come over to be in the executive branch, to be her chief of staff at the President's Council of Economic Advisers. Once again, Doctor, you are showing us that you are making the best possible decision. We very much appreciate it.

Dr. Romer. Well, I very much appreciate you. My current chief of staff is 2 weeks away from having a baby and wants to stay home with her baby, and I could not be more thrilled. And I am sorry to steal Nan from you, but I feel very, very lucky that she is coming over to help us so that we can continue to help you.

Representative Hinchey. We are going to miss her, but we are going to look for that help as well. Thank you very much.

Representative Brady. And, Mr. Chairman, let me add my bipartisan congratulations to Nan as well on her new venture.

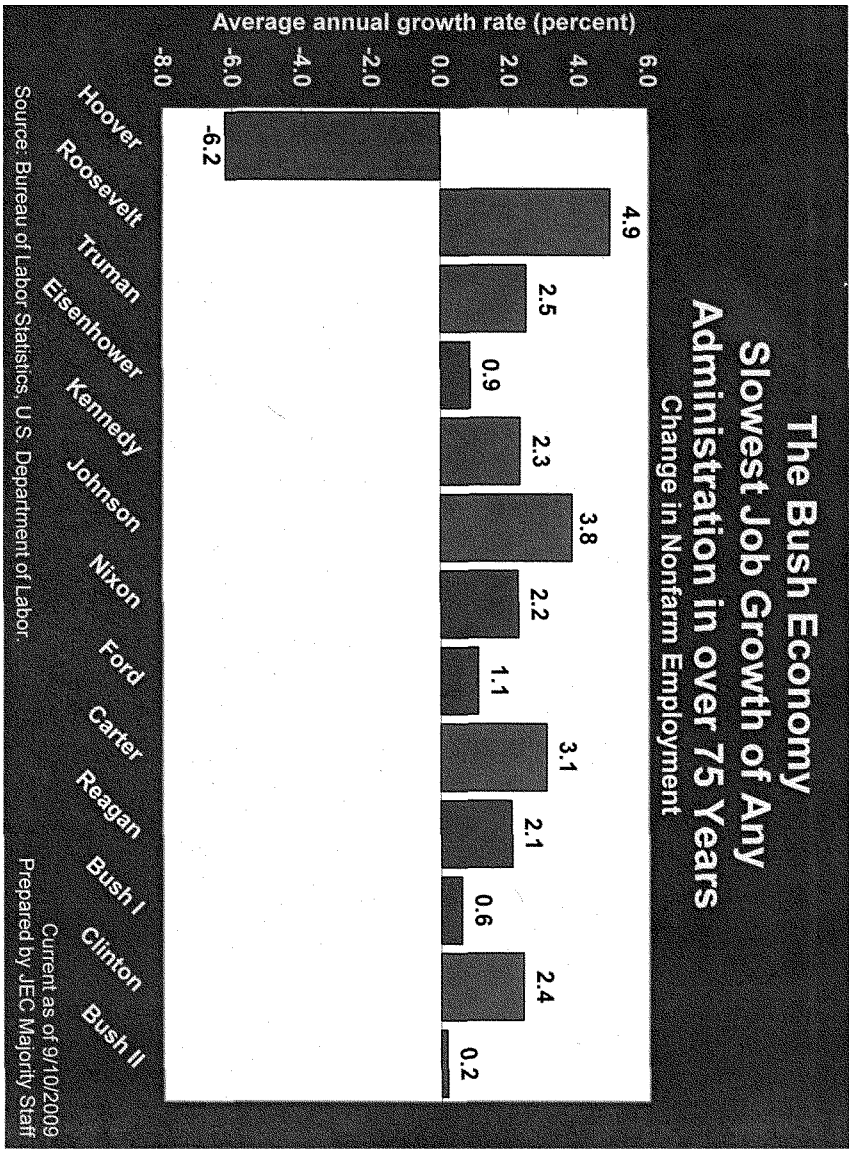
Representative Hinchey. Mr. Brady, thank you very much.

Dr. Romer, thank you so much for being with us. Thank you for your testimony and your very clear and competent responses to all of the complex questions that you received here today. We very much appreciate it, and we are very happy to be able to continue to work with you. Thank you so much.

Dr. Romer. Thank you. It has been wonderful to be with you.

[Whereupon, at 11:45 a.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD


The Bush Economy
Slowest Job Growth of Any
Administration in over 75 Years
Change in Nonfarm Employment
Average annual growth rate (percent)
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
4.9
2.5
0.9
2.3
3.8
2.2
1.1
3.1
2.1
0.6
2.4
0.2
-6.2
Hoover
Roosevelt
Truman
Eisenhower
Kennedy
Johnson
Nixon
Ford
Carter
Reagan
Bush I
Clinton
Bush II
Current as of 9/10/2009
Source: Bureau of Labor Statistics, U.S. Department of Labor.
Prepared by JEC Majority Staff

PREPARED STATEMENT OF CAROLYN MALONEY, CHAIR, JOINT ECONOMIC COMMITTEE

I want to welcome Dr. Christina Romer, the President's Chair of the Council of Economic Advisers, and thank her for her testimony here today. The Council of Economic Advisers and the Joint Economic Committee were both created by the Employment Act of 1946 and share an important history of providing the White House and Congress with analysis of economic conditions and economic policy.

Our hearing today is on the economic outlook. The current Administration took office only nine short months ago. Nine months ago, the economy was facing the worst economic crisis since the Great Depression with GDP falling at its fastest rate in almost three decades. In January alone, 741,000 jobs were lost, but jobs losses of about 600,000 or more per month had started in November of 2008. Those punishing job losses continued for 5 straight months. However, thanks to the American Recovery and Reinvestment Act, we are finally seeing signs of recovery. For example, the $35.4 billion obligated to states so far for education has saved 250,000 teacher jobs.

However, I am deeply concerned about the state of the labor market, as I have been since the start of this recession. GDP growth is of little comfort to the millions who have lost their jobs. The unemployment rate is at an unacceptably high 9.8 percent. I am particularly interested in Dr. Romer's outlook on the labor market and additional measures that may be needed to boost job creation.

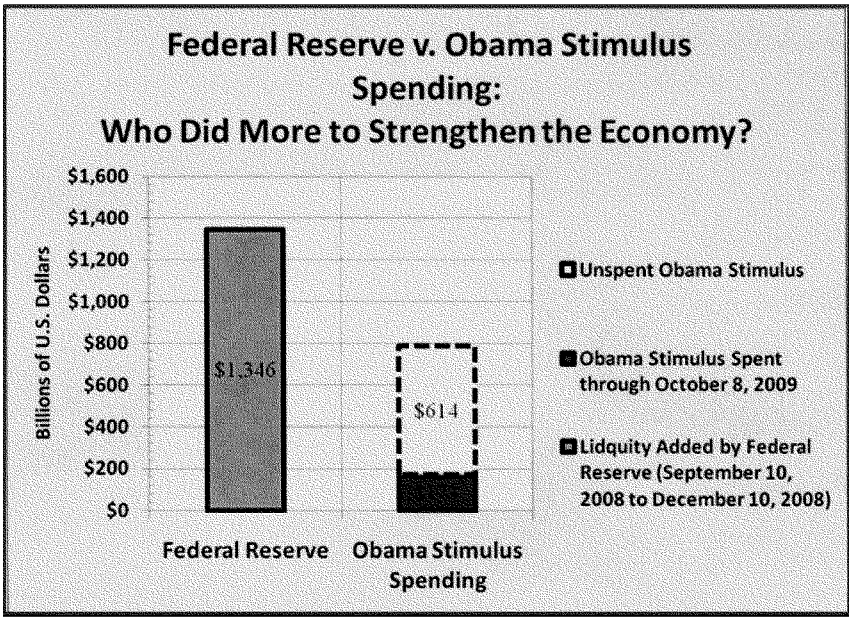
As the economy recovers we must continue our commitment to the unemployed to ensure that working class Americans aren't once again left out of economic recovery, as they were under the Bush Administration. People are losing their unemployment benefits at alarming rates. In my home state of New York, close to half of the unemployed are losing their state unemployment benefits, and the same story can be told in states around the country. That is why I encourage the members of the Senate to follow the House in passing a bill that extends unemployment benefits.

As the 2001 recession subsided, the average American family was left behind; job creation and median family income never recovered to the levels experienced during the Clinton years. We must do more to ensure that as we recover from this recession we do not see a repeat of the dismal jobs record of the Bush Administration. One statistic I find striking is that for every job opening there are six people applying.

Despite this fact, the Recovery Act is working. In fact, it is softening the impact of this recession on workers. According to a report that the Council of Economic Advisers released last month, the Recovery Act reduced average monthly job losses by 169,000 in the second quarter of this year. In addition, the U.S. economy had 1 million more jobs in August because of the Recovery Act.

The report also notes that the Recovery Act has contributed significantly to economic growth. Using the latest GDP numbers, the Recovery Act raised GDP growth by 2.6 percentage points in the second quarter. In the third quarter, analysts expect an even bigger boost. Next week, we will hold a hearing where the Bureau of Economic Analysis will report advance estimates of GDP for the third quarter, and I am optimistic that the numbers will show that the bold actions taken by Congress and the Obama Administration are turning the economy around. The Administration and Congress continue efforts to help create jobs. Just yesterday, the Administration announced a series of proposals to help small businesses, including providing tax relief to small businesses and promoting access to credit.

Dr. Romer, we thank you for your testimony and I look forward to working with you as the committee continues our focus on fixing the economy, helping struggling families, and, above all, putting people back to work.


Federal Reserve v. Obama Stimulus Spending:
Who Did More to Strengthen the Economy?
Billions of U.S. Dollars
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
$1,346
$614
Federal Reserve
Obama Stimulus Spending
Unspent Obama Stimulus
Obama Stimulus Spent through October 8, 2009
Lidquity Added by Federal Reserve (September 10, 2008 to December 10, 2008)

PREPARED STATEMENT OF KEVIN BRADY, SENIOR HOUSE REPUBLICAN, JOINT ECONOMIC COMMITTEE

I am pleased to join in welcoming Chairwoman Romer before the Committee this morning.

There are some encouraging signs that the recession may be nearing its trough. The commercial paper and corporate bond markets are functioning. The stock market is up. Housing prices may be stabilizing. Industrial production edged up 2.8 percent during the last three months. Job losses continue, but are slowing. And the October survey of economists in *The Wall Street Journal* forecasts that real GDP will grow at an annualized rate of 3.1 percent during the third quarter.

Even if this forecast proves correct, the U.S. economy still suffers from many fundamental problems. In September, payroll jobs fell by 263,000, while the unemployment rate rose to 9.8 percent. The same *Wall Street Journal* survey also forecasts that the unemployment rate will rise to 10.0 percent by December.

Commercial real estate prices continue to fall. Because of the collapse of the market for commercial mortgage-backed securities, many property owners cannot roll over performing commercial mortgage loans at maturity. Regional and community banks are likely to suffer large losses on their commercial mortgage loan portfolios that may impair their ability to supply credit to families and small businesses.

I am concerned that any growth in the second half of this year may prove transient, and consequently the unemployment rate may continue to increase well into 2010. Those in Washington shouldn't kid themselves: A jobless recovery is no recovery for American workers.

During the last four months of 2008, the Federal Reserve injected more than $1.3 trillion of liquidity into the U.S. economy. With the traditional lag between monetary actions and their effects becoming apparent in the real economy, this liquidity injection last fall supported real GDP in the second quarter and should boost real growth in the second half of this year.

Compared to the Federal Reserve's $1.3 trillion "adrenaline shot," President Obama's stimulus spending pales. As of this month, only $173 billion, or 22 percent of the program's total, had been spent—to the view of many, too slowly, too wastefully, and too unfocused on jobs. Like the hunter in the party who takes credit for every bird that falls, stimulus promoters should be wary of taking credit for the result of unprecedented Fed actions that are casting a far greater influence over the economy's performance.

But neither liquidity injections nor fiscal stimulus can create a sustained expansion. As the Chief Executive and Co-Chief Investment Officer of Pimco Mohamed El-Erian noted, these government interventions are unsustainable "sugar highs." If the United States is to avoid slipping back into a "w-shaped" recession, the private sector must once again become the driver of economic growth.

It is unclear how this hand-off will occur. The balance sheets of U.S. families remain damaged from the collapse of housing prices and the excessive debts accumulated during the bubble years. The growth of personal consumption is likely to remain restrained. The large inventory of foreclosed homes is likely to dampen housing investment. Therefore, a sustained expansion must depend upon business investment and net exports.

Here is a major concern going forward: Entrepreneurs and business leaders make investment decisions based on their expectations of risk and return. Government policies affect these perceptions. Unfortunately, the Obama Administration and congressional Democrats have simultaneously dampened the expected return and increased the risk associated with new business investment through their actions and inaction.

Higher income tax rates and higher taxes on capital gains and dividends are set to begin in 2011. The White House and Congress are proposing job-killing energy and international tax increases that will drive investment and jobs offshore. Congress has not acted in a timely manner to extend the research and development tax credit and the homebuyer's tax credit as well as an increase in the net operating loss carry-back period from two to five years.

Uncertainty about cap-and-trade and healthcare legislation further depresses business investment. Firms fear the additional energy costs associated with what many term the "cap and tax" bill that passed the House and are unsure what the Senate may do. The various trillion-dollar healthcare bills leave firms, especially small businesses, confused and concerned about additional taxes and regulatory burdens.

As a result, many companies in my district and around the country are delaying important investment decisions—and the job creation that goes with it.

In short, the government's uncertainty and interference is quickly turning a "rescue operation" into an anchor around the private sector's neck.

With U.S. consumer spending lagging, a key opportunity to recovery lies in selling American goods and services overseas to recovering markets. Yet America is sitting on the sidelines while other nations are aggressively shaping these new markets. The Doha Round negotiations remain stalled. Congress has not acted upon three completed trade agreements with Colombia, Panama, and South Korea while competing countries reach agreements that leave American companies and farmers at a severe competitive disadvantage.

The United States is on an unsustainable fiscal course. According to the Congressional Budget Office (CBO), projected federal deficits will swell publically held federal debt from 40.8 percent of GDP at the end of the last fiscal year to 67.8 percent at the end of fiscal year 2019. And this CBO projection is before adding new healthcare benefits and other costly initiatives.

Moreover, the CBO projects that the growth of existing entitlement programs will drive federal deficits and debt even higher over the long term. Instead of resolving these imbalances and consequently protecting both beneficiaries and taxpayers, President Obama and congressional Democrats are seeking to create new entitlement programs that would further damage our fiscal position.

Finally, the United States could face the risk of a dollar crisis in the future. Recent history in Asia and Latin America warns us that currency crises occur suddenly with devastating consequences. If the fear that fiscal irresponsibility may force the Federal Reserve to monetize federal budget deficits were to cause foreign investors to shun Treasury debt, the foreign exchange value of the dollar could collapse, sending prices soaring. Fortunately, the risk of a dollar crisis is still very small. However, this risk may grow if Congress does not begin to control federal spending.

There is much to be concerned about in America's economy. Today is no time to be taking false credit for economic indicators—but rather outlining the Administration's strategy going forward to address these challenges.

Dr. Romer, I look forward to hearing your testimony.

From Recession to Recovery: The Economic Crisis, the Policy Response, and the Challenges We Face Going Forward

Christina D. Romer
Chair, Council of Economic Advisers

Testimony before the Joint Economic Committee
October 22, 2009

Chair Maloney, Vice Chairman Schumer, Ranking Members Brady and Brownback, and members of the Committee, it is an honor to be with you today. There is no question that the past year has been one of enormous challenges for the American economy. The recession that began in December 2007 has been the worst we have faced since the Great Depression. The suffering it has brought to American workers and their families has been terrible. The toll that it has taken on American businesses has been great across the spectrum—affecting firms both large and small; those in services as well as manufacturing; and firms in every state and community.

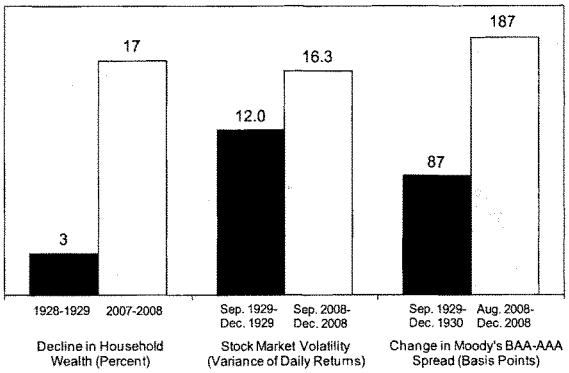
In my testimony this morning, I want to discuss the economic crisis and the efficacy of the policy response. I also want to talk about the outlook for the U.S. economy and describe what I see as the key risks to the forecast. Finally, I want to discuss some of the policy challenges that we are likely to face going forward.

I. Shocks to the Economy

The economy the Administration inherited when President Obama took office was, to put it bluntly, in terrible shape. One way of describing the severity of the crisis we faced that I find striking is to observe that the shocks that hit the U.S. economy last fall were, by almost any measure, larger than those that precipitated the Great Depression. Figure 1 compares some key

indicators of the shocks in the two periods.

Figure 1
Shock Indicators: Great Depression vs. Current Recession



Sources: See text.

A key causal factor in both downturns was a decline in household wealth that lowered consumer spending. In 1929, however, the crash of the stock market in October mainly reversed a large run-up in stock prices that had taken place between June and August, and house prices declined only slightly. As a result, household wealth fell by just 3 percent between December 1928 and December 1929. In 2008, in contrast, stock prices fell 24 percent in September and October alone, and house prices fell 9 percent over the year. All told, household wealth fell 17 percent between December 2007 and December 2008, more than five times the decline in 1929. [1]

Another factor creating uncertainty and restraining spending in both periods was volatility in financial markets. But asset price volatility, which was very high in late 1929, was even greater in the fall and winter of 2008. The variance of daily stock returns measured using the S&P index was more than one-third larger in the current episode than in the final four months

of 1929.[2]

If falling and volatile asset prices were important in both 1929 and 2008, the defining feature in both cases was a full-fledged financial panic. In the Great Depression, it was not until late 1930 that the economy suffered the first wave of banking panics, highlighted by the failure of the official-sounding Bank of the United States in December. In 2008, the U.S. financial system similarly survived the initial declines in house and stock prices. But the outright failure of Lehman Brothers (and other financial takeovers and rescues that same week) proved too much for the system. The financial system truly froze and liabilities once assumed to be completely safe, such as money market mutual funds, threatened to trade at a discount.

One frequently cited indicator of the depth of the panic in September 2008 is the skyrocketing of credit spreads. One spread for which we have data back to the 1920s is that between Moody's AAA and BAA grade bonds. In the fall of 1929, this spread barely changed. By December of 1930, after the banking panic in late 1930, it had risen to 87 basis points above its level before the stock market crash. In contrast, this spread rose 187 basis points between August and December 2008.[3]

The result of these shocks was a rapidly contracting economy. Real GDP fell at a 5.4 percent annual rate in the fourth quarter of 2008 and at a 6.4 percent rate in the first quarter of 2009. Employment, which had been falling by less 150,000 jobs per month before September, fell by an average of 622,000 jobs per month from October through March.

II. Policy Response

What kept the economy from heading into a second Great Depression in 2008 and 2009 was the strong and timely policy response. The Federal Reserve began cutting interest rates in

late 2007, and by December 2008 it had brought its target for the federal funds rate to essentially zero. As credit market after credit market froze or evaporated, the Federal Reserve created many new programs to fill the gap and maintain the flow of credit.

Congress's approval of the not-always-popular Troubled Asset Relief Program (TARP) was another crucial step. Creating a program that could be used to shore up the capital position of banks and take troubled assets off banks' balance sheets has proven both necessary and valuable. Similarly, Congress's willingness to release the second tranche of the funds last January gave the new administration the tools it needed to further contain the damage and start repairing the financial system. The stress test, conducted early last spring to give a read on the health of the nineteen largest banks, was only possible because the Treasury could credibly commit to filling any identified capital needs with public capital if necessary. As it turned out, the scrubbing of the books of our major financial institutions, and the public release of that information, calmed fears and led to a much needed and very valuable wave of private capital-raising.

Another important part of the policy response were the steps taken to stabilize housing markets and help distressed homeowners. The infusion of funds into the government sponsored enterprises (GSEs) and the Federal Reserve's purchases of agency debt have kept mortgage rates low and mortgage credit flowing even as other credit markets have been disrupted. And, the Administration's program to support mortgage modifications for responsible homeowners threatened with foreclosure is already helping to keep hundreds of thousands of homeowners in their homes.[4]

A key piece of the policy response to the economic crisis was the American Recovery and Reinvestment Act of 2009 (ARRA). The ARRA provides $787 billion of fiscal stimulus to

counteract the shortfall in aggregate demand, making it the boldest countercyclical fiscal action in American history. The fiscal stimulus was designed to be spread relatively evenly over 2009 and 2010, with only about $100 billion of the stimulus occurring in 2011 and later.[5] The fiscal package was formulated to provide a range of types of stimulus. Roughly one-third of the total stimulus is tax cuts for individuals and businesses; another third is fiscal relief to state governments and aid to people directly hurt by the recession; and the final third is direct government investment spending in infrastructure, alternative energy, health information technology, and other areas.

Table 1 reports estimates of the fiscal stimulus that has occurred through the end of the 2009 fiscal year, broken down by functional category.

Table 1
Fiscal Stimulus by Functional Category

	Billions of dollars through the end of:		
Category	March	June	September
Individual Tax Cuts	2.3	16.0	31.8
AMT relief	0.0	7.6	13.4
Payments to seniors	0.0	13.3	13.7
Business Tax Incentives	0.1	14.4	25.4
State fiscal relief	8.5	28.2	43.8
Aid to Directly Impacted Individuals	0.8	14.4	40.4
Government Investment Outlays	0.0	5.9	26.1
Total[a]	**11.8**	**99.8**	**194.5**

Sources: Recovery.gov; CEA calulations; updated simulations from the Department of the Treasury (Office of Tax Analysis) based on the Mid-Session Review.

Note: a. Items may not add to total due to rounding.

This table shows that $194.5 billion of the total has gone out as tax cuts or outlays, almost exactly what the Congressional Budget Office (CBO) estimated at passage. In addition, another $146 billion of spending has been obligated, meaning that funds are available as expenses are

incurred and projects completed.[6] The numbers through September show that the largest areas of stimulus so far have been tax cuts, state fiscal relief, and aid to directly impacted individuals through programs such as unemployment insurance and nutritional assistance. In 2010, direct government investment outlays are anticipated to become more significant.

In a report issued on September 10, the Council of Economic Advisers (CEA) provided estimates of the impact of the ARRA on GDP and employment. Table 2 reports our estimates of the impact of the ARRA on real GDP growth in the second and third quarters of 2009, along with estimates from a number of government and private forecasters.

Table 2
Estimates of the Effects of the ARRA on GDP Growth

	2009:Q2	2009:Q3
	Percentage Points, Annual Rate	
CEA: Projection Approach	+2.3	+2.7
CEA: Model Approach	+3.1	+3.6
CBO: Low	+1.9[a]	+1.9[a]
CBO: High	+5.1[a]	+5.1[a]
Goldman Sachs	+2.2	+3.3
IHS/Global Insight	+2.3	+2.3
James Glassman, J.P.Morgan Chase	+3.0	+4.0
Macroeconomic Advisers	+2.1	+1.9
Mark Zandi, Moody's Economy.com	+2.8	+3.6
NABE Survey	+0.5	+0.8[b]

Source: CEA, "The Economic Impact of the American Recovery and Reinvestment Act of 2009: First Quarterly Report," September 10, 2009.

Notes: a. Data reflect the average effect on growth, 2009:Q2 - 2009:Q4.
b. Approximate. NABE reports that about 1/3 of respondents expect the Recovery Act to add less than 0.5 percentage points to growth in the second half of 2009, and slightly over half expect it to add between 0.5 and 1.5 points; the remainder presumably expect it to add more than 1.5 points.

These estimates suggest that the ARRA added two to three percentage points to real GDP growth in the second quarter and three to four percentage points to growth in the third quarter. This

implies that much of the moderation of the decline in GDP growth in the second quarter and the anticipated rise in the third quarter is directly attributable to the ARRA.

Table 3 shows the CEA's estimates of the effect of the ARRA on employment, relative to what would have occurred without the Act, in the second and third quarters of 2009, along with those of a number of other forecasters.

Table 3
Estimates of the Effects of the ARRA on Employment

	2009:Q2	2009:Q3
CEA: Projection Approach	+507,000[a]	+1,040,000[b]
CEA: Model Approach	+434,000	+1,159,000
CBO: Low	+300,000	+600,000
CBO: High	+767,000	+1,533,000
IHS/Global Insight	+250,000	+690,000
Macroeconomic Advisers	+250,000	+620,000
Moody's Economy.com	+502,000	+1,073,000

Source: CEA, "The Economic Impact of the American Recovery and Reinvestment Act of 2009: First Quarterly Report," September 10, 2009.

Notes: a. Datapoint reflects an estimate for June.
b. Datapoint reflects an estimate for August.

The estimates indicate that as of August, the ARRA had raised employment relative to the baseline by between 600,000 and 1.5 million jobs.

At the end of October, the Recovery Board will release estimates of the number of jobs created or saved reported by recipients of certain ARRA funds. Importantly, only about one-third of ARRA spending is covered by the direct reporting data. The tax cuts, unemployment insurance, payments to seniors, and much of the state fiscal relief are not amenable to direct reporting. And, the reporting data only cover the direct impact of the spending. Any multiplier effects resulting from the increased spending of workers hired or retained because of ARRA

funds are not covered by the reports. As a result, the directly reported job creation and retention estimates will only be a fraction of the total employment impact. Even so, we anticipate that these reports will confirm that the Recovery Act has had a significant impact on employment in its first eight months of existence.

In addition to the current policy response, the U.S. economy has benefited from some important policy developments and institutional changes since the 1930s. One development is the rise of automatic stabilizers. Since the Great Depression, the government budget has become substantially more cyclically sensitive. We have a larger tax system and a social safety net that leads automatically to higher government spending in a recession. The result is a budget deficit that naturally swells in a severe downturn. This process helps to counteract the decline in aggregate demand, and has been working strongly in the current episode.

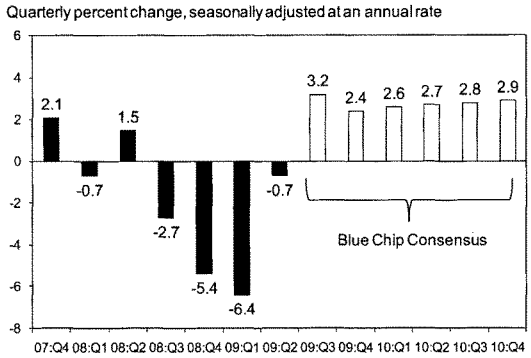
Another past policy development that has served us extremely well in the current crisis has been the existence of deposit insurance. Despite all the uproar in financial markets last fall, one striking fact is that ordinary Americans never lost faith in the security of their bank deposits. It is a credit to the quiet efficiency and stellar reputation of the Federal Deposit Insurance Corporation (FDIC) that over a hundred banks have failed since last fall with barely a ripple felt by depositors.[7] This well-functioning system short-circuited a channel through which the sfinancial crisis could have mushroomed. The FDIC's ability and willingness to insure the issuance of debt by larger banks was also a key factor containing the crisis.

III. Economic Outlook

Forecasts. Because of the unprecedented policy response, the economic outlook has improved markedly in recent months. Figure 2 shows the growth rate of real gross domestic

product (GDP) since the end of 2007, together with the Blue Chip consensus forecast for 2009Q3 through the end of 2010.

Figure 2
Real GDP Growth



Sources: GDP data from Department of Commerce, Bureau of Economic Analysis.
Forecast from October 10, 2009 Blue Chip Economic Indicators.

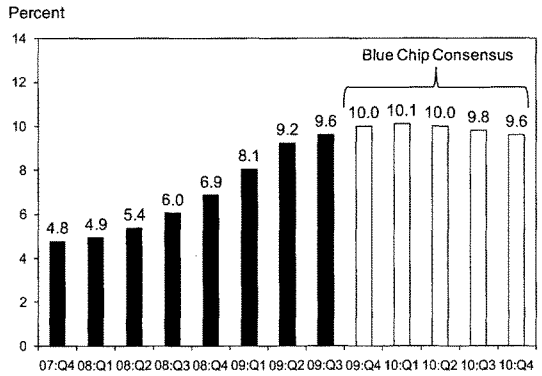
The path of actual GDP growth emphasizes just how severe the current recession has been. Real GDP fell 3.8 percent between the second quarter of 2008 and the second quarter of 2009. The fall at a 6.4 percent annual rate in the first quarter of this year was the third worst quarterly decline since 1947, and the worst since 1980Q2. Equally notable is the improvement in GDP performance in the second quarter. Though still declining, the moderation in the rate of decline represented the largest improvement in real GDP growth since 2000.

The Blue Chip forecast shows that GDP growth is anticipated to be positive in the third quarter, and each subsequent quarter through the end of 2010. The CEA's analysis of the component data released to date, including the monthly data on personal consumption expenditures, core capital goods shipments, and industrial production, is roughly consistent with the Blue Chip estimate for the third quarter. There is a substantial range of uncertainty around

any forecast. However, if GDP growth for the third quarter is indeed positive, as anticipated, this would be strong evidence that economic recovery is underway.

Figure 3 shows the actual quarterly behavior of the unemployment rate beginning at the business cycle peak in 2007Q4. It continues with the Blue Chip forecast through the fourth quarter of 2010.

Figure 3
Unemployment Rate



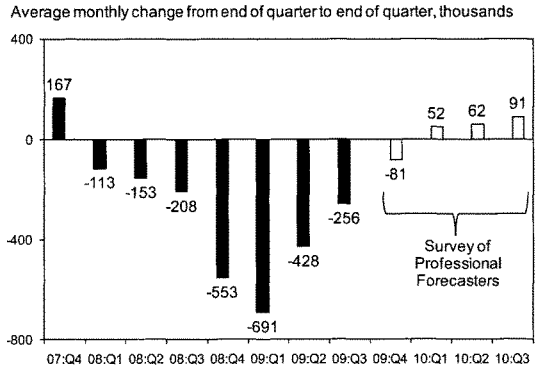
Sources: Unemployment data from Department of Labor, Bureau of Labor Statistics. Forecast from October 10, 2009 Blue Chip Economic Indicators.

Consistent with the recent cyclical pattern, the unemployment rate is predicted to continue rising for two quarters following the resumption of GDP growth. Whether this happens and how high the unemployment rate eventually rises will obviously depend on the strength of the GDP rebound. Leaving aside timing issues, the unemployment rate typically falls when GDP growth exceeds its normal rate of roughly two and a half percent per year and rises when GDP growth falls short of this pace. With predicted growth right around two and a half percent for most of the next year and a half, movements in the unemployment rate either up or down are likely to be

small. As a result, unemployment is likely to remain at its severely elevated level.

Figure 4 shows the quarterly average of the monthly change in payroll employment.

Figure 4
Payroll Employment Growth



Sources: Payroll data from Department of Labor, Bureau of Labor Statistics.
Forecast from the third quarter 2009 Survey of Professional Forecasters.

The enormous declines over the last four quarters are graphic evidence of how horrible this recession has been for American workers. Since the recession began in December 2007, payroll employment has fallen by 7.2 million. Given that employment growth of nearly 100,000 per month is necessary to keep up with normal labor force growth, employment is currently about nine million below its normal trend level.

Because a Blue Chip forecast does not exist for employment, we continue the graph with consensus forecasts from the Survey of Professional Forecasters. These forecasts suggest payroll employment loss will slow substantially in the fourth quarter of this year and payroll employment growth will then turn positive in the first quarter of next year. Importantly, employment growth is expected to be quite low (below 100,000 per month) through the end of

the forecast in the third quarter of 2010. This is consistent with forecasts of modest GDP growth and continued high unemployment. Thus, while job losses will likely end early next year, robust job gains may still be several quarters away.

Risks to the Forecast. All forecasts are subject to substantial margins of error, and the errors are often particularly large at times like the present, when the economy is near an inflection point. For this reason, it is important to consider the possible risks to the forecasts.

First, there are reasons to think that GDP growth could be either weaker or stronger than the consensus forecast. On the weaker side, one concern is the leveling out of fiscal stimulus. Fiscal stimulus has its greatest impact on growth around the quarters when it is increasing most strongly. When spending and tax cuts reach their maximum and level off, the contribution to growth returns to roughly zero. This does not mean that stimulus is no longer having an effect. Rather, it means that the effect is to keep GDP above the level it would be at in the absence of stimulus, not to raise growth further. Most analysts predict that the fiscal stimulus will have its greatest impact on growth in the second and third quarters of 2009.[8] By mid-2010, fiscal stimulus will likely be contributing little to growth.

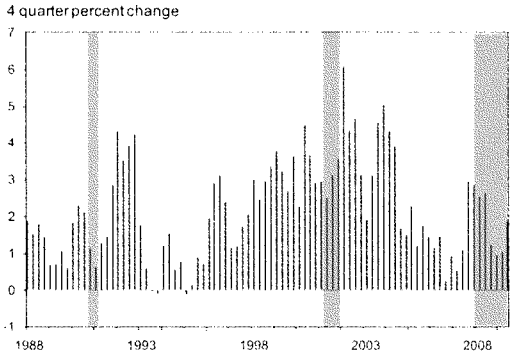
Related to this, continued tightness in credit markets is a concern. According to the Federal Reserve Board's Senior Loan Officer Opinion Survey, last released in August 2009, lending standards had ceased to tighten as rapidly as they had last fall and winter, but they had not yet begun to loosen.[9] Quantity measures of lending and issues of corporate debt remain low and small-business owners in particular report significant credit tightness.[10] On the other hand, credit spreads are down dramatically from the fall of 2008, suggesting some easing of conditions.[11] Tight credit market conditions are a factor that could hamper recovery of private sector demand and tamp down future GDP growth.

On the positive side, surveys of consumer and business confidence have risen substantially in recent months, and the stock market has increased as well. For example, both the Michigan survey and the Conference Board measure of consumer sentiment show dramatic improvement from earlier in the year.[12] Likewise, the Conference Board CEO Confidence Survey and the Business Roundtable CEO Economic Outlook Survey show that business leaders have become more optimistic in both the second and third quarters of 2009.[13] The S&P 500 has increased 62 percent from its low point in March, and 22 percent since the end of 2008.[14] If such measures continue to rise strongly, private demand could rise more rapidly than anticipated, which would raise GDP growth.

Risks to the GDP forecast would translate into risks to the employment and unemployment forecasts. If GDP growth falls substantially short of 2½ percent per year, the unemployment rate would likely continue to rise and employment to decline. If GDP rises strongly, labor market indicators could improve more quickly.

In addition, one has to consider separate risks to the employment forecast. Figure 5 shows the percentage change in labor productivity from four quarters before for the period 1988 to the present, with recession periods shaded in grey.

Figure 5
Productivity Growth



Source: Department of Labor, Bureau of Labor Statistics, Nonfarm Business Sector Productivity.
Note: NBER recessions shaded in grey.

In the recoveries from the last two recessions, productivity has risen rapidly. This, together with slow GDP growth, resulted in unusually weak labor market improvement for several quarters following the business cycle troughs.

In the current recession, productivity has increased substantially. If GDP growth comes in as expected in the third quarter, the rise in productivity would be particularly large. A continuation of this behavior could lead to weaker than expected employment gains and possibly continued job loss. On the other hand, because productivity has risen substantially during the recession, it is possible that firms have pushed the productivity of current workers as far as possible. In this case, GDP gains could translate particularly strongly into employment increases.

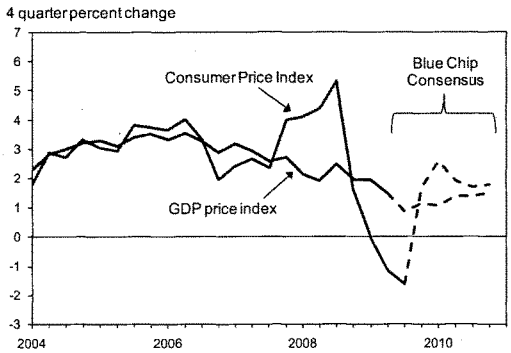
Inflation Concerns. While it is natural to focus most closely on real economic variables such as GDP and employment, much recent discussion has focused on the possibility of inflation.

Some have expressed concern that the unprecedented monetary actions taken by the Federal Reserve and the similarly unprecedented fiscal actions taken by Congress and the Administration have created conditions likely to result in inflation.

Such concerns are unwarranted in the near and medium term. Historically for the United States, the main determinant of movements in inflation is the relationship between output and the economy's productive capacity, with additional influences from oil price movements and other supply disturbances.[15] When output and employment are high relative to the economy's comfortable capacity, inflation rises, as it did in the late 1960s and late 1970s. When output and employment are low relative to capacity, inflation falls, as it usually does during and after recessions.[16] Economic theory and evidence suggests that there is a relationship between monetary expansion or budget deficits and inflation, but that it operates via the demand for goods: rapid money growth and large budget deficits lead to inflation when they fuel a growth in demand beyond the economy's normal capacity.

The behavior of inflation so far over the recession and forecasts of its likely behavior going forward fit with this view. Figure 6 shows inflation measured using both the consumer price index, which is highly influenced by the behavior of food and energy prices, and the GDP price index, which is less influenced by these volatile components. The figure shows that both measures of inflation have fallen over the course of the recession.

Figure 6
Inflation Rate



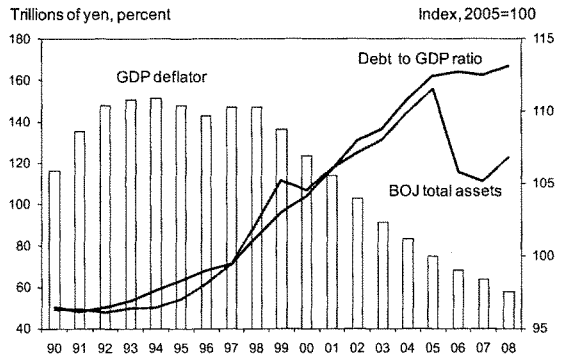
Sources: Actual GDP inflation comes from the Bureau of Economic Analysis. Actual CPI inflation comes fom the Bureau of Labor Statistics. Forecasts are from October 10, 2009 Blue Chip Economic Indicators.
Notes: Solid lines represent actual inflation, whereas dashed lines represent Blue Chip forecasts. The GDP inflation forecast begins in 2009Q3, and the CPI inflation forecast begins in 2009Q4. The Blue Chip 4 quarter percent changes are imputed from the reported quarterly growth forecasts.

Measures of expected inflation, whether from professional forecasters (such as the one shown in the chart), surveys of consumers, or inferences based on interest rates on inflation-protected securities, all show that expectations of inflation remain subdued.[17] Indeed, it appears that the major reason that actual and expected inflation have not fallen further is that the Federal Reserve's record of inflation control over the past quarter century has kept inflation expectations well anchored.

Even stronger evidence that a large expansion of central bank reserves and budget deficits in a weak economy do not lead to inflation comes from Japan. Starting in 2001, the Bank of Japan undertook a massive expansion of bank reserves in an economy where short-term interest rates had effectively reached zero, much as the Federal Reserve has done over the past year. In addition, the continued stagnation of the economy and demographic changes, coupled

with occasional (though limited) efforts at fiscal stimulus, led to large budget deficits. As Figure 7 shows, in the face of this expansion, the price level in Japan has fallen steadily—that is, there has been not inflation, but deflation.

Figure 7
Inflation, Debt and Monetary Policy in Japan



Source: Bank of Japan.
Notes: GDP deflator measured as an index on the right axis. Debt to GDP ratio is a percent on the left axis. Bank of Japan total assets measured in trillions of yen on the left axis.

This reinforces the message that the relevant inflation worry in a weak economy is inflation that is too low, not too high.

IV. Challenges We Face Going Forward

Likely economic conditions present policymakers with many challenges going forward. First, the switch from decline to growth may lead to calls for the end to rescue operations. As I have described, the economic trauma of the past year has been extreme and has led to unprecedented and sometimes unpopular government actions. As the immediate crisis fades,

there may be a tendency to wish to return to more normal policy positions.

Such a premature end to stimulus would be misguided. The forecasts I have described are largely predicated on continued fiscal ease and the Federal Reserve's announced policy that "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."[18] Excessive moves toward fiscal policy tightening could lead to a return to output decline and a reacceleration of job losses. The current policies that have generated a dramatic turnaround of the economy need to be seen through to their completion.

A second challenge that we face is clearly the budget deficit. The final numbers just released show that the fiscal 2009 deficit reached $1.4 trillion, or about 10 percent of GDP.[19] The Mid-Session review released in August predicted a similarly large deficit in 2010, and substantial structural deficits even once the recession is over and the economy is fully recovered.[20] Such long-term deficits are unacceptable and need to be dealt with. Over the long run, sustained deficits crowd out private investment and reduce long-run growth.

Given the current precarious state of the economy, substantial near-term spending cuts or tax increases to reduce the deficit would threaten the recovery. However, the current efforts for health insurance reform present a critical opportunity to improve the long-run fiscal situation dramatically. Health reform that is at least revenue neutral in the short run, and that genuinely slows that growth rate of costs in the long run, is a crucial precondition for reducing the long-run deficit.

A third policy challenge that we face is the likelihood that labor market conditions will remain painfully weak through 2010. As I have described, current forecasts do not predict substantial employment gains in 2010, and unemployment is unlikely to end 2010 much below its current levels. The suffering and potential permanent damage that such a sustained period of

high unemployment will bring is likely to spur calls for further action to stimulate employment growth and cushion the effects of unemployment.

As policymakers consider the options, rigorous evaluation of alternatives must be conducted. Particularly in the context of large budget deficits, the efficacy of different options must be considered. Whether expiring programs are continued or new programs are instituted should be decided on the basis of their efficacy in putting people back to work and improving the future strength of the economy.

V. Conclusion

As I have described, the last year has been one of extreme challenge and aggressive policy response. That many analysts believe the low point of the recession has been reached is perhaps the most concise evidence that the policies are working.[21] A recession that showed no signs of ending last January appears to be firmly entering the recovery phase.

Unfortunately, despite this dramatic turnaround, the U.S. economy still faces many challenges. We enter the fourth quarter of 2009 with the unemployment rate nearing 10 percent and likely to remain severely elevated. The Congress and the Administration will need to continue their excellent record of policy coordination to not just start the process of recovery, but to finally finish it.

ENDNOTES

[1] Stock price data for 1929 are the S&P 90, a daily index with 50 industrial stocks, 20 railroad stocks, and 20 utilities, and the data for 2008 are the S&P 500. The data are from Global Financial Data, https://www.globalfinancialdata.com/, series SPXD. House price data are from the Federal Housing Finance Administration seasonally-adjusted purchase-only house price index, http://www.fhfa.gov/webfiles/14980/MonthlyHPI92209.pdf. Data on household wealth in the 1920s are from Wojciech Kopczuk and Emmanuel Saez, "Top Wealth Shares in the United States, 1916–2000," *National Tax Journal* 57 (June 2004): 445-487. Estimates of nominal end-of-year household net worth were provided by the authors via email. Data on modern household wealth are from Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, Table B.100, http://www.federalreserve.gov/datadownload. The Flow of Funds estimate includes wealth of both households and nonprofit organizations. The Kopczuk and Saez estimate of household net worth overlaps with the Flow of Funds for the years 1952-2002. Over this period the correlation between the two series of annual percent change in net worth is 0.99.

[2] Data for 1929 are the S&P 90; data for 2008 are the S&P 500. Variances are calculated over the daily percent return for September through December of each year. The variance was 16.3 for September through December 2008; 12.0 September through December 1929. For all of 1930 variance was 2.4, and 3.3 for September through December 1930.

[3] Board of Governors of the Federal Reserve System, Selected Interest Rates, http://www.federalreserve.gov/datadownload. AAA rates through December 6, 2001 are an average of AAA utility bonds and AAA industrial bonds. AAA rates from December 7, 2001 on are an average of AAA industrial bonds only.

[4] According to the Treasury Department, over 500,000 homeowners have entered into trial modifications under the Administration's program. See U.S. Department of the Treasury, Making Home Affordable Program, Servicer Performance Report Through September 2009, http://www.treas.gov/press/releases/docs/MHA%20Public%20100809%20Final.pdf.

[5] Detailed estimates of the components of the American Recovery and Reinvestment Act of 2009 are from the Congressional Budget Office, "Cost Estimate for the Conference Agreement for H.R. 1," February 13, 2009, available at http://www.cbo.gov/ftpdocs/99xx/doc9989/hr1conference.pdf. CBO provides estimates by fiscal year. The assumption that the stimulus in 2010Q4 will equal the average quarterly stimulus in fiscal 2010 implies that the total stimulus beginning in 2011 is $103 billion.

[6] This figure is from www.recovery.gov, and represents the difference between ARRA obligations and outlays through September 30, 2009.

[7] The list of failed banks is available on the FDIC website, at http://www.fdic.gov/bank/individual/failed/banklist.html.

[8] See, for example, Goldman Sachs, "US Daily: Fiscal Stimulus: A Little Less in Q2, A Little More Later (Phillips)," August 4, 2009; Macroeconomic Advisers, "The US Economic Outlook: Is the Upturn Imminent? How Strong?" presentation by Chris Vavares, June 11, 2009, exact quarterly figures from email communication; Moody's economy.com, described in Mark Zandi, "U.S. Fiscal Stimulus Revisited," DismalScientist, June 22, 2009, exact quarterly numbers from email communication.

[9] The Federal Reserve Board's Senior Loan Officer Opinion Survey is available at http://www.federalreserve.gov/boarddocs/snloansurvey/200908/.

[10] According to the Federal Reserve Board (FRB), Table 1.46, in August, $59 billion of bonds were issued by U.S. corporations, up from the recent low of $25 billion in October 2008, but down from the first half of 2009 and substantially below the $200 billion 2005-2007 average. See http://www.federalreserve.gov/econresdata/releases/corpsecure/current.htm. The value of commercial paper issued in the third quarter of 2009 was below any other quarter since 2004, as reported in the FRB Commercial Paper release, http://www.federalreserve.gov/releases/cp/volumestats.htm. Commercial and industrial loans by domestically-chartered banks have decreased steadily since their peak in October 2008, according to the FRB release H.8, http://www.federalreserve.gov/releases/h8/current/default.htm. The National Federation of Independent Business (NFIB) reported that the net percent of firms reporting that credit was harder to get was 14 percent in both August and September 2009, up from an average of 9 percent in 2008 and 6 percent in 2007. Data are from NFIB Small Business Economic Trends survey, http://www.nfib.com/tabid/350/Default.aspx, and downloaded from Haver Analytics on October 21, 2009.

[11] For example, the spread between the Moody's BAA bonds and the Treasury 30-year nominal bonds fell 251 basis points between April and September of this year. Interest rate data are from FRB table H.15, http://www.federalreserve.gov/releases/h15/current/h15.htm.

[12] The University of Michigan index of consumer sentiment was an average of 68.4 in the third quarter of the year, up for an average of 58.2 in the first quarter of 2009. See University of Michigan/Reuters, Surveys of Consumers, http://www.sca.isr.umich.edu/main.php. The 2009 press release can be found on the Reuters website: https://customers.reuters.com/community/university/default.aspx. The data were downloaded from Haver Analytics on October 19, 2009. The Conference Board consumer confidence index rose from an average of 29.9 in the first quarter to an average of 51.7 in the third quarter. See the Conference Board, Consumer Confidence Survey, http://www.conference-board.org/economics/consumerConfidence.cfm. The data were downloaded from Haver Analytics on October 19, 2009.

[13] The Conference Board Measure of CEO Confidence rose from a low of 24 in the fourth quarter of 2008 to 55 in the second quarter of 2009 and 63 in the third quarter. See the Conference Board, "CEO Confidence Improves in the Third Quarter," http://www.conference-board.org/attach/CEOCQ32009.pdf. The Business Roundtable Economic Outlook Survey Diffusion Index rose from -5.0 in the first quarter of 2009 to 18.5 in the second quarter and 44.9 in the third. See Business Roundtable, "Business Roundtable Releases Third Quarter 2009 CEO Economic Outlook Survey," http://www.businessroundtable.org/sites/default/files/Business%20Roundtable%20Releases%20Third%20Quarter%202009%20CEO%20Economic%20Outlook%20Survey.pdf.

[14] Daily measures of the Standard & Poor's 500 stock price index were downloaded from Haver Analytics on October 20, 2009, which collects the series from the *New York Times*. The stock price index reached its lowest point of 677 on March 9, 2009. The index rebounded to 1098 on October 19, 2009, 62% higher than the low in March, and 22% higher than the December 31, 2008 index of 903.

[15] For discussions of the determinants of inflation, see, for example, James H. Stock and Mark W. Watson, "Phillips Curve Inflation Forecasts," National Bureau of Economic Research Working Paper No. 14322, September 2008; Robert J. Gordon, "The History of the Phillips Curve: Consensus and Bifurcation," unpublished paper, Northwestern University, March 2009; Laurence M. Ball and N.

Gregory Mankiw, "Relative-Price Changes as Aggregate Supply Shocks," *Quarterly Journal of Economics* 110 (February 1995), 161-193; Douglas Laxton, David Rose, and Demosthenes Tambakis, "The U.S. Phillips Curve: The Case for Asymmetry," *Journal of Economic Dynamics and Control* 23 (September 1999), 1459-1485.

[16] For the behavior of inflation, see, for example, http://research.stlouisfed.org/fred2/graph/?chart_type=line&s[1][id]=CPIAUCSL&s[1][transformation]=pc1.

[17] The forecasting firm Macroeconomic Advisers predicts an average core CPI inflation rate of 1 percent (at an annual rate) from 2009Q3 to 2011Q4 as of September 21, 2009. Differences between yields on Treasury Inflation-Protected Securities (TIPS) and yields on nominal Treasury notes imply measures of breakeven inflation rates that are the rate of inflation that would give an investor the same return at maturity on a nominal security and on a TIPS. These breakeven inflation rates reflect investors' inflation expectations as well as liquidity premia and inflation risk premia. Averaged over the month of August, the implied breakeven inflation rate over 5 years from 5-year TIPS was 1.3 percent, and the implied breakeven inflation rate over 10 years from 10-year TIPS was 1.8 percent. The TIPS and nominal rates were reported by the Board of Governors of the Federal Reserve System and the calculations were done by Haver Analytics. The Federal Reserve Bank of Philadelphia, *The Livingston Survey* (June 2009), reports expected CPI inflation of 1.7 percent for 2009-2010. Their long-term (10-year) CPI expectation is 2.36 percent. See http://www.phil.frb.org/research-and-data/real-time-center/livingston-survey/.

[18] See Federal Reserve Press Release for September 23, 2009, http://www.federalreserve.gov/newsevents/press/monetary/20090923a.htm.

[19] U.S. Department of the Treasury, Joint Statement of Tim Geithner, Secretary of the Treasury, and Peter Orszag, Director of the Office of Management and Budget, on Budget Results for Fiscal Year 2009, http://www.ustreas.gov/press/releases/tg322.htm.

[20] U.S. Office of Management and Budget, "Mid-Session Review, Budget of the U.S. Government: Fiscal Year 2010," Table 1, http://www.whitehouse.gov/omb/assets/fy2010_msr/10msr.pdf.

[21] Blue Chip Economic Indicators, September 10, 2009, p. 14. In response to special question number 1, "Is the U.S. recession over?," 81.8% of respondents answered yes.

PREPARED STATEMENT OF MICHAEL C. BURGESS, M.D.

The economic outlook is bleak and we are going to go down as the most job-killing Congress in history. Since the stimulus passed—which I did not vote for—unemployment has skyrocketed from 6% to nearly 10%. At the same time, the Democrats have increased taxes; moved on cap-and-tax . . . I mean cap-and-trade; Democrats are going to pass a health care bill which costs nearly a trillion dollars and doesn't do anything to make the actual cost of service lower.

A trillion dollars is a funny thing. It's a hard thing to understand but let's put this in relation to time. One million seconds comes out to be about 11½ days. A billion seconds is 32 years. And a trillion seconds is 32,000 years.

I feel like it's been 32,000 years since this new Administration started instead of nine months.

Our national deficit for this year alone is $1.5 trillion. This is a trillion more than this time last year. The Obama Administration has been saying this is because they inherited a financial mess and used that excuse to pass a $787 billion stimulus bill which only 22% has been handed out. That's like telling someone in the mist of the Mt. Saint Helens volcanic eruption to use a swimming pool to put the fire out.

Why has only 22% of the stimulus money been handed out? We are shedding jobs at a scary rate—and all we seem to be doing is give out more unemployment dollars.

Furthermore, the second quarter GDP numbers show that private investment went negative while the federal, state and local spending went up, thus showing better GDP. What is the federal government's exit strategy from shoring up the private sector?

Already, the consequences are immense. I already talked about the deficit. Then we have to consider the diminished value of the dollar.

These are serious concerns, in a tough time, and it's curious that we are hearing conversations about yet another stimulus. If things are going so well, if GDP is allegedly up 3.1% this third quarter; if the Obama stimulus has created the million plus jobs that they are touting, then why is there even talk of yet another stimulus bill?

I look forward to hearing from Ms. Romer to hear how the Obama Administration will finally stop borrowing money to spend on programs which aren't creating jobs.

Thank you.

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