IMPEDIMENTS TO JOB CREATION

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MARCH 30, 2011

Serial No. 112–09

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

70–877 WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

DAVE CAMP, Michigan, *Chairman*

WALLY HERGER, California
SAM JOHNSON, Texas
KEVIN BRADY, Texas
PAUL RYAN, Wisconsin
DEVIN NUNES, California
PATRICK J. TIBERI, Ohio
GEOFF DAVIS, Kentucky
DAVID G. REICHERT, Washington
CHARLES W. BOUSTANY, JR., Louisiana
DEAN HELLER, Nevada
PETER J. ROSKAM, Illinois
JIM GERLACH, Pennsylvania
TOM PRICE, Georgia
VERN BUCHANAN, Florida
ADRIAN SMITH, Nebraska
AARON SCHOCK, Illinois
LYNN JENKINS, Kansas
ERIK PAULSEN, Minnesota
KENNY MARCHANT, Texas
RICK BERG, North Dakota
DIANE BLACK, Tennessee

SANDER M. LEVIN, Michigan
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York

JON TRAUB, *Staff Director*
JANICE MAYS, *Minority Staff Director*

CONTENTS

IMPEDIMENTS TO JOB CREATION

WEDNESDAY, MARCH 30, 2011

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The committee met, pursuant to call, at 10:03 a.m., in Room 1100, Longworth House Office Building, the Honorable Dave Camp [chairman of the committee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Camp Announces Hearing on Impediments to Job Creation

March 23, 2011

Congressman Dave Camp (R–MI), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on government policies and actions that are impediments to job creation. **The hearing will take place on Wednesday, March 30, 2011, in Room 1100 of the Longworth House Office Building, beginning at 10:00 A.M.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

There is widespread acknowledgment that the current pace of job creation in the United States is not sufficient to significantly reduce the nation's persistently high unemployment rate. If the current rate of growth continued, the unemployment rate would not return to "normal" until 2016 or later. With nearly 14 million Americans unemployed, and millions more unable to find full-time work or so discouraged that they've given up even looking for a job, Congress must ensure that government policies and actions are not preventing job creation. Many employers and economists believe that the recent increases in the scale and scope of government intervention in the economy are contributing factors to the lack of private sector job creation. Additionally, a bipartisan chorus of experts have stated that large deficits and debt significantly hamper the U.S. economy and limit economic growth. The hearing will explore the extent to which the expansion of the role of government is impeding economic growth and the extent to which current and projected budget deficits and debt are suppressing activity in the private sector and therefore suppressing job growth.

In announcing the hearing, Chairman Camp stated, **"Contrary to what some in Washington believe, we cannot spend our way to prosperity. Washington needs to create an environment that allows the private sector to do what it does best—invest and create jobs. This hearing will help us identify areas where Congress needs to act to ensure that the government is not impeding job creation."**

FOCUS OF THE HEARING:

The hearing will focus on identifying impediments to job creation and the impact of budget deficits and growing debt levels in particular.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on April**

13th, 2011. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721 or (202) 225–3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman CAMP. The Ways and Means Committee will come to order for a full committee hearing on Impediments to Job Creation. If members would take their seats and members of the audience would take their seats, we will begin shortly.

I think every member of this committee, Republican and Democrat alike, would agree on one basic fact, and that is the U.S. economy is not growing fast enough. If the pace of private sector job creation does not increase significantly, the national unemployment rate will remain unacceptably high for at least another 5 years.

Currently, there are 14 million Americans who are unemployed. Millions more have given up looking for a job. These families have already waited too long for Congress to figure out we cannot spend our way to prosperity and job growth. Our experience over the last 2 years is clear; more government intervention fueled by more debt and higher taxes is not the answer. I am not sure that all of my colleagues in Congress have figured this out yet, and I hope they will listen carefully to what we will hear this morning.

During the President's Deficit Commission on which I, Mr. Ryan and Mr. Becerra from this committee all served, we heard nonpartisan testimony that once a Nation's total debt equaled 90 percent of its Gross Domestic Product, that that became a drag on economic growth. In fact, it would slow growth by about 1 percent a year.

The fact that large amounts of government debt slow down job creation should not be lost on lawmakers, especially since according to CBO, by the end of this year, our total debt will be over 100 percent of our GDP. The U.S. debt is so large that these experts warned it is costing us about a million jobs.

I have had a chance to preview the witnesses' testimony, and they agree the recent run-up in the size and cost of government is holding our economy back. The Federal Government has grown so large it is casting a dark shadow over our recovery and literally has the families and employers I talk to in Michigan scared. Given that our debt well exceeds $40,000 for every man, woman and child in the country, you can understand why.

The American people know we are on an unsustainable path. What they don't know is when the system will come crashing down on them; when Washington will come looking to them for even more tax revenues or when foreign governments that are financing our debt, especially China, will call on us to repay the loans we have taken out.

While fear can be a motivating factor, it has never propelled a Nation to prosperity. In our current situation, just the opposite appears to be true. Fear over rising debt levels and higher taxes has scared families and employers stiff. Small and large businesses alike are so uncertain about the future, they are even sitting on profits rather than invest them in this landscape of uncertainty. Not surprisingly, the result has been anemic job creation.

The American public understands intuitively what economic research confirms. The smart policy is to control government spending. Based on the testimony I have seen, we will hear a lot of expert agreement this morning that this is the most effective path to addressing both our Nation's fiscal crisis and our Nation's job crisis. We need to get the government out of the way and let the private sector do what it does best, invest and create jobs.

The problems created by growing deficits and debt are not new, nor are they the creation of one party alone. But they have gotten much more severe and what many viewed as a future problem is firmly here today. The truth is, there is plenty of blame to go around. But it would be a shame if we fall into the habit of pointing fingers rather than working to find bipartisan solutions that allow government to carry out its important functions without imposing crippling tax burdens on its families and job creators.

I look forward to hearing from our witnesses in a few minutes, but I will now yield to Ranking Member Sandy Levin for the purposes of his opening statement.

Mr. LEVIN. Thank you, Mr. Chairman. This is a hearing on impediments to job creation. A major impediment to job creation is the failure of the majority in the House to take any specific steps for job creation. In this committee, they have not marked up a single jobs bill. And when we on the Democratic side introduce a jobs bill, like the continuation of the very successful Build America Bonds, there is nothing in response but stony silence. Clearly, we must take steps to address the deficit.

When the President took office, he had facing him a $1.5 trillion deficit. But the deficit must not undermine economic recovery, or be used as a maneuver to tear apart the fabric of programs that are important for American families. This is exactly what happens when a party is gripped by extremism. This extremism is reflected in H.R. 1, which undermines important education programs like Pell Grants and Head Start, that represent vital investment in our future growth in jobs, law enforcement funding like the COPS program, that puts police on our streets, and environmental programs such as the Clean Water Revolving Fund, which creates jobs and ensures we have safe drinking water.

Attacks on these programs is consistent with, and in my judgment, indeed encouraged by Republican witness testimony presented today with the blanket statement, “The disease is government spending.” It is also supported by the approach of another witness, Mr. Biggs, who years ago said the following in support of privatization of Social Security. “In that way, Social Security reform, featuring personal retirement accounts, doesn’t send just one liberal sacred cow to the slaughterhouse, it sends the whole herd. The greatest long-term effect of reforming Social Security to personal retirement accounts will not be on individual retirement savings, it will be on the way they view their relationship to the government to the economy and to each other.”

If one wants to talk about a slaughterhouse and impediments to job creation, Federal Reserve Chairman Bernanke has predicted that the House Republican plan would lose, “A couple of hundred thousand jobs,” and there are estimates that go way beyond the 200,000 or several hundred thousand.

Being very uncomfortable, Republicans have suddenly decided that they had better try to frame their efforts by pinning to them the word jobs. But playing games with words won’t work. It is not a substitute for real action. If we want to talk about jobs and American families, real action would include bringing trade adjustment assistance up for a vote on the floor of the House.

Now having lapsed, the 2009 program allowed almost 200,000 workers without a job to undertake retraining as they try to find a job. This legislation was passed by this committee, but it has shamefully been set aside by House Republicans guided by the rigid ideology that is so rampant within the Republican conference. We need to take real action to help put Americans back to work. We welcome this debate and we look forward to the testimony today.

Chairman CAMP. Thank you, Mr. Levin. I would say that this committee did pass the repeal of 1099s, which received a large bipartisan vote on the House floor and support of more than 70 Democrats, which actually helps small businesses in their efforts to create jobs.

Today’s panel includes four witnesses. Dr. Edward Lazear from Stanford University. Dr. Andrew Biggs from the American Enterprise Institute, Dr. Heather Boushey from the Center for American Progress, and Dr. Veronique de Rugy from the Mercatus Center at George Mason University. I would like to thank all of our witnesses today for their participation in today’s hearing.

STATEMENTS OF EDWARD LAZEAR, PROFESSOR, STANFORD UNIVERSITY; ANDREW BIGGS, RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE; HEATHER BOUSHEY, SENIOR ECONOMIST, CENTER FOR AMERICAN PROGRESS; AND VERONIQUE DE RUGY, SENIOR RESEARCH FELLOW, MERCATUS CENTER, GEORGE MASON UNIVERSITY

Chairman CAMP. Each of you will be given an opportunity to use 5 minutes to present your testimony. Your full written statements will be entered into the record in their entirety. After all the panel completes their statements, we will then go to member questioning. So I will begin by recognizing Dr. Lazear for 5 minutes, thank you and welcome.

Mr. LAZEAR. Chairman Camp.

Chairman CAMP. If you could pull the microphone close, and you do have to push a button to make sure it is on. There should be a green light. Not now, no. Try again.

Mr. LAZEAR. Now?

Chairman CAMP. Try the other one.

Mr. LAZEAR. It is red.

Chairman CAMP. We will check for a second and see what is happening.

Mr. LAZEAR. It is not a good start.

Chairman CAMP. We will have you slide over.

I apologize for the technical glitch.

STATEMENT OF EDWARD LAZEAR

Mr. LAZEAR. All right.

Chairman Camp, Ranking Member Levin and Members of the Committee, thank you for giving me the opportunity to speak to you today. In my 5 minutes, I would like to cover three issues. First, as is becoming well accepted, the current spending pattern is unsustainable. Second, the problem was created by policy and can be remedied by changing policy. Third, if the spending picture is not altered, economic growth will suffer, and with it employment, wages and the standard of living of the typical American.

It is becoming common knowledge that the U.S. budget deficit is a threat to our long run economic survival. As our debt gets large relative to GDP, we will eventually have to service this debt out of tax revenues and offsets in other spending. More important will be the effect on the private economy as high levels of government borrowing raise interest rates and stifle business investment. A well-known study suggests that growth could fall by half at debt levels that we are rapidly approaching.

Although the discussion is usually put in terms of the deficit, focusing on the deficit can lead to the wrong policy choices. The deficit is the difference between expenditures and revenues, but it is not only the difference that matters. The economic literature has documented that higher taxation also impedes growth. If spending is high, taxes must also be high to control the deficit.

Policy is primarily responsible for the large deficits that are projected to be sustained into the near and distant future, although it is true that tax receipts fall during recessions. As economic activity rebounds, so to does revenue. The spending side is different. It is controlled by government policy and the President's projections move our post recession spending ratios up considerably from our historic norm of 20.8 percent. The long run numbers are frightening as chart 1 shows. The President's projections show an expanding gap between expenses and receipts. This implies that the deficit and debt will rise in the future, perhaps to crisis levels.

I believe that we should take immediate actions to retrace our footsteps. We are currently well above the historic spending levels, but we can return to sustainable spending without slowing the recovery. This would require that we cut spending significantly in the next couple of years.

In addition, I believe that we should institute a rule that constrains the growth in spending to the inflation rate, minus 1 percent point, which would return us to historic levels in a few years.

With the unemployment rate still close to 9 percent, job creation is obviously a primary focus. In the short run, increased employment comes with economic growth as chart 2 shows. If you can switch the chart please, thank you. You see those lines move parallel there.

The economy rarely creates jobs in the absence of economic growth, but over the longer run, the main effect of economic growth is on wage, which has a direct impact on the typical American standard of living. The link requires two steps. First, GDP growth is usually linked to productivity growth as chart 3 shows. Flip to chart 3, yeah. Second, both theory and experience imply that wage growth comes with productivity growth. Chart 4 shows that periods of high productivity growth are also periods of high compensation growth.

In the labor market it is important to bear in mind one final point. Even during deep recessions a tremendous amount of hiring occurs. At the worst part of the recession, there was still around 3½ million hires per month, which means that over 30 percent of our workforce turned over in a year. Most hiring is for the purpose of replacement, not expansion. To ensure that hiring increases to levels that prevailed at the peak it is important that our labor market remain flexible.

Let me conclude. We can best deal with our labor market problems by ensuring that we have a pro growth economic environment. Perhaps the largest threat to long-term growth is the recent high level of government spending, which will result in high deficits or will require that we raise taxes substantially. Either course impedes economic growth. The high level of spending can be reversed. If we adopt the appropriate policy, we can look forward to economic growth, low unemployment and rising wages. Thank you, and I welcome your questions.

Chairman CAMP. Thank you very much.

[The prepared statement of Mr. Lazear follows:]

Testimony to the Ways and Means Committee on the Effects of Spending and Deficits on Job Growth

Edward P. Lazear

Chairman Camp, Ranking Member Levin and members of the committee: Thank you for giving me the opportunity to speak to you today.

In my five minutes, I would like to cover three issues. First, as is becoming well-accepted, the current spending pattern is unsustainable. Second, the problem was created by policy and can be remedied by changing policy. But raising taxes in an attempt to meet spending is not the right solution to the problem. Third, if the spending picture is not altered, economic growth will suffer, and with it, employment, wages, and the standard of living of the typical American.

It is becoming common knowledge that the US budget deficit is a threat to our long run economic survival. Most concerns are over the effect of the budget deficit on growing debt and the consequence of that debt on the ability of the US to borrow. As our debt gets large relative to GDP, we will eventually have to service this debt out of tax revenues and offsets in other spending, both of which will place significant burdens on the fiscal situation. More important will be the effect on the private economy as high levels of government borrowing raise interest rates and stifle business investment. A well-known study by Reinhart and Rogoff suggest that as debt-to-gdp ratios get above 90%, growth rates fall significantly. By one estimate, economic growth would be about 1½% at a 90% debt-to-gdp ratio, and about 3½% at levels of debt-to-gdp below 30%. Given the President's budget and forecast deficit if enacted, our debt-to-gdp ratio will be over 70% by this time next year.[1]

Although the discussion is usually put in terms of the deficit, focusing on the deficit can lead to the wrong policy choices. Historically (over a thirty year period of 1979-2008), the ratio of federal spending-to-GDP has been 20.8%, while the ratio of receipts-to-GDP has been 18.3%, resulting in an average deficit of 2½%. Chart 1 shows this. The horizontal dotted lines show the long run averages of spending-to-GDP and receipts-to-GDP, at 20.8% and 18.3%, respectively.

The deficit is the difference between expenditures and revenues, but it is not only the difference that matters. It is one thing to have a 2½% deficit when spending is 20.5% of GDP and quite another to have a 2½% deficit when spending is 25% of GDP. In the first case, taxes would equal 18% of GDP. In the second, taxes would equal 22.5% of GDP. The economic literature has documented that it is not only high debt ratios that impede growth. It has also been demonstrated by a number of authors that higher taxation impedes growth. If spending is high,

[1]The relevant debt is publicly held debt, not that which includes that issued by one US government entity and held by another US government entity.

taxes must also be high to control the deficit.[2] Although estimates vary, the conclusion is that the adverse effect of taxation on growth is significant.

Policy is primarily responsible for the large deficits that are projected to be sustained into the near and distant future. Although it is true that tax receipts fall during recessions, as economic activity rebounds, so too does revenue. As the recovery continues, we can expect to return to tax levels that equal about 18% of GDP. The spending side is different. It is controlled by government policy and the President's projections move our post-recession spending ratios up considerably from our historic norm of 20.8%. The long run numbers that he presents are frightening, as Chart 1 shows. While the in the past, there are ups and downs in spending and receipt ratios, the President's projections for the future show an expanding gap between expenses and receipts. This implies that the deficit and debt will rise in the future, perhaps to crisis levels.

The President does not propose to raise taxes by an amount large enough to bring the deficit down to historic levels, nor do I believe that he should. Doing so would deprive Americans of even more of their own wealth and would be bad for the economy. So what is the alternative?

I believe that we should take immediate action to retrace our footsteps. The current ratios of government outlays-to-GDP were surpassed only during World War II. The outlay-to-GDP ratio averaged 20.1% between 2005 and 2008 and the 1979-2008 thirty-year average was 20.8%, well below the 24.4% that we averaged over the past two years. Part of the spending increase over the past two years reflects an attempt to stimulate the economy through increased government spending. We can debate the effectiveness of that stimulus, but let us focus on the future, not the past. The President forecasts this year's ratio to be 25.3% and next years to be 23.6%.[3] Both numbers are too high and sustained spending at these levels will lead to significant debt and lower growth.

It is possible to get back to historic levels in a relatively rapid fashion without slowing the current recovery. This would require that we cut spending significantly in the next couple of years. In addition, I believe we should institute a rule that constrains the growth in spending. In a piece published in the Wall Street Journal about six months ago, I proposed an "inflation-minus-one rule" that would limit the growth in expenditures in any given year to the recent inflation rate, minus one percentage point. Because GDP generally grows considerably faster than this rate, over time, the ratio of spending to GDP would fall. My calculations suggest that, coupled with the initial cuts, we could return to the size of government that prevailed throughout most of our recent history within about four years. Continued restraint would allow us to balance

---

[2]Some examples: Barro (1991) finds that growth is inversely related to the share of government consumption in GDP. Hansson and Henrekson (1994), find that government total outlays have negative effects on productivity. Waldman (1999) find that taxing personal income is negatively related to growth and the more progressive tax structures are associated with lower economic growth. Prescott (2002) argues that the difference in taxation between the US and France explains much of the difference between the two countries' growth rates. Bergh and Karlsson (2010) find that government size robustly correlates negatively with growth.

[3]Economic Report of the President, 2011, Table B-79.

the budget at historic receipts-to-GDP ratios within the decade.

With the unemployment rate still close to 9%, job creation is obviously a primary focus. In the short run, increased employment comes with economic growth, as chart 2 shows. The two series, employment growth and GDP growth, move in tandem. History has shown us that the economy rarely creates jobs in the absence of economic growth. But over the longer run, the main effect of economic growth is on wages, which has a direct impact on the typical American's standard of living. The link requires two steps.

First, GDP growth is usually linked to productivity growth, as chart 3 shows. The one-year-moving-average of GDP and labor productivity are shown to move parallel with one another. When we have good periods of GDP growth, we usually have good periods of productivity growth. To enjoy high productivity growth over a sustained period, rapid economic growth is necessary.

Second, both theory and experience imply that wage growth comes with productivity growth. Chart 4 shows the four-year moving average of productivity growth and wage growth. In periods during which productivity grows rapidly, wages also grow rapidly. When productivity falters, so too do wages.

In the labor market, it is important to bear in mind one final point. Even during deep recessions, a tremendous amount of hiring occurs. At the worst part of the recession, there were still around 4 million hires per month,[4] which means that about 35% of the labor force turned over in a year. Churn is an important feature of our labor market and most hiring is for the purpose of replacement, not expansion. Anything that restricts labor mobility is likely to result in increased unemployment. Europe's severance pay requirements are a case in point. The restrictions placed on employers to separate workers have backfired. Employers are reluctant to hire when they know that they cannot layoff during downturns. To ensure that hiring increases to the levels that prevailed at the peak, it is important that we make sure that our labor market remains flexible.

Let me conclude. We can best deal with our labor market problems by ensuring that we have a pro-growth economic environment. Perhaps the largest threat to long term growth is the recent high level of government spending, which will result in high deficits or will require that we raise taxes substantially. Either course impedes economic growth. The high level of spending can be reversed. If we adopt the appropriate policy, we can look forward to economic growth, low unemployment and rising wages.

Thank you and I welcome your questions.

---

[4]Bureau of Labor Statistics, JOLTS data.

References

Barro, R. J. 1991. "Economic growth in a cross section of countries." *The Quarterly Journal of Economics,* 106(2): 407-443.

Bergh, A. and Karlsson, M. 2010. "Government size and growth: Accounting for economic freedom and globalization." *Public Choice*, 142: 195-213.

Hansson, P. and Henrekson, M. 1994. "A new framework for testing the effect of government spending on growth and productivity." *Public Choice,* 81: 381-401.

Prescott, E. C. 2002. "Prosperity and depression: 2002." *The American Economic Review,* 92(2): 1-15.

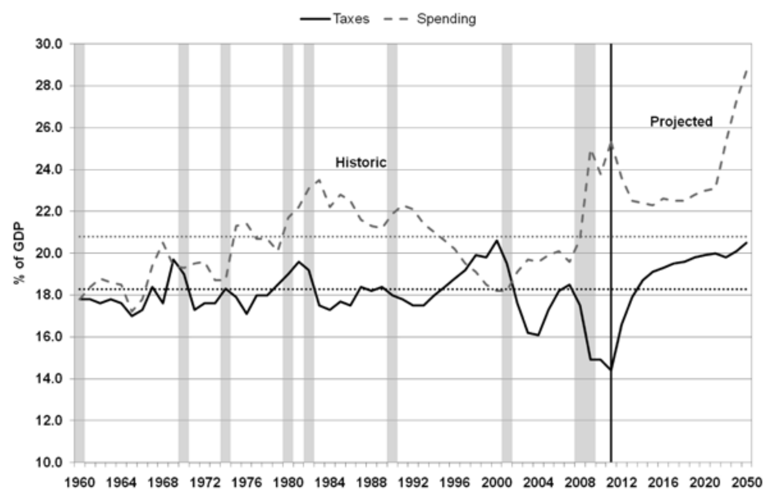
US Government, *Economic Report of the President,* 2011.

US Government, Bureau of Labor Statistics, JOLTS data.

Widmalm, F. 1999. "Tax structure and growth: Are some taxes better than others?" *Public Choice, 107*: 199-219.

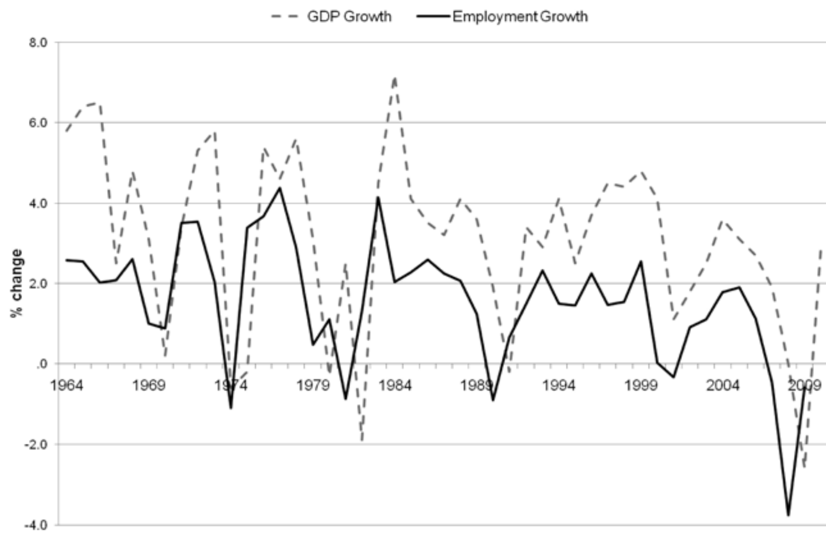
Charts

Chart 1. Spending and Taxes

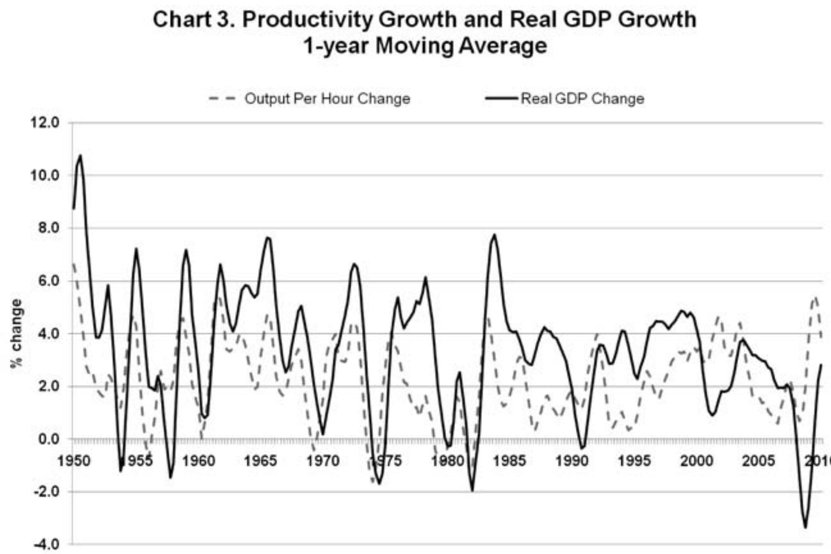


Source: Office of Management and Budget.

Chart 2. Employment Growth and Real GDP Growth

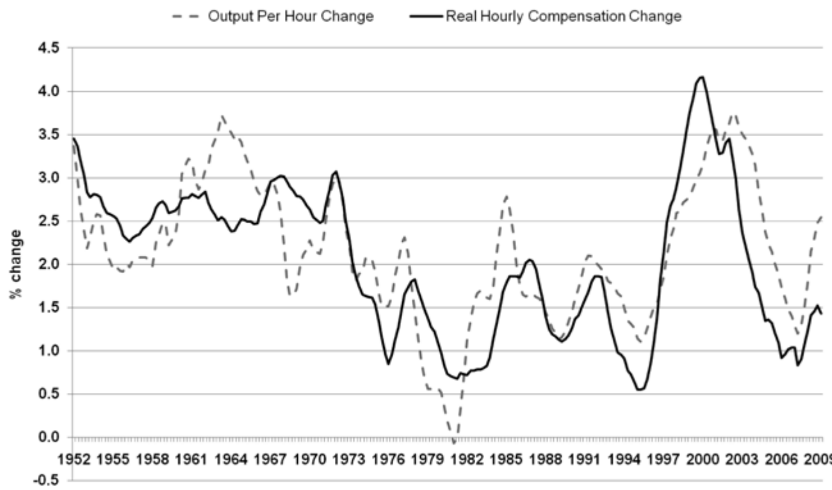


Source: Economic Report of the President 2011.



Note: Data are from 1950Q1 to 2010Q4.
Source: Bureau of Labor Statistics.

Chart 4. Productivity Growth and Real Wage Growth
4-year Moving Average



Note: Data are from 1950Q1 to 2010Q4.
Source: Bureau of Labor Statistics.

8

Chairman CAMP. Dr. Biggs, you have 5 minutes.

STATEMENT OF ANDREW BIGGS

Mr. BIGGS. Thank you very much. Chairman Camp, Ranking Member Levin and Members of the Committee. Thank you for offering the opportunity to testify with regard to Federal deficits and debt and how they might be resolved in a positive way with regard to job creation in the economy.

Addressing deficits and debt is a truly daunting task. The CBO projects that over the next 25 years alone, the Federal Government faces a fiscal gap of 4.8 percent of GDP. Bridging that fiscal gap would require an immediate and permanent 23 percent increase in all Federal tax revenues, or an equivalent reduction in Federal outlays. Delaying action only makes the gap larger.

To resolve this gap, the Federal Government must undergo a significant fiscal consolidation, which is defined as a policy aimed at reducing government deficits and debt accumulation. Without a fiscal consolidation a debt or currency crisis is inevitable. Over the past several decades, many developed countries have undertaken fiscal consolidations, some have succeeded and others have failed. Both in causing lasting reductions in debt and in generating positive impacts in economic growth.

What has separated the successes from the failures? To help answer this question in a recent article with my AEI colleagues, Kevin Hassett and Matthew Jensen, we reviewed the extensive existing literature on fiscal consolidations as well as conducting our own data analysis. We analyzed over 20 countries covering a span of nearly 4 decades. We first isolated instances in which countries attempted to reduce their budget deficits, either through increased revenues or reduced government outlays. We then revisited these countries several years later to see which fiscal consolidations have succeeded in reducing debt and which had failed. And more importantly, we analyze what separated the successes from the failures.

Our findings are striking. Countries that address their budget shortfalls to reduce spending were far more likely to succeed in reducing their debt than countries whose budget balancing strategies depended upon higher taxes. The typical unsuccessful fiscal consolidation consisted of 53 percent tax increases and 47 percent spending cuts. By contrast, the typical successful fiscal consolidation consisted of 85 percent spending cuts. These results are consistent with a large body of peer-reviewed academic research.

Also consistent with other studies, we found the successful consolidations focused spending cuts in two areas: Social transfers, largely meaning entitlements in the American context and government wage bill, which means the size and pay of the public sector workforce.

A second area of research, however, is more contentious. Some economists have found the fiscal consolidations can spur economic growth even in the short term by generating confidence in the private sector at the larger and more disruptive changes have been averted down the road. These expectational effects can offset the traditional Keynesian effects in which any fiscal consolidation, whether tax- or spending-based, would drain demand from the economy and hurt short-term growth.

Harvard University economist Silvia Ardagna and Alberto Alesina found that only around 1 quarter of fiscal consolidations coincided with an increase in economic growth, but those that did were overwhelmingly composed of spending cuts, making up around 85 percent of the total. Fiscal consolidations that did not spur growth were composed on average of 63 percent tax increases and only 37 percent spending reductions.

The IMF recently published a paper arguing that fiscal consolidations don't, in general, lead to higher economic growth. But IMF did conclude that spending-based fiscal consolidations will produce superior economic outcomes in terms of growth unemployment than would a tax-based consolidation. And that a fiscal consolidation that focused on reduced transfer spending likely would increase economic growth. For instance, the IMF study found an expenditure based fiscal consolidation would lead to GDP 1.4 percent higher 3 years later than would a tax based consolidation, equal to around $200 billion in today's dollars.

Likewise, unemployment would be around one-half percentage point lower under an expenditure consolidation than tax-based consolidation. In today's economy, that would be equivalent to around 600,000 additional jobs. Moreover, the IMF approach does not negate the prior conclusion that spending-based fiscal consolidation are more likely to be successful in reducing deficits and debt than tax-based consolidations.

To be clear the economic leadership isn't saying that the best way to stimulate the economy is to cut government spending. If short-term stimulus were the only goal, tax cuts likely would be preferable. But the literature does agree that if you must undergo a fiscal consolidation, and to be clear, we must in the very near future, then a fiscal consolidation based on spending reductions is more likely to succeed in reducing debt, and is more friendly to economic growth than a tax-based fiscal consolidation. Thank you.

[The prepared statement of Mr. Biggs follows:]

American Enterprise Institute for Public Policy Research

Statement before the United States House of Representatives

Committee on Ways and Means

Hearing on Impediments to Job Creation

Andrew G. Biggs

Resident Scholar

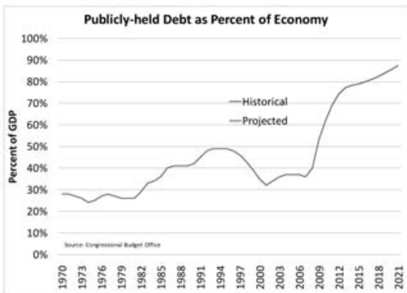
American Enterprise Institute

March 30, 2011

Chairman Camp, Ranking Member Levin and Members of the Committee. Thank you for offering me the opportunity to testify with regard to federal deficits and debt and how they might be resolved with the minimum impact on job creation in the economy.

My name is Andrew Biggs and I am a resident scholar at the American Enterprise Institute. The views I express today are my own and do not represent those of AEI or any other institution.

Hemingway wrote that people go bankrupt in two ways: gradually, and then suddenly. We are well into the gradually phase. The suddenly phase could come sooner than we imagine if financial markets conclude that America's elected officials lack the will to bring its finances into order.



Economists Carmen Reinhart and Kenneth Rogoff have found that debt even at current levels reduces average economic growth rates by around 1 percentage point, a result that over time would have a massive impact upon employment and the American standard of living.[1] Making matters worse, the Congressional Budget Office forecasts that publicly-held debt – already at its highest level since the aftermath of World War Two – will rise to 87 percent of GDP by 2021 under the President's budget proposal.

Addressing deficits and debt is a truly daunting task. The CBO projects that over the next 25 years alone the federal government faces a "fiscal gap" of 4.8 percent of GDP.[2] Bridging that fiscal gap would require an immediate and permanent 23 percent increase in all federal tax revenues or an equivalent reduction in federal outlays. Delaying action only makes the gap larger.

This fiscal gap is *not* the result of Americans paying too little taxes. Indeed, the CBO forecasts that tax revenues over the next 25 years will equal 20.7 percent of GDP, 15 percent *above* the average since 1970.[3] Rather, the gap arises through sharply rising federal outlays, principally on the Social Security, Medicare and Medicaid programs.

To resolve this gap, the federal government must undergo a significant fiscal consolidation, which is defined as "a policy aimed at reducing government deficits and debt accumulation."[4] Without a fiscal consolidation, a debt or currency crisis is inevitable.

The history of financial crises is one of surprises. No one can know when market participants will decide that enough is enough. Accordingly, the United States may have only one chance to choose correctly. That is why it is important to understand what approaches have and have not worked in the past.

Over the past several decades many developed countries have undertaken fiscal consolidations. Some have succeeded and others failed, both in causing lasting reductions in debt and in generating positive impacts on economic growth.

What has separated the successes from the failures? To help answer this question, in a recent article with my AEI colleagues Kevin Hassett and Matthew Jensen, we reviewed the extensive existing literature on fiscal consolidations as well as conducted our own data analysis.[5]

Successful and unsuccessful fiscal consolidations

Our approach extends a method that is widely used by economists in academia and nongovernmental organizations such as the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF).

Using a large dataset covering over 20 OECD countries and spanning nearly four decades, we first isolated over 100 instances in which countries took steps to address their budget gaps. Some of these fiscal consolidations were principally spending-based while others relied more on taxes.

We returned to these countries several years later to see which fiscal consolidations had succeeded in significantly reducing debt and which had failed. Our baseline standard for success is that a fiscal consolidation must reduce the ratio of debt to GDP by 4.5 percentage points over a three year period.[6] We then analyzed how successful fiscal consolidations differed from unsuccessful ones.

Our findings are striking: countries that addressed their budget shortfalls through reduced spending were far more likely to reduce their debt than countries whose budget-balancing strategies depended upon higher taxes.

The typical unsuccessful fiscal consolidation consisted of 53 percent tax increases and 47 percent spending cuts. By contrast, the typical successful fiscal consolidation consisted of 85 percent spending cuts. These results are consistent with a large body of peer-reviewed research.[7]

A fiscal consolidation can fail either because the government subsequently backtracked or because poor economic performance caused GDP to decline, thereby raising the debt/GDP ratio. Expenditure-based consolidations have strengths in both areas. Most have included structural changes to make spending programs more sustainable, while (as discussed below) spending reductions appear to be more conducive to positive economic performance. In either case, spending-based consolidations are more likely to "stick" and reduce debt over the longer term.

Consistent with other studies, we found that successful fiscal consolidations focused spending cuts in two areas: social transfers, largely meaning entitlements in the American context, and the government wage bill, which means the size and pay of the public sector workforce. For instance, one 1996 IMF study concluded that "fiscal consolidation that concentrates on the expenditure side, and especially on transfers and government wages, is more likely to succeed in reducing the public debt ratio than tax-based consolidation."[8] Other studies concur.[9]

Fiscal consolidations and economic growth

A fiscal consolidation will be easier to pass legislatively and more likely to succeed if it contributes to rather than detracts from economic growth, particularly if reforms must be undertaken at a time when the economy is already weak.

For that reason, the economics literature has asked whether a successful fiscal consolidation can improve or at the least be neutral with regard to short-term economic growth. Traditional Keynesian economics generally says no: if government withdraws funds from the economy, either by increasing taxes or by reducing outlays, lower demand would at least temporarily reduce economic output.[10]

However, many economists now agree that these negative Keynesian effects can be partially or fully offset if a large and credible fiscal consolidation generates confidence that more disruptive steps have been avoided down the road.[11] Individuals, businesses or markets may quickly become more willing to spend, to invest or to lend if short-term steps avert a long-term crisis.[12]

Generating confidence and credibility is one reason reductions in transfer spending and government wages appear to be important. As the OECD noted, "governments more committed to achieving fiscal sustainability may also be more likely to reform politically sensitive areas. As a by-product of doing so, they may at the same time bolster the credibility of the consolidation strategy, thereby improving its chances of success."[13]

But not all fiscal consolidations spur growth. Harvard economists Sylvia Ardagna and Alberto Alesina found that only around one-quarter of fiscal consolidations coincided with an increase in economic growth. Again, there was a stark difference between fiscal consolidations associated with increased growth and those that were neutral or negative with regard to growth. Ardagna and Alesina conclude that "the expansionary episodes of fiscal adjustments are mostly characterized by spending cuts," finding that fiscal consolidations that increased economic growth on average were composed of 85 percent spending cuts and 15 percent tax increases. Fiscal consolidations that did not spur growth were composed on average of 63 percent tax increases and 37 percent spending reductions.

The finding that successful fiscal consolidations may spur growth is not without controversy. A recent IMF study has countered that most fiscal consolidations will not increase short-term growth, causing a debate between economists that has not yet been settled.[14] But it is important to stress what this disagreement is *not* about.

First, this controversy is not about whether spending-based fiscal consolidations are more likely to succeed than tax-based consolidations. Even using the IMF study's methods, spending-based consolidations are more likely to reduce deficits and debt than tax-based consolidations.[15]

Second, the IMF study does not dispute that spending-based fiscal consolidations generate superior short-term economic outcomes than tax-based consolidations. The IMF concluded that three years following a spending-based consolidation:

- GDP would be around 1.4 percentage points larger than under a tax-based consolidation, a difference in today's terms of around $200 billion. A spending-based consolidation would have a small and statistically insignificant negative impact on growth, while a tax-based consolidation would significantly reduce output. The GDP gap between spending and tax-based consolidations would be even larger when spending cuts are focused on transfer programs and/or when revenue increases are based upon indirect taxes, such as sales taxes or a VAT.

- Unemployment would be around 0.5 percentage points lower than under a tax-based consolidation, equal in today's terms to around 615,000 jobs.

The IMF study found that gains in GDP and reductions in interest rates would take place over the longer-term as well.

While an economic debate continues, both approaches agree that expenditure-based fiscal consolidations are superior to tax-based consolidations when it comes to boosting the economy. And both approaches agree that spending-based consolidations are more likely to reduce debt than tax-based consolidations.

Conclusions

Whether to address the fiscal gap through tax increases or spending cuts is not merely a philosophical preference for large or small government. Rather, a large body of research analyzing historical data indicates that fiscal consolidations focused on reducing spending are far more likely to reduce debt and enhance the economy than tax-based consolidations.

Where do current budget blueprints stand? While different baselines produce different results, the recommendations from the President's Fiscal Commission and the Bipartisan Policy Center's Debt Reduction Task Force appear to be 50 to 55 percent expenditure reductions in the near term, rising somewhat over time. While these plans have much that is commendable, in the historical context the expenditure shares of these proposals are on the low end of what is likely to succeed.

We are not living in ordinary times and so the ordinary ways of making policy decisions no longer apply. The normal way of doing things has simply been to argue over the rate at which government outlays increase. The "new normal," so to speak, will be deciding how much to cut. The answer, according to historical data and a long record of academic research, is that to succeed most of our fiscal retrenchment should take place on the expenditure side.

References

Alesina, A., & Ardagna, S. (2009). Large Changes in Fiscal Policy: Taxes Versus Spending . *NBER Working Paper No. w15438* .

Alesina, A., & Perotti, R. (1996). Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects. *NBER Working Paper 5730* .

Alesina, A., & Perotti, R. (1997). The Welfare State and Competitiveness. *The American Economic Review, Vol. 87, No.5* , 921-939.

Biggs, Andrew G., Kevin A. Hassett and Matt Jensen. "A Guide for Deficit Reduction in the United States Based on Historical Consolidations That Worked." AEI Economic Policy Working Paper 2010-04. December 27, 2010

Bipartisan Policy Center. (2010). *Reviving the Economy, Cutting Spending, and Debt, and Creating a simple, Pro-growth Tax System.* Washington, DC: Bipartisan Policy Center.

Blanchard O., 1990. "Comment on Giavazzi and Pagano." NBER Macroeconomics Annual, MIT Press, Cambridge, MA, 1990.

Department of Finance of Ireland. (2010). *The National Recovery Plan 2011-2014.* Dublin.

Kumar, Manmohan S., Daniel Leigh, and Alexander Plekhanov. "Fiscal Adjustments: Determinants and Macroeconomic Consequences." International Monetary Fund. Working Paper WP/07/178, July 2007.

Leigh, D., Devries, P., Freedman, C., Guajardo, J. L., & Pescatori, A. (2010). Will It Hurt? Macroeconomic Effects of Fiscal. In *World Economic Outloo k: Recovery, Risk, and Rebalancing.* Washington, DC: International Monetary Fund.

McDermott, J., & Wescott, R. (1996). *Fiscal Reforms that Work.* Washington, DC: International Monetary Fund.

OECD. (2007). IV. Fiscal consolidation: Lessons From Past Experience. In *OECD Economic Outlook.*

OECD. (2008). *OECD Economic Outlook No. 84 Database*. Retrieved 2010 1-December from http://stats.oecd.org/Index.aspx?DataSetCode=EO84_MAIN

Perotti, R. (1996). Fiscal Consolidation in Europe: Composition Matters. *American Economic Review Vol.86* , 105-110.

Perotti, R. (1999). Fiscal Policy in Good Times and Bad. *The Quarterly Journal of Economics Vol. 114* , 1399-1436.

Reinhart, C., & Rogoff, K. (2010). Growth in a Time of Debt. *NBER Working Paper No. w15639* .

The Fiscal Commission. (2010). *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform.* Washington, DC: The Fiscal Commission.

The Ministry of Finance of Greece. (2010). *Update of the Hellenic Stability and Growth Programme.* Athens.

Treasury of the United Kingdom. (2009). *International Examples of Spending Consolidations.*

von Hagen, J., & Strauch, R. (2001). Fiscal consolidations: Quality, Economic Conditions, and Success. *Public Choice, Vol. 109* , 327-346.

Zaghini, A. (1999). The Economic Policy of Fiscal Consolidations: The European Experience. *Banca Italia - Servizio di Studi Papers 355* .

---

[1] Reinhart and Rogoff (2010). Note that Reinhart and Rogoff's calculations are based upon *gross* public debt, which in the case of the U.S. would include intergovernmental debt held in the Social Security and other trust funds. By this measure, U.S. debt is already above the 90 percent of GDP level that Reinhart and Rogoff find leads to adverse economic outcomes.

[2] Over 50 years the gap rises to 6.9 percent of GDP and over 75 years to 8.7 percent of GDP. Congressional Budget Office (2010).

[3] CBO's alternate baseline projects average revenues of 20.7 percent of GDP over the next 25 years, versus an average of 18 percent of GDP from 1970 through 2010.

[4] OECD. "Glossary of Statistical Terms."

[5] Biggs, Hassett and Jensen (2010).

[6] We also generated calculations using different standards for what constitutes success, which tended to reinforce the findings reported here.

[7] For reference, Alesina and Perotti (1996) report that successful consolidations were 64 percent expenditure cuts and 37 percent revenue increases. Unsuccessful consolidations were 34 percent expenditure cuts and 66 percent revenue increases. Alesina and Ardagna (1998) report that successful consolidations were 62 percent expenditure cuts and 38 percent revenue increases. Unsuccessful consolidations were -79 percent expenditure cuts and 178 percent revenue increases. Alesina and Ardagna (2009) report that successful consolidations were 135 percent expenditure cuts and -35 percent revenue increases. Unsuccessful consolidations were 34 percent expenditure cuts and 66 percent revenue increases. Von Hagen and Strauch (2001) report that successful consolidations were 52 percent expenditure cuts and 48 percent revenue increases. Unsuccessful consolidations were 12 percent expenditure cuts and 88 percent revenue increases. Zaghini (1999) reports that successful consolidations were 77 percent expenditure cuts and 23 percent revenue increases. Unsuccessful consolidations were 2 percent expenditure cuts and 98 percent revenue increases. McDermott and Wescott (1996) found that expenditure based consolidations have a 41 percent chance of success; whereas revenue based consolidations have a 16 percent chance of success.

[8] McDermott and Wescott (1996).

[9] Columbia University economist Roberto Perotti concluded, "the more persistent adjustments are the ones that reduce the deficit mainly by cutting two specific types of outlays: social expenditure and the wage component of government consumption. Adjustments that do not last, by contrast, rely primarily on labor-tax increases and on capital-spending cuts." See Perotti (1995). A 2007 IMF study found that "Reduction in [the government] wage bill and social security spending (including social transfers, health care, and unemployment benefits) made an important contribution to fiscal adjustment in a number of cases. Such cuts were usually facilitated by structural reforms aimed at improving the efficiency of public services provision and the incentive structure of insurance schemes. In contrast, tax increases and capital expenditure cuts were accompanied by structural changes in only a few instances." See Kumar, Leigh, and Plekhanov (2007).

[10] This would be the case in the Keynesian view unless a fiscal consolidation allowed for more accommodative monetary policy, which Leigh, et al (2010) find is the case when the consolidation is expenditure-based.

[11] Perotti (1999). Ardagna and Alesina (2009).

[12] Blanchard (1990).

[13] OECD (2007).

[14] Leigh, et al (2010). Alesina (2010) responds to this study.

[15] This was one of the findings of Biggs, Hassett and Jensen (2010).

Chairman CAMP. Thank you very much. Dr. Boushey, you also have 5 minutes.

STATEMENT OF HEATHER BOUSHEY

Ms. BOUSHEY. Wonderful. Thank you, Chairman Camp, and Ranking Member Levin for inviting me here today to testify. My name a Heather Boushey, I am a senior economist with the Center for American Progress Action Fund.

I want to get right to my point. The policies that will create jobs are those that will increase aggregate demand by making investments that not only boost employment in the short term, but lay the foundations for long-term economic growth. Every policy should be examined to through the lens of whether or not it supports job creation and rebuilding our Nation's middle class.

Let's be clear, we are here today because of the failed economic policies of the 2000s. The collapse of the housing market and the financial crisis upended the labor market causing unemployment to spike from just below 5 percent in early 2008 to 10 percent just a year and a half later in late 2009. With the Federal funds rated zero since December of 2008 and evidence of a liquidity trap, fiscal policy has been your primary lever to address high unemployment.

While one cause of our current Federal deficit is the higher expenditures and lower tax revenues due to the Great Recession, the main causes of today's deficit were evident before the recession took hold. The prior administration left our country with a run-up of debt from a two unfunded wars along side massive tax cuts. The long-term challenges are compounded by the need to get health care costs under control.

The supply side mantra of tax cuts for the wealthy has left our Nation indebted in ways that profoundly harmed our economy. The early 2000s saw unprecedented tax cuts for the wealthy, yet in the economic recovery that followed, growth in investment, employment and output were all slower than any other economic recovery in more than half a century. For the first time since the end of World War II, our Nation's middle class families saw their incomes fall in inflation-adjusted terms over an economic recovery. The hollowing out of our middle class is clear evidence of a failed economic model. It also encouraged economic instability as households borrowed to make up for falling incomes.

We need to put our economy on a path to balance that starts policy that creates jobs now, make the investments we need to lay the foundation for long-term economic growth and build our middle class. In doing so, we will be able to repay our debts and see strong growth in the years to come. And I will note the Rogoff and Reinhardt study that has been discussed this morning connecting the high debt to lower growth is entirely driven by the demobilization following World War II, and therefore is not applicable necessarily in today's circumstances.

There remain five seekers today for every job opening available. This unemployment is not a structural problem. The National Federation of Independent Businesses continues to report that the primary concern of small businesses in this country is sales. The shortfall and aggregate demand amounts to almost 6 percent of U.S. Gross Domestic Product even though the economy has been growing for six quarters now. This is the output gap that we need to fill in order to make our economy whole so that everyone who once worked can find a job.

High unemployment not only creates significant hardships for individual families, it continues to threaten the recovery. The unemployed can't spend what they don't earn, which why unemployment directly adds to our Nation's aggregate demand problem.

Funds spent on benefits and services designed to help the unemployed find new work have mitigated, not exacerbated the problem. The best economic evidence is that unemployment benefits and transitional jobs programs have helped the current recovery. By boosting economic growth, the actions we have taken over the past couple of years has actually made the long-term deficits smaller than it would have been without action.

To address unemployment, Congress should focus on three specific policy goals: Boost aggregate demand and invest in our economy, including investing in infrastructure, which is the best way to ramp up employment now while building the foundation for a high productivity future; second, stop adding to the problem of unemployment. Once someone loses their job in this economy, they are facing a historically low odds of finding a new job; third, help the unemployed beat the odds and find work. In particular, programs like TANF emergency funds that put people to work in public-private partnerships should be reinstituted.

The cost of inaction continue to far outweigh the cost of action. While we need to keep our eye on a growing Federal debt addressing the scourge of long-term unemployment now will do more to cut future deficits than not. Getting our economy growing again is the most important thing we need to do to address our budget woes, and that includes both a long hard look at our tax revenue and increasing that. Thank you.

Chairman CAMP. Thank you very much.

[The prepared statement of Ms. Boushey follows:]

Center for American Progress Action Fund

Testimony Before the House Committee on Ways and Means
on "Government Policies and Actions that Are Impediments to Job Creation"

Heather Boushey,
Senior Economist, Center for American Progress Action Fund
March 30, 2011

Thank you, Chairman Camp and Ranking Member Levin for inviting me here today to testify on government policies and actions that are impediments to job creation. My name is Heather Boushey and I'm a Senior Economist with the Center for American Progress Action Fund.

The challenges workers face today are tougher than they've been in generations. Until we fill the gap in aggregate demand, we will continue to have unacceptably high unemployment, which in turn will continue to drag down economic growth. Unemployment—the ultimate unused capacity—is a terrible thing. Allowing it to fester when you have tools at your disposal to alleviate it sends a message that government policymakers don't really care about the very real hardships families are facing or don't recognize the enormous waste of human potential.

The policies that will create jobs are those that will increase aggregate demand by making investments that not only boost employment in the short term but also lay the foundations for long-term economic growth. Every policy should be examined through the lens of whether or not it supports job creation and rebuilding our nation's middle class.

Yes, our nation is piling up debt, but in this economic moment, expansionary fiscal (and monetary) policy is the most prudent course of action. The collapse of the housing market and financial crisis upended the labor market, causing unemployment to spike from just below 5 percent in early 2008 to 10 percent by late 2009. With the federal funds rate at zero since December 2008, the federal government was left with fiscal policy as its primary lever to address rising unemployment. Without these steps, our economy would have continued its downward spiral and deficits would have increased even more than they did.

While one cause of our current federal deficit is the higher expenditures and lower tax revenues due to the Great Recession, the main causes of today's deficit were evident before the recession took hold. The prior administration left our country with a run-up of debt from two unfunded wars alongside massive tax cuts. The long-term challenges are compounded by the need to get health care costs under control.

The supply-side mantra of tax cuts for the wealthy has left our nation indebted in ways that profoundly harmed our economy. The early 2000s saw unprecedented tax cuts for the wealthy, yet in the economic recovery that followed, investment growth, employment, and output all were slower than any other economic recovery in the post-World War II era. For the first time in any economic recovery since the end of World War II, our nation's middle-class families saw their incomes fall in inflation-adjusted terms. This hollowing out of our middle class is clear evidence that this was a failed economic model and further was a factor in increased economic instability as households borrowed to make up for falling incomes.

Moving forward, we need to put our economy on a path to balance. That path starts with policies that create jobs now, make the investments we need to lay the foundations for long-term economic growth, and rebuild our middle class. Only through rebuilding our middle class and creating broad-based employment gains we will be able to repay our debts and see strong economic growth in the years to come.

In my testimony today, I will make three key points:

- **The unemployment problem continues to be caused by too little aggregate demand.** If we want to help the unemployed then we need to address the output gap—the gap between what our economy is producing and what it could be producing at full employment.

- **Today's unemployment is not a structural problem.** The Great Recession caused the record-high numbers of unemployed and the record-long spells of unemployment that we've seen.

- **Funds spent on benefits and services designed to help the unemployed find new work have mitigated, not exacerbated the problem.** The best economic evidence is that unemployment benefits and transitional jobs programs have helped, not hurt, the current economic recovery. What's more, by boosting economic growth, the actions we've taken have actually made the long-term deficit smaller than it would have been without action.

Today's high unemployment is a function of the reality that there simply aren't enough jobs to go around because there is not sufficient demand in our economy. The shortfall in aggregate demand amounts to almost 6 percent of U.S. gross domestic product, primarily due to lost investment and lost employment resulting from the burst of the real estate bubble and the ensuing Great Recession. This is the output gap we need to fill in order to make our economy whole so that everyone who wants to work can find a job.

While the economy has been growing for six quarters now, businesses have not yet begun to ramp up hiring. High unemployment not only creates significant hardships for individual families; it continues to threaten the economic recovery: The unemployed can't spend what they don't earn, which is why high unemployment directly adds to our nation's aggregate demand problem. Thus, there is a direct link between lack of hiring and future economic growth.

To address this, Congress should focus on three specific policy goals:

- **Focus on policies that boost aggregate demand and investment in our economy.** Investment—including investment in infrastructure—is the best way to ramp up employment now while building the foundation for a high-productivity future. This is why policymakers should make sure our investments focus on job creation.

- **Stop adding to the problem of unemployment.** Once someone loses their job, they face historically low odds of finding a new one. Congress should seek to ensure those who are working can stay in their jobs.

- **Help the long-term unemployed beat the odds and find work.** We know from decades of research that the displaced and long-term unemployed are more often at the bottom of the hiring queue, and as a result often suffer years of lowered earnings. Congress should consider reinvigorating the TANF Emergency Funds that put people to work in public-private partnerships.

And, I will note, at this point in the economic recovery, the costs of inaction continue to far outweigh the costs of action. While we need to keep our eye on a growing federal debt, addressing the scourge of long-term unemployment now will do more to cut future deficits than not. Millions of unemployed pay much less in taxes now than they will once they get back to work, which is one reason why getting our economy growing again is the most important thing we need to do to address our budget woes.

Insufficient aggregate demand is hindering job creation

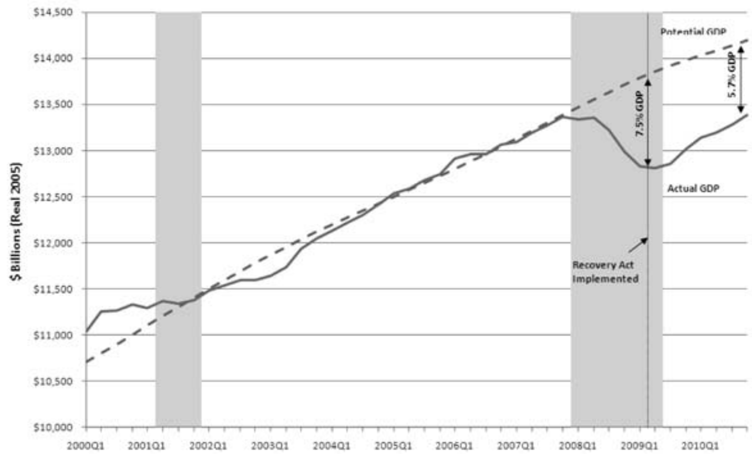
The unemployment problem continues to be caused by too little aggregate demand. **If we want to help the unemployed, we need to address the output gap—the gap between what our economy is producing and what it could be producing at full employment.**

U.S. gross domestic product, or GDP, grew at an annual rate of 3.1 percent in the fourth quarter of 2010, the sixth quarter of positive growth in a row.[1] Much of this growth would not have happened without the American Recovery and Reinvestment Act of 2009, or ARRA, alongside other policies aimed at addressing the fallout from the housing and financial crises in the last two years of the Bush administration.

Yet, our economy continues to have what economists call "excess capacity," which means there is not enough demand for all the goods and services we have the capacity to produce, and thus not enough demand for more workers. As of February 2011, capacity utilization was 76 percent, 4.6 percent below its average from 1972 to 2009.[2] Excess capacity is a technical term economists use to describe what Americans are currently seeing every day around them—excruciatingly high unemployment, especially long-term unemployment, and the devastation it causes families and communities all around our nation.

Another way to measure excess capacity is the "output gap," or the gap between what our economy currently produces and what it would be producing if workers and the economy's productive assets were to be used at full employment. The output gap is equal to almost 6 percent of our total gross domestic product (see Figure 1). This is down from 7.5 percent when growth was at its nadir, just before ARRA was passed and signed into law.[3]

Figure 1. US Gross Domestic Product: Actual and Potential



Source: Author's calculation of Bureau of Economic Analysis and Congressional Budget Office data.

What's more, we are now in another jobless recovery while corporate profits soar. From December 2008 to September 2010, profits in the nonfinancial corporate sector rose in inflation-adjusted terms by 92.9 percent before taxes and 94.9 percent after taxes. In September 2010, profits were at their highest point since at least September 2007, several months before the start of the Great Recession.[4] The nonfarm nonfinancial business sector is holding almost $1.9 trillion in cash, the highest level since the fourth quarter of 1959.[5]

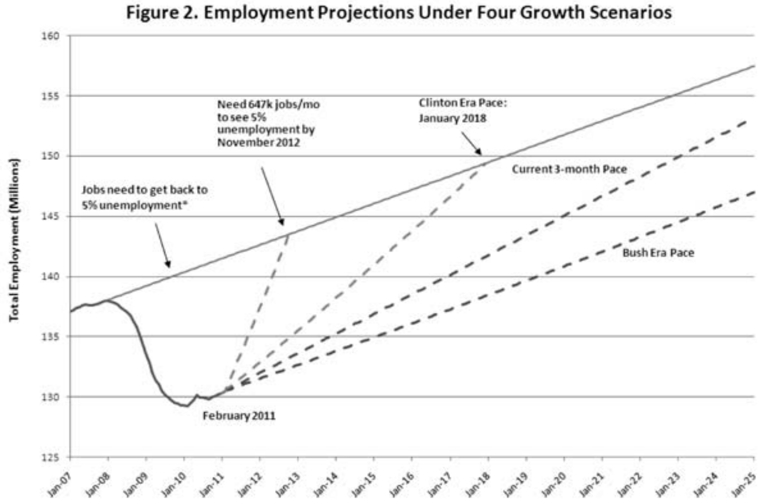
We can see the lack of urgency to hire across the private sector due to lack of demand in a wide array of data. The National Federation of Independent Businesses, for example, continues to report that its members—most of whom have fewer than 40 employees—see a lack of sales as the key factor that they are concerned about.[6] This is an aggregate demand problem: Businesses don't see enough demand for products, which then hampers hiring. The Federal Reserve's survey of senior loan officers also shows that while banks are lending for mergers and acquisitions, which often lead to job losses, they are not lending for investment in plants and equipment that will create jobs and expanding economic opportunities.[7]

Even though corporate America is flush with cash, investment is at the lowest level in more than four decades. So far in this business cycle, from December 2007 to December 2010, business investment has averaged 10.4 percent of GDP, the lowest average for four decades. This low level of investment is not because of the cost or availability of capital, which continues to be at lows not seen since the 1960s.[8]

Without investment, our resources—the American people—languish in unemployment. A key challenge for policymakers is sorting out how to encourage investment.

Thus, while the recession ended in June 2009, for everyday Americans there hasn't been a recovery. The private sector has been adding jobs every month for nearly a year, averaging 152,000 jobs per month over the past three months.[9] This is a faster pace than economic recovery in the 2000s but at this rate we won't reach 5 percent unemployment for decades (see Figure 2).[10] But the current pace of job growth is insufficient for labor market recovery in any relevant timeframe.

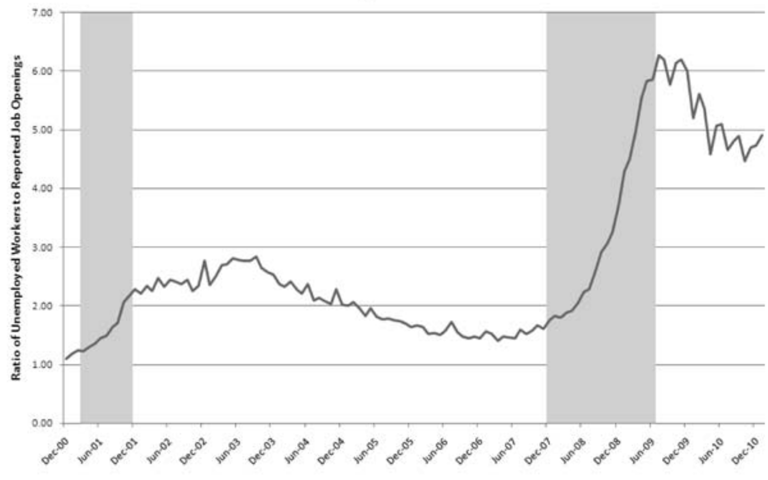
Figure 2. Employment Projections Under Four Growth Scenarios



Source: Author's calculation of BLS data.
*Assumes monthly labor force growth of 100,000

There are nearly five workers seeking a job for every opening available (see Figure 3). In typical economic times—before the Great Recession—there were about one and a half job seekers for every job opening.[11] After a record 21 months at or above 9.0 percent, unemployment fell to 8.9 percent in February. Nearly half of those unemployed (43.9 percent) have been job searching for at least six months.[12]

Figure 3. Ratio of Unemployed Workers to Reported Job Openings, monthly, 2000 to 2010



Source: Bureau of Labor Statistics, Jobs Openings and Labor Turnover Survey and Current Population Survey

High unemployment has long-term consequences for workers and their families as well as our economy overall. The nearly 6 million unemployed workers who have been searching for a new job for at least six months are unable to make use of their skills or contribute to our nation's productive capacity. Consider these facts: Average mature workers who lose a stable job will see their earnings fall by 20 percent over 15 years to 20 years, and the labor market consequences of graduating from college in a bad economy are large, negative, and persistent.[13]

Many workers may never find jobs at the income level of the jobs they lost during this Great Recession. Recent data from the Bureau of Labor Statistics find that as of December 2009 among those who were displaced from their job—permanently losing their job or laid off because their employer's plant closed or business failed—between 2007 and 2009, just half (49 percent) were re-employed. This is the lowest re-employment rate on record for the series, which began in 1984. Of those re-employed in full-time work, more than half (55 percent) were earning less than they had prior to job displacement.[14]

The unemployed cannot spend what they don't earn, a fact that threatens economic recovery. Families that receive unemployment insurance benefits typically spend these benefits rather than save them. To put some back-of-the-envelope numbers on this, think of it this way: The typical worker brings home about $40,000 annually, but with nearly 14 million out of work and without unemployment benefits, our economy would shrink by about $600 billion.[15] It's that gap that unemployment insurance fills. And that's why unemployment insurance is critical to sustaining the economic recovery, and why we can't just fill the output gap with tax cuts. In a report for the Department of Labor, Wayne Vroman, economist at the Urban Institute, estimated that the unemployment insurance system closed about one-fifth (18.3 percent) of the shortfall in the nation's GDP during the Great Recession.[16]

Funds spent on benefits and services designed to help the unemployed find new work have mitigated, not exacerbated the problem

Unemployment benefits are good for the economy and in high-unemployment times such as in the current labor market, and they do not hinder workers from finding employment. The argument that helping the long-term unemployed encourages them to remain unemployed rather than seek work ignores the reality that there are nearly five job seekers for every one job opening. Furthermore, a number of new research papers show that unemployment benefits do not extend spells of unemployment in any economically meaningful way.

Research from the 1970s and 1980s that examined when people exit unemployment benefits found a "spike" in workers exiting just as their unemployment benefits expired. A key paper in the early literature was by Harvard economist Lawrence Katz and University of Chicago economist Bruce Meyer, which found there were sharp increases in the rate at which workers with unemployment benefits exited unemployment for employment—increases that coincided with the time when unemployment benefits were likely to lapse. But there was no such spike for those who did not receive unemployment benefits.[17]

In testimony before the U.S. Congressional Joint Economic Committee in April 2010, Katz himself noted that "much of the responsiveness in this analysis came from firms and industries using temporary layoffs and the sensitivity of recall dates to unemployment insurance benefits."[18] Temporary layoffs are less common now than during the 1970s and early 1980s downturns. More recent research suggests only modest effects of unemployment benefits on the timing of finding employment:

- San Francisco Federal Reserve economists Rob Valletta and Katherine Kuang analyzed data on unemployed individuals during the Great Recession and calculated that, in the absence of extended benefits, the unemployment rate would have been about 0.4 percentage points lower at the end of 2009, or about 9.6 percent rather than 10 percent.[19]
- Economists David Card and Phillip B. Levine found that additional weeks of unemployment benefits only increased the fraction of workers who exhausted—that is, used up all unemployment benefits available to them—by 1 to 3 percentage points, and had the program run long enough to affect claimants from the first day of their spell, the average recipient would have collected regular benefits for just one extra week.[20]
- Using unique panel data from Austria that actually links receipt of unemployment benefits and employment, which is not available in U.S. administrative panel data, University of California, Berkeley, economists Raj Chetty and David Card found that "fewer than 1 percent of jobless spells have an ending date that is manipulated to coincide with the expiration of UI benefits."[21]

- Based on existing empirical research using U.S. data, Chetty finds that a 10 percent increase in the value of UI benefits increases unemployment durations by only 4 percent to 8 percent.[22]

Other empirical work shows how unemployment benefits give workers the time to search for a new job. Massachusetts Institute of Technology economist Jon Gruber found that unemployment insurance smoothes consumption for households with an unemployed worker, which helps them maintain their spending even in the face of a job loss.[23] Chetty estimated that 60 percent of difference in the length of time workers with unemployment benefits spend unemployed is due to a liquidity effect—a constraint on household finances because they have little access to cash in the short term—rather than to reduced incentives to search for a new job.[24]

Unemployment is not a structural problem

While some groups have been harder hit than others, today's unemployment is not a structural problem. In May 2007, the unemployment rate was 4.5 percent. Just more than a year and a half later, the private sector was shedding 700,000 to 800,000 jobs per month, and unemployment continues to linger just below 9 percent.[25] For the unemployment problem to be structural, it would have to be the case that our nation's workers and employers all of a sudden became mismatched due to some new set of technological advances that made 1 in 10 workers instantaneously obsolete. There is no evidence this has been the case in the years since 2007.

There are a number of ways to think about this. First, if today's high unemployment were largely about shifting workers out of the sectors hardest hit by the bursting of the housing bubble—primarily construction—job losses would have to be concentrated there. But the distribution of job losses due to the Great Recession was fairly broad and widespread across industries, contradicting the idea that there are one or two sectors U.S. workers need to transition out of. Manufacturing, professional and business services, transportation and warehousing, financial activities, leisure and hospitality, and information services have all lost a larger share of jobs than construction.

Supporters of the structural unemployment theory argue that the collapse of the housing market reduced geographic mobility of unemployed workers. According to economist John Schmitt, that is just not the case. Using data from the Displaced Workers Survey, he finds that:

> … house prices have had almost no observable impact on displaced workers' likelihood to move. Displaced workers in states that experienced a large decline in the house price index were no more likely to stay (90.7 percent) than were displaced workers who lost their jobs in states with smaller house-prices declines (91.7 percent) or house-price increases (91.8 percent).[26]

Further, if unemployment was structural, the money pumped into the economy through the extraordinary monetary and fiscal policies enacted over the past few years would have led to higher prices. The logic is that if more money were chasing a limited pool of workers or capacity, then prices should go up. Yet, in fact, what we've seen is the opposite. Over the past year, prices have risen by 2.2 percent.[27]

There are many reasons for policymakers to be concerned about the skills of the U.S. labor force: American students are consistently behind their academic peers internationally. According to the Department of Education, out of 30 peer countries, students in the United States were ranked 30th for math, 23rd for science, and 17th for reading.[28] But even if unemployment was a structural problem and training and education could solve it, this is not a solution that can address our immediate high unemployment. Setting up those programs and getting workers the skills they need will take time and our economy will not see the fruits of those endeavors for years. Investing in education is critical for our economy but it cannot solve our current unemployment problem.

Addressing aggregate demand has shown good results

Congress has taken important steps to encourage private-sector job creation. The Congressional Budget Office credits ARRA with saving or creating 1.3 million to 3.5 million jobs in 2010, and CBO estimates that 2.7 million jobs will be saved or created in 2011.[29] The Recovery Act kept teachers in schools and police officers on their beats even as state and local tax revenues fell. It kept money flowing into the pockets of the long-term unemployed, which in turn helps not only those individual families hardest hit by the Great Recession but also keeps dollars flowing into their local communities. It helps unemployed workers access health care, undoubtedly mitigating the well-documented negative health effects of unemployment.

Economists Alan Blinder and Mark Zandi estimate that the Recovery Act and other fiscal policies saved or created 2.7 million jobs, and that without them unemployment would stand at 11 percent and job losses would have totaled 10 million. On top of this, they estimate that if nothing had been done to address the financial crisis—no Troubled Asset Relief Program, no bailouts of American International Group Inc., and no investment in the auto industry—our economy would have 5 million fewer jobs than we do today, and unemployment would be sharply higher at 12.5 percent.[30]

Even with the success of the Recovery Act, there have been clear indications since 2009 that in order to fill the output gap and lower unemployment, Congress will need to focus on policies that raise, not lower, aggregate demand.[31] As Federal Reserve Chairman Ben Bernanke noted this January in testimony before the U.S. Senate Committee on the Budget:

> Our nation's fiscal position has deteriorated appreciably since the onset of the financial crisis and the recession. To a significant extent, this deterioration is the result of the effects of the weak economy on revenues and outlays, along with the actions that were taken to ease the recession and steady financial markets. **In their planning for the near term, fiscal policymakers will need to continue to take into account the low level of economic activity and the still-fragile nature of the economic recovery** (emphasis added).[32]

Sustained government spending until the economic recovery hits its full stride is the best—and only—option to push the unemployment rate down. Because the Great Recession was preceded by a massive financial crisis, we knew from day one that it was likely to be deeper and more protracted than more recent recessions.[33] We've also known for more than two years now that the Federal Reserve has no more room to lower interest rates to boost demand.[34]

In other recent recessions, lowering interest rates was sufficient to push the economy toward sustainable growth, but this time that's not possible. The last recession that brought us double-digit unemployment, in the 1980s, was caused by tightening of monetary policy by the Federal Reserve under Chairman Paul Volcker as he tried to address rampant inflation. The Federal Funds Rate hit nearly 20 percent in 1981, which stopped inflation but then also gave the Federal Reserve a great deal of room to lower rates to encourage economic activity.[35]

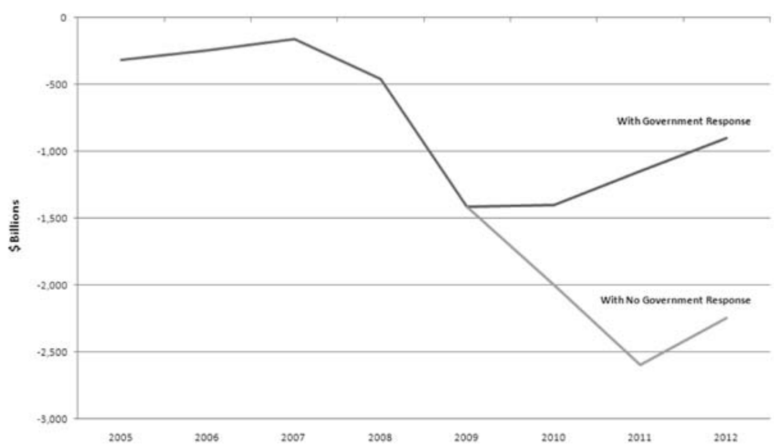
Today, to boost growth, the Federal Reserve has pursued quantitative easing, using the proceeds from the central bank's mortgage bond portfolio to buy long-term government debt. That is, they are using unorthodox methods of pumping money into an economy and working to lower interest rates that central bankers do not usually control. Their effect is the same as printing money in vast quantities but without ever turning on the printing presses. The Federal Reserve's response to the Great Recession has been effective in lowering interest rates and addressing the crisis in the banking system but it has not yet successfully increased investment or led to sufficient job creation.

At present, and owing both to the second round of quantitative easing by the Fed and to strong global demand for U.S. Treasury assets, the United States is enjoying historically low interest rates. At the same time, excessively contractionary monetary policy by the European Central Bank is keeping interest rates higher in Europe while fast economic growth in developing countries that pay a higher risk premium present investors with attractive speculative opportunities. The combined effect of these forces is to push foreign currencies up and make the U.S. dollar more competitive internationally.

The international value of the dollar has improved in competitiveness by nearly 11 percent in inflation-adjusted terms over the past two years. This means that goods of U.S. exporters are priced more competitively in world markets and that foreign goods face an 11 percent disadvantage in U.S. markets. A secondary factor, as the result of bilateral diplomacy, China has resumed its policy of appreciating its currency, the yuan, against the dollar. Yet Chinese appreciation is still not happening fast enough and has much further to go.

It is important to remember that by taking actions to avert greater unemployment, we averted a bigger federal deficit. The steps taken to shore up our economy have ended up being a better investment for jobs and for the deficit than doing nothing at all (see Figure 4). Economists Blinder and Zandi estimated that had Congress done nothing, the deficit would have ballooned to more than 2.5 times as large as it did, hitting more than $2 trillion by the end of fiscal year 2010, $2.6 trillion in fiscal year 2011, and $2.25 trillion in fiscal year 2012. In actuality, they estimate that by the end of fiscal year 2010, the federal budget deficit will be $1.4 trillion, and it will fall to $1.15 trillion in fiscal year 2011 and $900 billion in fiscal year 2012.[36]

Figure 4. Federal Budget Deficit, in Billions, 2005-2012



Source: Congressional Budget Office and Blinder and Zandi, *How We Ended the Great Recession*

The most important reason for the rise in the deficit is rising unemployment and falling incomes.[37] In 2009, federal receipts were $419 billion below 2008 levels, a 17 percent drop, which was the largest decline from one year to the next in more than 70 years. Individual income tax receipts decreased by 20 percent and corporate income tax revenues plummeted by more than 54 percent, which means corporations paid less than half in taxes than they paid the year before.[38]

Yet there is a rising chorus of voices singing the praises of deficit reduction over the benefits of saving our economy through expansionary fiscal policies. Once our economy recovers, of course, the deficit must be addressed, but until unemployment begins to fall and the economic recovery is firmly in train, these voices push us in the wrong direction. Their rhetoric argues that we not burden the next generation with unsustainable debts, but the reality is this—by not boosting demand for goods and services by helping existing excess capacity, including the nearly 14 million currently unemployed workers in our country, millions of workers will find no means of support today and will see their economic future grow dimmer by the week.

Policy recommendations

Unlike any point in the decades since before World War II, the challenge of laying the foundation for a strong economy lies with you and this body of government. These are unusual times because it continues to be the case that fiscal policy is the primary lever the federal government has at its disposal to spur economic growth. I urge you to consider that these extraordinary times call for extraordinary action. The sense of imminent collapse of our financial sector is, thankfully, behind us, but the fallout for our economy remains and it is just as dramatic and continues to require bold steps.

Congress should focus on three specific policy goals:

- **Focus on maintaining the boost in aggregate demand.** Investment—including investment in infrastructure—is the best way to ramp up employment now while building the foundation for a high-productivity future.

- **Stop adding to the problem of unemployment.** Once someone loses their job, they continue to face historically low odds of finding a new job. There are ways Congress can act to keep people in the jobs they have now.

- **Help the long-term unemployed beat the odds and find work.** We know from decades of research that the displaced and long-term unemployed are more often at the bottom of the hiring queue and often suffer years of lowered earnings. Specifically, Congress should consider reinvigorating the TANF Emergency Funds that put people to work in public-private partnerships.

Let's be clear: An overgrown financial sector, bloated on the real estate bubble it helped create, threw our economy into crisis. Moving forward, policymakers must continue to ensure our financial markets are focused on making funds available to promote investment in America, not just speculation and dividends for those in the financial services industry. We need vibrant capital markets so innovative companies can access funds to invest. We do not need innovative financial products to allow Wall Street to siphon off these funds for its own gain.

Boost aggregate demand

Investment is the key to creating jobs now and building the foundation for a high-productivity future. The American Society of Civil Engineers estimates that we need to spend at least $2.2 trillion over the next five years just to repair our crumbling infrastructure.[39] This doesn't even include things like high-speed rail, mass transit, and renewable energy investments we need to free ourselves from foreign oil and climate change.

In January, the Commerce Department reported that private business investment in overall buildings, factories, and equipment grew only $18 billion, while investment in new buildings and factories grew only $700 million, adding just 0.13 percent to the growth in U.S. GDP. As CAP Economist Adam Hersh put it, "the tepid investment recovery is particularly troubling, given that in the 2001 to 2007 business cycle expansion, we'd already experienced the slowest investment growth rate since World War II. Making matters worse, much of that investment was misallocated into nonproductive residential and commercial real estate."[40]

Federal Reserve Chairman Ben Bernanke was right in February when he said the recovery is not truly established until the unemployment rate returns to a normal level.[41] Bringing unemployment down will require both increased investment, which is currently lower than in past recoveries, and a strong middle class that has the jobs and incomes to maintain consumption. Policymakers should continue to encourage investment in infrastructure and in the skills of our nation's workforce and make sure that these investments create good jobs, the kind that will rebuild our middle class.

The Obama administration proposed a $50 billion infrastructure fund, which is a good start, but we need to invest more to both address today's jobs problem and lay the foundation for long-term economic growth. Infrastructure has been a traditionally bipartisan issue—and one that hopefully this Congress can build a bridge across the aisle to address.

Build America Bonds are another policy that has been shown to boost investment in infrastructure. Build America Bonds are a fairer and less-expensive way for the federal government to subsidize local capital projects than tax-exempt municipal bonds.[42] When a locality issues a Build America Bond, the federal government covers 35 percent of the bond's interest costs, whereas tax exempt municipal bonds provide private investors with bonds that do not incur tax liabilities on the bond's interest earnings.

Build America Bonds are more economically efficient than tax-exempt municipal bonds for two reasons. First, the federal government eliminates the windfall to high-income investors, ensuring instead that 100 percent of the federal subsidy benefits state and local governments. In 2010, $275.5 billion in tax-exempt debt was issued by units of local government in 2010.[43] A significant portion of the federal subsidy for tax exempt municipal bonds, however, is captured by bond buyers in the top income tax brackets. Based on 2010 data, 10 percent to 20 percent of the benefits of the tax-exempt municipal bonds leak to high-income bond buyers rather than to the intended beneficiaries, state and local governments financing infrastructure projects. [44] A municipal bondholder in the 35 percent bracket pays $35 less in taxes for every $100 in interest income he receives, while a buyer in the 10 percent bracket saves just $10. Because bondholders in the top income bracket typically provide insufficient demand for the needs of municipalities, municipalities must offer rates that provide tax benefits to investors in the lower income brackets, creating windfall gains for those in the higher brackets.[45]

Second, Build America Bonds are attractive to buyers who are not helped by the municipal bond tax exemption, such as pension funds, foreign investors, and life insurance companies. By appealing to a broader array of investors, the direct subsidy bonds accessed untapped demand in the market. "[T]he BAB program has succeeded in opening up the municipal market to non-taxable and other non-traditional investors," wrote Andrew Ang, Vineer Bhansali, and Yuhang Xing in the first independent report of the Build America Bonds program.[46]

As a result of eliminating the windfall to high-income investors and creating a larger market for municipal bonds, Build America Bonds create a more efficient market for infrastructure investments.[47] And this has produced significant cost savings. In September 2010, the Treasury Department estimated that state and local governments saved more than $12 billion in net present value by issuing Build America Bonds.[48]

Further, Build America Bonds have had positive effects on the tax-exempt market. In the year following the creation of Build America Bonds, yields on long-term tax-exempt bonds dropped by about 20 to 30 basis points.[49] More tellingly, the spread between tax-exempt bond yields and taxable Treasury bond yields narrowed significantly during the life of the program, which indicates that the market for tax-exempt bonds was becoming more efficient. Lower yields mean lower borrowing costs for states, which in turn means that public projects are more affordable for states—and ultimately, a better deal for taxpayers.[50]

Build America Bonds were created by Congress as a part of the American Recovery and Reinvestment Act and made available in 2009 and 2010 before the program's authority lapsed at the end of 2010. In 2010, $117 billion in Build America Bonds were issued ($181.5 billion over the two years in which the program was in effect) in support of infrastructure projects with the cost of the federal subsidy for infrastructure estimated to be $1.8 billion.[51] Legislation introduced this session, the Building American Jobs Act, would restore the Build America Bond Program.

The unemployment insurance system and other automatic stabilizers must remain in working order. Filling the gap in demand will require continued attention to one of the key sources of demand: high unemployment. We all have an interest in not seeing the cost of hiring workers rise as firms struggle to ramp up hiring, but we also need to make sure the unemployment insurance system has the integrity to continue to act as an important automatic stabilizer. Recent analysis shows this system generated significant positive economic effects and kept unemployment from rising to more than 11 percent.[52]

Even though the unemployment rate remains at a near-record high, a number of states are looking to cut back on jobless benefits to minimize the increase in unemployment taxes businesses pay. State officials are concerned these tax hikes could deter companies from hiring.[53] Some states, such as Florida, Arkansas, and Michigan, are debating reducing the number of weeks that the jobless can collect state unemployment. Others, including Indiana, want to limit the number of people eligible for benefits.

These kinds of cutbacks not only harm families but will reduce the macroeconomic impact of the unemployment insurance system. Wayne Vroman of the Urban Institute examines the effect of the wide differences in unemployment benefit recipiency across states on the economic stabilizing effect of unemployment benefits. He compares the effect on stability of the 10 states with the highest recipiency rates to the 10 states with the lowest and finds that the high-low differential in stabilizing effects was 1.5 to 1. That is, states with high recipiency rates were 50 percent more effective that low recipiency states in stabilizing their economies through unemployment benefits.[54]

States are looking to cut back benefits because their unemployment systems are insolvent. The unemployment insurance system is structured to work as an insurance system and, quite simply, not enough in "premiums" were paid in advance during the years the economy was growing in the 2000s to cover benefits if unemployment rose. During the Great Recession, states did not have enough money saved up to pay out benefits to the millions of unemployed. Now, most of the states' unemployment insurance trust funds are insolvent, with 32 states and the U.S. Virgin Islands owing a total of $46.5 billion, and the debt could rise to $68.3 billion by the end of 2013.[55] The loans from the federal government will require that in 2011, 25 states must pay an extra $2 billion in federal unemployment taxes levied on employers, an increase of 30 percent over 2010.[56]

To address the problem, the Center for American Progress has laid out a comprehensive plan that not only addresses the immediate solvency crisis in the hopes of limiting unemployment benefit cuts in the near term but also shores up the system for the next recession.[57] The plan forgives the trust fund loans of insolvent states and rewards states that maintained positive trust fund balances on two conditions. First, states must agree to improvements to the core functions of the unemployment insurance system and a greater role for the federal government to ensure sufficient funds for times of high unemployment. Second, they must agree to reduce the wide disparity in eligibility rules and benefits across states by harmonizing standards.

This proposal will reduce costs for states as their labor markets struggle to emerge from the Great Recession, improve benefits for the unemployed, and better stabilize our economy in future recessions. The Obama administration has put forward a proposal in its recent budget that is a good first step, extending interest waivers on outstanding loans for a while longer.[58] Sen. Dick Durbin (D-IL) has also introduced a bill that would forgive loans but does not increase the federal role and thus cannot guarantee the system is sustainable in the long term.[59]

Stop adding to the problem: If someone has a job, help them keep it

One of the striking things about today's labor market in the wake of the Great Recession is that the market for job seekers is the worst in generations. The best thing to do for the long-term unemployed is to make sure our economy stops creating unemployment. A key piece of that is to keep recovery dollars flowing until the economy fully recovers. Here are three tested policies to focus on.

Aid to the states. Reductions in government spending not only drag down U.S. economic growth but also reduce overall employment. Reductions in government spending pulled down U.S. economic growth by an annual rate of 1.7 percent over the fourth quarter of 2010.[60] The Great Recession had a devastating impact on states' fiscal health. Unlike the federal government, states cannot deficit spend, which in turn means they have to make difficult choices amid declining revenue and a weak economy. According to the Center on Budget and Policy Priorities, "thus far some 44 states and the District of Columbia are projecting budget shortfalls totaling $125 billion for fiscal year 2012." If nothing is done, this will be the worst year on record for state budgets, and it comes on top of sharp layoffs over the past couple of years.[61]

This means serious problems for the U.S. jobs market: In February, local governments shed another 18,000 jobs, for a total of 377,000 since their peak in September 2008, nearly three-quarters of which were jobs held by women. State governments shed 12,000 jobs in February and 82,000 since their peak in August 2008.[62] As of February 2011, 43 percent of those unemployed who had jobs in the public administration industry have been out of work and searching for a job for at least six months.[63]

Simply put, schools are laying off teachers, public universities are trimming their staffs, and community colleges are cutting back. These cutbacks are one of the most unfortunate outcomes of the fiscal crisis precipitated by the Great Recession and constitute not just lost jobs now, but also eventually worse educational outcomes for tens of millions of students across the country—consequences that will have long-term negative effects on the economy.

Helping state and local governments and school districts boasts clear advantages over many of the alternatives. First, the added resources will immediately and directly boost employment in a very hard-hit sector. Distinct from the private sector, job cuts are being forced exclusively by impossible budget situations, not by a lack of demand for services. Ameliorating those budget dilemmas will result in more jobs. Second, additional aid will prevent further cuts to state and local education systems—investments that will pay dividends far beyond the current recovery.

Work sharing. When businesses need to cut back on staffing, they have two options: lay off workers or reduce hours. There are strong incentives in our labor market to simply lay off workers—benefits are often tied to the worker, not their hours.

Currently, 17 states have opted into the "short-time compensation" or "work-sharing" program within their unemployment insurance system, which allows workers to receive partial benefits from the unemployment insurance system if their hours have been reduced, not just if they lost their job or their pay is reduced. The unemployment insurance system also provides partial benefits to workers whose wages have been cut (including due to working part time) but the thresholds are fairly low. The unemployment benefit is typically equal to the difference between the weekly benefit amount and earnings, and all states disregard some earnings as an incentive to take short-time work.[64] Recent data from the Department of Labor shows that for every dollar of unemployment benefits provided during the Great Recession, $2 was added to U.S. gross domestic product, or the total output of goods and services in our economy.[65]

Short-term compensation or work-sharing proposals have been garnering wider support over the past year.[66] New evidence from Germany shows that "short-term work programs," which encourage employers to reduce hours rather than lay off workers, can significantly reduce unemployment. While output fell more in Germany during the Great Recession than it did in the United States (through winter 2010), the German unemployment rate actually *decreased.* Recent research by the International Monetary Fund points to the importance of the massive expansions to Germany's short-term work program (Kurzarbeit), which led to hours reductions but not unemployment.[67]

These findings are not directly applicable in the United States as the program was implemented in largely union settings, but it should encourage Congress to examine this kind of policy. Congress should promote nationwide implementation of the short-term compensation program by encouraging the Department of Labor to provide clear guidance on the program and encourage more states to adopt it.[68] Congress could adopt a technical amendment as part of an extension of the federal Emergency Unemployment Compensation program or another vehicle. Enactment of an amendment would send a clear signal that states should adopt short-time compensation laws as an option for employers.

Help the unemployed beat the odds and find a new job

The economic literature is clear: The long-term unemployed suffer more and are at risk of never regaining as strong a foothold in the labor market. Many who cannot find work will end up moving from unemployment benefits to Social Security Disability Insurance, an even greater likelihood if unemployment benefits for the long term are not restored.[69] Especially for younger workers, the lifetime costs of unemployment can be startlingly high. There are ways Congress has helped and can continue to help.

Reinstate TANF Emergency Funds. This program was funded through ARRA but expired on September 30, 2010. It led to partnerships with the business community to create 250,000 new jobs for low-income and long-term unemployed workers. Extending this program for another year would continue to create thousands of jobs for long-term unemployed workers. The TANF Emergency Fund gave states more than $1 billion to operate subsidized jobs programs and promoted public-private partnerships. This program was implemented in states with both Democratic and Republican governors, with much success. Texas, for example, created nearly 40,000 jobs with this program.[70]

Recent polling shows that 8 in 10 voters favor Congress continuing to fund the TANF Emergency Fund, which was described in the poll as "states partnering with the private sector to create temporary subsidized jobs to move low-income parents from welfare to work."[71] Congress should refund this program and put people back to work.

Promote successful vocational programs. There are successful models for how community colleges can partner with the private sector to create vocational programs that work. To train the next generation of workers, we need to make sure our educational institutions are adequately addressing the real training needs of employers. One way to do this is through the "new vocationalism" movement, which seeks to integrate vocation and employment-oriented goals in academic educational programs. A key way this has been happening around the country is through partnerships between community colleges and businesses, as outlined by my colleague Louis Soares.[72]

There are a variety of success cases and recommendations that policymakers "promote systematic innovation by reviewing federal, state, and local finance and regulation to facilitate the 'good practice' innovations."[73] Federal and state policymakers can ensure that formula funding streams and regulations do not stifle good practice when partners are building an alternative education program; use competitive grant funds to promote partnerships that emphasize sustainable, systemic change; and continue to emphasize desired student outcomes to keep community colleges and partners focused on innovation. Policymakers should also look at what tools and information we need to really measure the value of good practice and gather the data needed to make it an evidence-based best practice.[74]

Invest more in national service programs such as AmeriCorps, VISTA, YouthBuild, and the youth service and conservation corps, which could create full-time positions for young people. These investments would in most cases be paid for jointly by public and private resources. Investing $830 million in fiscal year 2011 could create 60,000 jobs. Most of these jobs would be in nonprofit organizations.[75]

Invest in a summer youth employment program. The summer youth employment program does more than provide hundreds of thousands of youth with seasonal employment opportunities; it also has the potential to change the long-term employment prospects of disadvantaged youth who might otherwise be disconnected from the labor market. Youth get the experience and support they need to access entry-level jobs as they transition to adulthood through training in hard and soft jobs skills and exposure to services offered by community organizations.

Improve employment services. Research shows that employment services and job-search assistance can be helpful to unemployed workers.[76] Currently, the Workforce Investment Act systems are not designed to stay with a worker over time. Instead, they are focused on quick job placement. For the long-term unemployed, it may be challenging to get them into a job quickly and Congress should provide the one-stops with flexibility and funding to provide professional career-counseling services.[77]

Improvements to employment services can be done through WIA and Wagner-Pizer Act funding. One idea is to require that one-stop career center partners include opportunities to provide career guidance across agencies as part of their Memorandum of Understanding for co-location at the center.[78] The Department of Labor's new website, www.mynextmove.org, seeks to help workers identify career paths and skills necessary through an interactive web-based tool.

Conclusion

I'd like to come back to the question of: Are we doing everything we can to help the unemployed find jobs? Early in February, in the *Financial Times*, Rep. Darrell Issa (R-CA) made the case that "President Barack Obama's $814 billion economic expansion has woefully failed to reach each of its self-imposed targets."[79] That's partially true since the economy has not come back to full employment—clearly a goal that we all share—but the reality is that employment has not returned not because we acted together as a nation to address high unemployment but rather because we did not act enough.

The nearly 14 million people out of work today would be better off if we used our nation's resources to spur, not halt, economic growth. We now know that the perception of prosperity in the 2000s was in many ways a mirage. The housing bubble—fueled by financial services innovation that masked growing risks to the larger economy—and then the Great Recession revealed deeper structural problems. The housing bubble, rapid growth of the real estate and financial sectors, and debt-fueled growth during the Bush era masked what were otherwise largely negative trends for American workers.

We continue to live in one of the richest nations on the planet. We have the resources to solve problems that we decide to solve. We've had enough money to give billions of dollars away in tax cuts for the very wealthiest among us. And yet we seem to have lost our can-do conviction that the economy can indeed improve, and that we can again create good jobs for all who need them. There appears to be a growing acceptance that slow job creation is "just the way things are." A growing fatalism convinces us that our economy will be stuck at the bottom for quite some time.

These diminished expectations aren't merely evidence of a national funk. They also pose a real threat to our economy—not just by making businesses and consumers less willing to invest in the future but also by letting elected officials off the hook. We need greater investment to bring down unemployment, but the widespread idea that we are doomed to austerity gives policymakers an excuse not to tackle the problem.

In closing, I would like to underscore the urgency of Congress continuing to address long-term unemployment. In May 2010, Christina Romer, then-chair of the Council of Economic Advisers, said:

> It would be penny-wise but pound-foolish to try to deal with our long-run problem by tightening fiscal policy immediately or foregoing additional emergency spending to reduce unemployment. Immediate fiscal contraction would inevitably nip the nascent economic recovery in the bud—just as fiscal and monetary contraction in 1936 and 1937 led to a second severe recession before the

> recovery from the Great Depression was complete. And nothing would be more damaging to our fiscal future than a protracted recession and permanently higher unemployment.[80]

Addressing the federal budget deficit is certainly an important concern but economists are largely in agreement that cutting back on government spending before the recovery has fully taken hold is not the right policy. In fact, it could exacerbate unemployment. Record-high long-term unemployment will remain until employers begin hiring in much larger numbers than they are today. Because we are in the unusual situation of following a severe recession and a financial crisis—with policymakers having already tapped into expansionary monetary policy as far as they can—using the "power of the purse" is necessary to push the economy into a self-sustaining recovery. If we do that and lay the foundation for a strong recovery, we will be in a much better situation to address the deficit in the years to come.

---

[1] Bureau of Economic Analysis. 2011. "National Income and Product Accounts Table 1.1.1." (http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=1&FirstYear=2009&LastYear=2010&Freq=Qtr [January 25, 2011]).

[2] "Industrial Production and Capacity Utilization: Table G.17." (Washington DC: Federal Reserve Statistical Release, 2010), available at http://www.federalreserve.gov/releases/g17/current/default.htm.

[3] Adam S. Hersh and Isha Vij. 2011. "Economic Growth Continues, but Too Slowly to Secure Recovery: Policy Consistency Targeting Jobs is Necessary." Center for American Progress. (http://www.americanprogress.org/issues/2011/01/december_jobs.html [January 25, 2011]).

[4] Christian Weller. "Economic Snapshot for January 2011." (Washington DC: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/01/pdf/jan11_econ_snapshot.pdf.

[5] Adam S. Hersh and Christian E. Weller. "Measuring Future U.S. Competitiveness: U.S. Productivity and Innovation Snapshot." (Washington, DC: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/02/pdf/productivity_snapshot.pdf.

[6] Correspondence with NFIB; William C. Dunkelberg and Holly Wade. "NFIB Small Business Economic Trends." (Washington DC: National Federation of Independent Business, 2011), available at http://www.nfib.com/Portals/0/PDF/sbet/sbet201102.pdf.

[7] The Federal Reserve Board. "Senior Loan Officer Opinion Survey on Bank Lending Practices." (Washington DC: Federal Reserve, 2011), available at http://www.federalreserve.gov/boarddocs/snloansurvey/201102/table1.htm.

[8] Hersh and Weller, "Measuring Future U.S. Competitiveness: U.S. Productivity and Innovation Snapshot".

[9] Hersh and Vij, "Economic Growth Continues, but Too Slowly to Secure Recovery: Policy Consistency Targeting Jobs is Necessary", Bureau of Labor Statistics. 2011. "Current Population Survey." Department of Labor. (http://www.bls.gov/webapps/legacy/cpsatab1.htm [February 3, 2011]).

[10] Hersh and Vij, "Economic Growth Continues, but Too Slowly to Secure Recovery: Policy Consistency Targeting Jobs is Necessary".

[11] Bureau of Labor Statistics. "Job Openings and Labor Turnover Survey." (Washington: U.S. Department of Labor, 2010), available at http://data.bls.gov:8080/PDQ/servlet/SurveyOutputServlet;jsessionid=6230b1db2685c2223617.

[12] "Bureau of Labor Statistics. *Employment Status of the civilian population by sex and age*, (U.S. Department of Labor, 2010), Hersh and Vij, "Economic Growth Continues, but Too Slowly to Secure Recovery: Policy Consistency Targeting Jobs is Necessary".

[13] Henry Farber. "What Do We Know About Job Loss in the United States? Evidence from the Displaced Workers Survey, 1984-2004." *Federal Reserve Bank of Chicago: Economic Perspectives* 2 ((2005), Lisa B Kahn. "The Long-Term Labor Market Consequence of Graduating from College in a Bad Economy." *Labour Economics* 17 ((2010): 303-16.

[14] Bureau of Labor Statistics. 2010. "Worker Displacement: 2007-2009." U.S. Department of Labor. (http://www.bls.gov/news.release/disp.nr0.htm [February 6, 2011]).

[15] Author's calculations from U.S. Census Bureau and Bureau of Labor Statistics.

[16] Wayne Vroman. "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession." (Washington, DC: U.S. Department of Labor, 2010), available at http://wdr.doleta.gov/research/keyword.cfm?fuseaction=dsp_resultDetails&pub_id=2447&mp=y.

[17] Lawrence F. Katz and Bruce D. Meyer. "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment." *Journal of Public Economics* 41 ((1990): 45-72.

[18] Lawrence F. Katz, "*Long-Term Unemployment in the Great Recession,*" testimony before the Joint Economic Committee of the US Congress, "Consequences and Solutions Long-Term Unemployment: Causes," 2010, available at http://jec.senate.gov/public/index.cfm?a=Files.Serve&File_id=e1cc2c23-dc6f-4871-a26a-fda9bd32fb7e.
[19] Rob Valletta and Katherine Kuang. "Extended Unemployment and UI Benefits." (San Francisco: Federal Reserve Bank of San Francisco, 2010), available at http://www.frbsf.org/publications/economics/letter/2010/el2010-12.html.
[20] David Card and Phillip Levine, B. "Extended benefits and the duration of UI spells: evidence from the New Jersey extended benefit program." *Journal of Public Economics* 78 ((2000): 107-38.
[21] David Card, Raj Chetty, and Andrew Weber, "The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?" (Cambridge, MA: National Bureau of Economic Research, 2007).
[22] Ibid.
[23] Jonathan Gruber. "The Wealth of the Unemployed." (Cambridge: MIT Department of Economics, National Bureau of Economic Research, 2000), available at http://econ-www.mit.edu/files/102.
[24] Raj Chetty, "Moral Hazard vs. Liquidity and Optimal Unemployment Insurance" (Cambridge: National Bureau of Economic Research, 2008).
[25] Bureau of Labor Statistics. "The Employment Situation - January 2011." (Washington DC: Department of Labor, 2011), available at http://bls.gov/news.release/pdf/empsit.pdf.
[26] John Schmitt. "Deconstructing Structural Unemployment." (Washington DC: Center for Economic and Policy Research, 2011), available at http://www.cepr.net/documents/publications/dws-2011-03.pdf.
[27] Bureau of Labor Statistics. "Consumer Price Index - December 2010." (Washington DC: Department of Labor, 2011), available at http://www.bls.gov/news.release/pdf/cpi.pdf.
[28] Holly Xie, Howard L. Fleischman, Paul J. Hopstock, Marisa P. Pelczar, and Brooke E. Shelley. ""Highlights From PISA 2009: Performance of U.S. 15-Year-Old Students in Reading, Mathematics, and Science Literacy in an International Context." (Washington, DC: National Center for Education Statistics, 2010), available at http://nces.ed.gov/pubs2011/2011004.pdf.
[29] U.S. Congressional Budget Office. "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from October 2010 Through December 2010." (Washington, DC 2011), available at http://www.cbo.gov/ftpdocs/120xx/doc12074/02-23-ARRA.pdf
[30] Alan Blinder and Mark Zandi. "How the Great Recession Was Brought to An End." (Washington, DC: Economy.com, 2010), available at http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf.
[31] A wide array of economists agree with this sentiment. See: Mark Zandi, "*Using Unemployment Insurance to Help Americans Get Back to Work: Creating Opportunities and Overcoming Challenges,*" testimony before the US Congress, Senate Committee on Finance, April 14, 2010.; Lawrence H. Summers. "Reflections on Fiscal Policy and Economic Strategy." (Baltimore: Remarks at the Johns Hopkins School of Advanced International Studies, 2010), available at http://www.whitehouse.gov/administration/eop/nec/speeches/fiscal-policy-economic-strategy.
[32] Ben S. Bernanke, "*The Economic Outlook and Monetary and Fiscal Policy,*" testimony before the Committee on the Budget, US Senate, 2011, available at http://www.federalreserve.gov/newsevents/testimony/bernanke20110107a.htm.
[33] Carmen Reinhart and Kenneth Rogoff. "The Aftermath of Financial Crises." *American Economic Review (Papers and Proceedings)* 99 (2) (2009): 466-72.
[34] Heather Boushey, "Keep the Money Flowing," Room for Debate, June 24, 2010, available at http://roomfordebate.blogs.nytimes.com/2010/06/24/can-obama-create-more-jobs-soon/?scp=1&sq=boushey&st=cse#heather.
[35] Federal Reserve. 2011. "Federal Funds Rate." Federal Reserve Statistical Release. (http://www.federalreserve.gov/releases/H15/data.htm [February 6, 2011]).
[36] Blinder and Zandi, "How the Great Recession Was Brought to An End".
[37] Michael Linden, "Breaking Down the Deficit" (Washington, DC: Center for American Progress, 2009).
[38] Ibid.
[39] "America's Infrastructure Report Card." (Washington DC: American Society of Civil Engineers, 2009), available at http://www.infrastructurereportcard.org/sites/default/files/RC2009_full_report.pdf.
[40] Adam Hersh. "The Missing Ingredient in Our Recovery: Investment Is Central to Continued Growth and Competitiveness." (Washington DC: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/01/recovery_gdp.html.
[41] Ben S. Bernanke. "The Economic Outlook and Macroeconomic Policy." (Washington DC: Speech at the National Press Club, 2011), available at http://www.federalreserve.gov/newsevents/speech/bernanke20110203a.htm.
[42] Jordan Eizenga. "Why We Need a Permanent Build America Bonds Program." (Washington DC: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/10/america_bonds.html

[43] Patrick McGee. "BABs Crimp Tax-Exempts, But Munis Set New Record." (New York: The Bond Buyer, 2011), available at http://www.bondbuyer.com/issues/120_30/-1023350-1.html.
[44] Alan Krueger. "Build America Bonds At Year One." (Washington DC: U.S. Department of the Treasury, 2010), available at https://ustreas.gov/offices/economic-policy/AK-NationalMunicipalBondSummit-3-18-2010.pdf
[45] Nathan Musick. "Subsidizing Infrastructure Investment with Tax-Preferred Bonds." (Washington DC: Congressional Budget Office and Joint Committee on Taxation, 2009), available at http://www.cbo.gov/ftpdocs/106xx/doc10667/10-26-TaxPreferredBonds.pdf.
[46] Andrew Ang, Vineer Bhansali, and Yuhang Xing. "Build America Bonds." (Columbus, Ohio: Council of Development Finance Agencies, 2010), available at http://www.cdfa.net/cdfa/cdfaweb.nsf/fbaad5956b2928b086256efa005c5f78/eba3283f20ee9da486257791007179d8/$FILE/BAB%20Report.pdf.
[47] Jordan Eizenga, Seth Hanlon, and James Hairston. "Myth vs. Fact: The Build America Bond." (Washington DC: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/11/bab_myth_fact.html
[48] Alan Krueger, testimony before the Senate Banking, Housing and Urban Affairs Committee, September 21, 2010, available at http://www.treasury.gov/press-center/press-releases/Pages/tg863.aspx
[49] Michael Decker. "Build America Bonds: An American Success Story." (New York: The Bond Buyer, 2009), available at http://www.bondbuyer.com/issues/118_210/build_america_bonds_success_story-1003300-1.html
[50] Jordan Eizenga. "Build America Bonds Can Rebuild Muni Market." (Washington DC: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/02/build_america_bonds.html
[51] Office of Management and Budget. "Fiscal Year 2012 Analytical Perspectives: Budget of the U.S. Government." (Washington DC: Executive Office of the President, 2010), available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/spec.pdf.
[52] Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession".
[53] Tami Luhby. "State Unemployment Benefits in the Crosshairs." (New York: CNN Money, 2011), available at http://money.cnn.com/2011/03/23/news/economy/state_unemployment_benefits/index.htm.; Karen Bouffard. "Michigan Lawmakers Cut Unemployment Aid for Future Applicants." (Lansing, MI: Detroit News, 2011), available at http://detnews.com/article/20110324/POLITICS02/103240373/Michigan-lawmakers-cut-unemployment-aid-for-future-applicants#ixzz1HWWuBqkk].
[54] There is not parity between disparities in recipiency and effect on macroeconomic stability as the ratio of stabilizing effect is lower than the ratio of recipiency across the two groups, which is 2 to 1. In Vroman's view, the explanation appears to be the stronger negative feedback of lagged unemployment in the high-recipiency states. See: Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession".
[55] Michael Cooper and Mary Williams Walsh. "U.S. Bills States $1.3 Billion in Interest Amid Tight Budgets." (New York: The New York Times, 2011), available at http://www.nytimes.com/2011/01/15/us/politics/15stimulus.html.
[56] Office of Unemployment Insurance. 2010. "UI Outlook Overview." Department of Labor. (http://www.ows.doleta.gov/unemploy/content/prez_budget.asp [January 28, 2011]).
[57] Heather Boushey and Jordan Eizenga. "Toward a Strong Unemployment Insurance System." (Washington DC: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/02/pdf/ui_brief.pdf.
[58] Office of Management and Budget. "Fiscal Year 2012 Budget of the U.S. Goverment." (Washington DC: Executive Office of the President, 2011), available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/budget.pdf.
[59] *Unemployment Insurance Solvency Act of 2011*, S.386, 112th Congress, 1st Session, available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=112_cong_bills&docid=f:s386is.txt.pdf.
[60] Bureau of Economic Analysis, "National Income and Product Accounts Table 1.1.1".
[61] Elizabeth McNichol, Phil Oliff, and Nicholas Johnson. "States Continue to Feel Recession's Impact." (Washington DC: Center for Budget and Policy Priorities, 2011), available at http://www.cbpp.org/cms/?fa=view&id=711.
[62] Heather Boushey. "Rebuilding the middle class: Creating jobs should be a top priority." (Washington DC: MarketWatch, 2011), available at http://www.marketwatch.com/story/creating-jobs-should-be-a-top-priority-2011-02-04.
[63] Bureau of Labor Statistics. 2011. "Current Population Survey, Table A.37. Unemployed Persons by Occupation, Industry, and Duration of Unemployment." Department of Labor. (http://www.bls.gov/web/empsit/cpseea37.htm [March 28, 2011]).
[64] Employment and Training Administration. "Comparison of State Unemployment Laws." (Washington DC: Department of Labor, 2009), available at http://workforcesecurity.doleta.gov/unemploy/uilawcompar/2009/comparison2009.asp.

[65] Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession".
[66] Mark Zandi, testimony before the Senate Finance Committee, "Using Unemployment Insurance to Help Americans Get Back to Work: Creating Opportunities and Overcoming Challenges," April 14, 2010, available at http://finance.senate.gov/imo/media/doc/041410mztest.pdf.; Paul Krugman. "Free to Lose." (New York: The New York Times, 2009), available at http://www.nytimes.com/2009/11/13/opinion/13krugman.html.; Kevin A. Hassett, "*Prospects for Employment Growth: Is Additional Stimulus Needed?,*" testimony before the House Committee on Financial Services, February 23, 2010, available at http://financialservices.house.gov/media/file/hearings/111/hassett.pdf. Dean Baker has also proposed a new tax credit to encourage shorter workweeks. See: Dean Baker. "Job Sharing: Tax Credits to Prevent Layoffs and Stimulate Employment." (Washington DC: Center for Economic and Policy Research, 2009), available at http://www.cepr.net/documents/publications/job-sharing-tax-credit-2009-10.pdf..
[67] "World Economic Outlook: Rebalancing Growth." (Washington, DC: International Monetary Fund, 2010), available at http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/text.pdf., figure 3.1.
[68] The short-term compensation program was established as a temporary program in 1982 and made permanent in 1992. However, there were discrepancies in the 1992 legislation that created an "administrative muddle" about what exactly states are allowed to do. The 1982 legislation had required that any employer who participated must continue health insurance and retirement benefits, and that the program must have the consent of bargaining representatives in unionized shops. The 1992 legislation, however, did not include those provisions, which has led to a lack of clarity about the program requirements.
[69] "Extending Unemployment Insurance Benefits: The Cost of Inaction for Disabled Workers." (Washington DC: Joint Economic Committee of the U.S. Congress, 2010), available at http://jec.senate.gov/public/?a=Files.Serve&File_id=a0bf909c-eb74-48bd-86fb-3b611694b052.
[70] Liz Schott and LaDonna Pavetti. "Walking Away From a Win-Win-Win: Subsidized Jobs Slated to End Soon Are Helping Families, Businesses, and Communities Weather the Recession." (Washington DC: Center for Budget and Policy Priorities, 2010), available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3274.
[71] Guy Molyneaux. "Key Findings From Survey on Poverty Issues." (Washington DC: Hart Research Associates, 2010), available at http://halfinten.org/uploads/support_files/Half_in_Ten_Poll_Results.pdf.
[72] Louis Soares. "The Power of the Education-Industry Partnership: Fostering Innovation in Collaboration Between Community Colleges and Businesses." (Washington DC: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/10/community_colleges.html.
[73] Ibid.
[74] Ibid.
[75] Melissa Boteach, Joy Moses, and Shirley Sagawa. "National Service and Youth Unemployment: Strategies for Job Creation Amid Economic Recovery." (Washington DC: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/11/pdf/nation_service.pdf.
[76] David E. Balducchi, Randall W. Eberts, and Christopher J. O'Leary, *Labor Exchange Policy in the United States.* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research 2004).
[77] Louis Soares. "Moving from Short-Term Jobs to Long-Term Skills: Priorites for Workforce Investment Act Reauthorization." (Washington DC: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/05/wia_reauthorization.html.
[78] Ibid.
[79] Darrell Issa. 2011. "Obama's Keynesian failures must never be repeated." Financial Times. (http://www.ft.com/cms/s/0/d949c6c8-32fc-11e0-9a61-00144feabdc0.html?ftcamp=rss#axzz1DJpPo9eD [March 28, 2011]).
[80] Christina Romer. "Back to a Better Normal: Unemployment and Growth in the Wake of the Great Recession." (Princeton, NJ: Speech at the Woodrow Wilson School of Public and International Affairs, Princeton University, 2010), available at http://www.whitehouse.gov/administration/eop/cea/Back-to-a-Better-Normal.

Chairman CAMP. Dr. de Rugy you have 5 minutes.

STATEMENT OF VERONIQUE DE RUGY

Ms. DE RUGY. Good morning, Chairman Camp, Ranking Member Levin and distinguished Members of the Committee. Thank you for inviting me to discuss how debt and deficits relate to economic growth and job creation. My name a Veronique deRugy and I am a senior research fellow at the Mercatus Center at George Mason University, where I specialize on tax and budget issues.

Deficits and debt matter. They are the symptom of a disease called government spending. Overspending in the past, along with the near explosion of Social Security, Medicare and Medicare spending means it will be drowning in red ink for the foreseeable future. Unfortunately, the persistent failures of lawmakers to cut spending have created a situation where the symptoms produce symptoms of their own.

I have three points to make today about large sustained deficits and debts. First, they cripple economic growth and destroy jobs; second, they are expensive and they are self-perpetrating; third, American families are the ones paying the price for these symptoms.

To the first point, large and sustained deficits and debt in evidently cripple economic growth and destroy jobs. The money the Federal Government borrows comes from American savings, so does the money that American invest in the private sector's growth. There comes a point where there just aren't enough savings to satisfy both masters. So if the government borrows more money, domestic investment will go down as State economists call crowding out. And this State's company will build fewer factories, cut back on research and development and generate fewer innovations. As a result, our Nation's future earning prospect will then, and our future living standard will suffer. And pouring more money to foreign investors isn't the solution either, as this money needs to be repaid too.

Second, deficits and debt are expensive and self-perpetrating. The more we borrow, the bigger our interest payments are. In spite of historically low interest rates, by the time my 8-year old daughter finishes high school, the Federal Government well spend a projecting $866 billion each year just to pay interest on our debt. That is more than what the U.S. spends now on two wars, plus the Department of Defense, Education, Energy and Homeland Security combined.

As our deficit grows, the interest on our debt grows too. All too soon we will have to borrow money to pay for the interest on our debt. And if persistent deficits lead to higher interest rates, through the combination of concerns about inflation and potential default, these new rates can magnify the power of compounded interest. In other words, deficits find us at low rate today can lead to more deficits financed at higher rates in the future.

Third, deficits and debt matter to American families and they are the ones who will suffer from economic uncertainty, high unemployment rate, higher interest rates, lower growth and lower standards of living brought by a fiscal crisis caused by too many deficits and too much debt. Yet the ones who will really suffer are our children. As the United States is set to embark in an unprecedented and massive transfer of wealth from younger taxpayers to older ones.

Make no mistake, our children will be the ones who pay for the decisions we are making today. That fiscal crisis could be slow, yet rampant discussion of our economy. It could be abrupt with creditors losing faith and pulling their money from the United States overnight. Either way, things are way worse than they look on paper.

According to the CBO, U.S. debt as a percentage of GDP will reach 200 percent by 2037. Those are projections. Not the real world. In the real world the economy could collapse before we could even get to the CBOs forecast level. Even the CBO acknowledges that possibility. And as long-term projections documents the CBO forecasts, the effect crowding out may have on GDP per capita and contrast it with commonly-used projections.

Depending on the assumption made this data shows that per capita growth collapsing about 10 to 20 years from now due to crowding out. The contrast between this data and the data usually referenced by scholars like me and a governmental official is striking.

What then should the government decide today? Well, Congress should address our fiscal imbalance today and tomorrow and should start to do it now. In particular, Congress should reform the main driver of spending explosion, Social Security, Medicare and Medicaid. That being said, I think everything should be on the table, including defense spending.

It should also resist the temptation to address these deficits by raising taxes. No amount of taxes could address the immense fiscal imbalance that our country which face in the future. Furthermore, raising taxes would add to our problems by hindering economic growth, thereby reducing tax revenue and adding to the deficit.

Thank you for the opportunity to testify before you today, and I am looking forward to your answers.

Chairman CAMP. Thank you, thank you all for your testimony.

[The prepared statement of Ms. de Rugy follows:]

MERCATUS CENTER
George Mason University
BRIDGING THE GAP BETWEEN ACADEMIC IDEAS AND REAL WORLD PROBLEMS
TESTIMONY

DEBT AND DEFICITS: THE SYMPTOMS, NOT THE DISEASE

MARCH 30, 2011

Veronique de Rugy
Senior Research Fellow

House Committee on Ways and Means

Good Morning Chairman Camp, Ranking Member Levin, and distinguished members of the committee. It is a pleasure to be here this morning to discuss the most important topic of debt and deficits and how they relate to economic growth and job creation.

Deficits and debt matter. First, they matter politically. Polls show that debt and deficits are defining issues of American politics.[1] Washington should indeed be focusing on these important issues. Unfortunately, this focus is often misplaced as debt and deficit are the symptoms of government spending, not the disease. The disease is government spending. As a result, the only way to cure debt and deficits is to cut government spending.

Debt and deficits are the symptoms, not the disease, but the persistent failures of lawmakers to cut spending have resulted in a situation where these symptoms have started provoking other symptoms. Think of them like tumors. Tumors are a symptom of cancer. But independently tumors wreak all sorts of havoc on the body. They not only fuel their growth by stealing nutrients from other bodily purposes, but they also impinge on the function of vital organs like the brain, the lungs, and the liver.

So it is with debt and deficits. They hinder economic growth and destroy jobs. Besides being expensive and self-perpetuating, they increase the probability of a severe fiscal crisis and can signal to investors that the United States may be getting closer to the time when it won't be able to pay those investors back.

While economists understand the negative consequences of the failure to cut spending and the persistence of deficit and debt, they can't pinpoint at what point these debt levels become unacceptable to global credit markets. Economists can't reliably predict what the form the fiscal crisis will take. For instance, the fiscal crisis could be a slow, yet rampant destruction of our economy. It could also be more abrupt with creditors losing faith and pulling their money from

[1] Tony Blankley, "Debt Doom Refocuses Politics," *Washington Times*, February 21, 2011.

the United States overnight, throwing the country into a vicious debt spiral, another deep recession, and ultimately a lower standard of living here and presumably around the world.

But the main reason why deficit and debt matter is that American families will be the ones on the receiving end of economic uncertainty, higher interest rates, lower growth, higher unemployment rates, and lower standards of living. Maybe even more importantly, future generations will have to pay today's deficits. We are about to embark on the most massive transfer of wealth from younger taxpayers to older ones in American history. It will be not just unprecedented but also unfair: Our children will pay for the decisions we make today.

The solution is for Congress to act now and cut spending. In particular, Congress should reform Social Security, Medicare, and Medicaid, which are the main drivers of the spending explosion. The solution is also for Congress to resist the temptation to address these deficits by raising taxes. First, no amount of taxes could address the phenomenal fiscal imbalance that our country will face in the future. But, raising taxes would also add to our problems by hindering economic growth,[2] thereby reducing tax revenue and adding to the deficit.

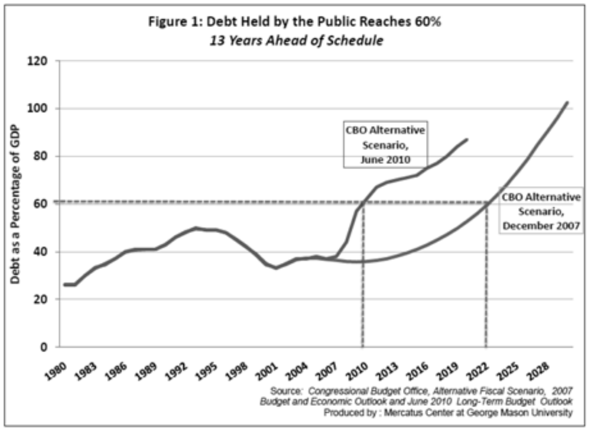
SECTION 1: BUDGET PROSPECTS

America's financial situation is unsustainable. According to the Congressional Budget Office's analysis of the President's Budget, in 2011 the federal government will spend \$3.7 trillion but will collect only \$2.2 trillion in revenue.[3] The result is a \$1.4 trillion deficit, or 9.5% of gross domestic product (GDP), up from \$1.29 trillion in 2010. Worse, Congressional Budget Office projections show that we'll be drowning in red ink for the foreseeable future, with deficits averaging nearly \$1 trillion during each of the next 10 years.[4]

While these numbers are dramatic, they pale in comparison to what the federal government owes to foreign and domestic investors. According to the CBO, in 2011 America's public debt, which historically has averaged less than 40% of GDP, will reach \$10.4 trillion, or 69.1 percent of GDP, the highest it has been in 50 years.[5] Based on these same estimates, the debt will cross the 90 percent threshold, a level at which many economists believe a country is putting itself in financial peril, by 2021.[6]

---

[2] Christina D. Romer & David H. Romer, "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," American Economic Review, American Economic Association, 100 (2010):763–801.
[3] Congressional Budget Office, *Preliminary Analysis of the President's Budget for 2012* (Washington, DC: CBO, 2011): 16 http://cbo.gov/ftpdocs/121xx/doc12103/2011-03-18-APB-PreliminaryReport.pdf.
[4] Ibid.
[5] Ibid., 6.
[6] Congressional Budget Office, *Long-Term Budget Outlook, Supplemental Data* (Washington, DC: CBO, June 2010, http://cbo.gov/doc.cfm?index=11579; Carmen M. Reinhart & Kenneth S. Rogoff. "Growth in a Time of Debt," *American Economic Review*, 100 (May 2010): 573-78.



However, things are deteriorating quickly so these estimates should be taken with a grain of salt. This chart compares the CBO's long-term public debt projections from 2010[7] with long-term projections calculated in 2007.[8] Three years ago, the CBO projected that the debt held by the public would not surpass 60 percent until 2023.[9]

What's more, with the impending entitlement crisis requiring more future borrowing, by 2020 interest on our debt and autopilot programs like Social Security, Medicare, and Medicaid will consume 92 cents of every dollar of revenue raised by the federal government. These costs will also account for 65 cents of every dollar spent by the federal government in 2020, up from 45 cents today. In other words, starting now non-interest and non-autopilot programs will gradually be squeezed out. In 2020, if current trends continue, the country will owe more than $17 trillion, or 87 percent of GDP.[10] We would reach 100 percent by 2023 and 200 percent by 2037.[11]

If we add to the debt held by the public the debt that the federal government owes to other accounts like Social Security, gross federal debt was $13.6 trillion in fiscal year 2010, or roughly 90 percent of the United States' GDP.[12]

As large as they are though, these debt numbers pale in comparison to the current unfunded liabilities. According the Financial Statement of the United States, in 2010 the net present value of the promises made to the American people for which the United States does not have the money to pay is roughly $75 trillion.[13]

---

[7] *Long-Term Budget Outlook 2010, Supplemental Data*
[8] Congressional Budget Office, *Long-Term Budget Outlook,* Supplemental Data (Washington, DC: CBO, December 2007), http://cbo.gov/doc.cfm?index=8877
[9] Ibid.
[10] Congressional Budget Office, *Long-Term Budget Outlook 2010, Supplemental Data.*
[11] Congressional Budget Office, *Long-Term Budget Outlook 2010, Supplemental Data.*
[12] U.S. Department of Treasury, Monthly Statement of the Public Debt of the United States, September 30, 2010, http://www.treasurydirect.gov/govt/reports/pd/mspd/2010/opds092010.pdf.
[13] U.S. Department of Treasury, *Financial Statement of the United States FY2010*, http://www.gao.gov/financial/fy2010/10frusg.pdf.

Needless to say, even ignoring the distortions and anti-growth effect of tax increases, no level of taxes could address today and tomorrow's fiscal imbalance.

SECTION 2: DEFICITS AND DEBT MATTER

There are several reasons why these deficits and debts matter.

1. Deficit and Debt are the Symptoms of Overspending

Deficits and debt are the symptoms of our overspending problem. Excessive government spending cripples economic growth.

Government spending can be paid with three sources: debt, new money, or taxes (or a combination of these). All three of these methods of payment remove real resources from the private economy. In other words, the government can't inject money *into* the economy without first taking money *out* of the economy.

For instance, if the government borrows money, there will likely be less capital available for the private sector to borrow for its own consumption or investment. If the government prints money, it will create inflation that reduces the value of the money and decreases purchasing power of those whose salaries and wages aren't indexed to inflation.

Finally, the government can collect money from present or future taxes. But taxes simply transfer resources from consumers to government, displacing private spending and investment. Families whose taxes have increased will have less money to spend on items for themselves and their children. They are poorer and will consume less. Also, it means they save less money, which in turn, reduces the amount of resources available for lending. In short, taxation reduces taxpayers' income.

In addition, taxation (like every other source of revenue) comes with costs. First, higher taxation encourages people to change their behaviors to avoid taxes. They might switch their efforts to non-taxed activities, such as household production, or underground activities. Economists call this a deadweight loss. Because people give up the taxed activity or good they prefer, this loss is like deadweight on the economy.

In addition, government injections of money into the economy have a direct impact on the economy. While often people who receive government money feel its positive impact on their lives (receiving an unemployment check or a government contract to build a road), it often has longer term negative consequences that overwhelms the initial benefits. It is difficult to get solid evidence on the economy's response to changes in government spending. Direct reporting measures—such as those employed by the Administration to measure the impact of the American Recovery and Reinvestment Act of 2009 through Recovery.gov, the U.S. government's website for tracking stimulus spending—capture the direct and observable effects of government spending on economic activity. These measures can be helpful, but they fail to account for the indirect, less-easily observable effects of government spending. To capture the big-picture effect of government spending, economists turn to the *spending multiplier.*

The *multiplier effect* or *spending multiplier* refers to the idea that an initial amount of government spending leads to a change in the activity of the larger economy. In other words, an initial change in the total demand for goods and services (what economists term aggregate demand) causes a change in total output for the economy that is a multiple of the initial change. For example, if the government spends one dollar, and as a result of this spending, the economy (as expressed by the Gross Domestic Product, or GDP) grows by two dollars, the spending multiplier is 2. If the economy grows by $1.50, the spending multiplier is 1.5. However, if the economy only grows by 50 cents (which, in the case of government purchases, means that the government spending actually shrank the private economy), the spending multiplier is 0.5.

A recent review of the empirical literature reveals a lack of consensus among economists about the actual value of the multiplier.[14] Some find large multipliers; some find small ones. Clearly, the size of the multiplier depends on the type of estimation techniques and assumptions built in the models. However, when we look at the multipliers found by leading figures in the profession, we find that in most cases a dollar in government spending produces *less* than a dollar in economic growth—and these findings often don't even take into account the impact of paying for that government dollar via increased taxes.

For instance, Harvard economists Robert Barro and Charles Redlick estimate that the multiplier for stimulus spending is between 0.4 and 0.7.[15] In addition, they calculate the impact on the economy if the government funds the spending with taxes. They find that the tax multiplier—the effect on GDP of an increase in taxes—is –1.1. This means that if the government raises taxes by $1, the economy will shrink by $1.1. When this tax multiplier is combined with the effects of the spending multiplier, the overall effect is negative.

Economist Valerie Ramey's work on how U.S. military spending influences GDP gives a preferred estimate of 1.2, but she also finds evidence that consumer and business spending fall after a rise in government purchases.[16] Thus, the paper suggests an overall negative impact on the economy. Clinton Administration economist Brad DeLong reports a short-run multiplier of only 0.5: a dollar of government spending shrinks the private sector by 50 cents.[17]

Another recent study by John Cogan, Tobias Cwik, John Taylor, and Volker Wieland concluded that the stimulus package couldn't have had a multiplier much greater than zero.[18] More recently, the Dartmouth economists James Feyrer and Bruce Sacerdote, who supported the stimulus, acknowledged that it didn't boost the economy nearly as much as the administration models claimed it would because most of the spending had a multiplier smaller than 1.[19]

This conclusion was also reached by the International Monetary Fund.[20] The paper concluded that a one percent increase in government purchases (as a share of GDP) increases GDP by a

---

[14] Patrick van Brusselen, "Fiscal Stabilisation Plans and the Outlook for the World Economy" (working paper, European Network of Economic Policy Research Institutes, Brussels, 2009), http://www.plan.be/admin/uploaded/200906111040040.nime_01_09.pdf.

[15] Robert Barro and Charles Redlick, "Macroeconomic Effects from Government Purchases and Taxes," (working paper, Mercatus Center at George Mason University, 2010), http://mercatus.org/publication/macroeconomic-effects-government-purchases-and-taxes.

[16] Valerie Ramey, "Identifying Government Spending Shocks: It's All in the Timing," (working paper, University of California, San Diego, 2008)

[17] Brad Delong sums up a number of multiplier estimates in "Deficit Spending and the Recovery" (lecture, KQED Forum, San Francisco, September 4, 2009), http://delong.typepad.com/sdj/2009/09/deficit-spending-and-the-recovery-talking-points-for-kqed-forum-morning-appearance-september-5-2009-9-am-pdt.html.

[18] "New Keynesian Versus Old Keynesian Government Spending Multipliers" – John Cogan, Tobias Cwik, John Taylor and Volker Wieland – NBER Working Paper 14782

[19] James Feyrer and Bruce Sacerdote, "Did the Stimulus Stimulate? Real Time Estimates of the Effects of the American Readjustment and Recovery Act," NBER Working Paper No. 16759 February 2011, http://www.nasbo.org/LinkClick.aspx?fileticket=H6sHQ5MhK5o%3D&tabid=81

[20] Charles Freedman, Michael Kumhof, Douglas Laxton, Dirk Muir, Susanna Mursula, "Global Effects of Fiscal Stimulus 1 During the Crisis," International Monetary Fund, February 25, 2010, http://www.stanford.edu/~johntayl/carnegie1march.pdf.

maximum of 0.7 percent and then fades out rapidly. This means that government spending crowds out other components of GDP (investment, consumption, net exports) immediately and by a large amount.

Finally, recent research from Lauren Cohen, Joshua Coval, and Christopher Malloy of Harvard Business School shows that federal spending in the states causes local businesses to cut back rather than grow.[21] In other words, when government spending grows, the private sector shrinks. The study found:

1. The average state experiences a 40 to 50 percent increase in earmark spending if one of its senators becomes chair of one of the top-three congressional committees. In the House, the average is around 20 percent.
2. For broader measures of spending, such as discretionary state-level federal transfers, the increase from being represented by a powerful senator is around 10 percent.
3. In the year that follows a congressman's ascendancy, the average firm in his state cuts back capital expenditures by roughly 15 percent.
4. There is some evidence that firms scale back their employment and experience a decline in sales growth.

In other words, the evidence tends to suggest that in most cases government spending cripples economic growth.

2. Large and sustained deficits and debt inevitably cripple economic growth.

In a much cited empirical research study, economists Carmen Reinhart of the University of Maryland and Kenneth Rogoff of Harvard examine the consequences of public debt on economic growth.[22] Using a historical data set spanning forty-four countries and two hundred years, their findings are startling. Across wealthy and poor countries, the median growth rates for countries with publicly held debt exceeding 90 percent of gross domestic product are roughly *one percent lower* than they would be otherwise. They find slightly different results for emerging markets.

The following table from their paper nicely illustrates their growth findings:

Table 1: Real GDP Growth as the Level of Debt Varies: Summary (annual percent change)

Measure	Period	Below 30 percent	30 to 60 percent	60 to 90 percent	90 percent and above
		Central (Federal) government debt/ GDP- Advanced economies			
Average	1946-2009	4.1	2.8	2.8	-0.1
Median	1946-2009	4.2	3.0	2.9	1.6
		Emerging Markets			
Average	1946-2009	4.3	4.8	4.1	1.3
Median	1946-2009	5.0	4.7	4.6	2.9
		Total (public plus private) Gross External Debt/GDP			
Average	1970-2009	5.2	4.9	2.5	-0.2
Median	1970-2009	5.1	5.0	3.2	2.4

Source: Reinhart and Rogoff, "Growth in a Time of Debt."

[21] Lauren Cohen, Joshua Coval, and Christopher Malloy "Do Powerful Politicians Cause Corporate Downsizing?" http://www.people.hbs.edu/cmalloy/pdffiles/envaloy.pdf
[22] Carmen M. Reinhart & Kenneth S. Rogoff. "Growth in a Time of Debt."

These results are particularly important today given the rapid growth in government debts around the world. In the United States, for example, debt will be at 69 percent this year. This is still relatively far from the 90% level that Reinhart and Rogoff identify as problematic. Unfortunately, according to CBO, current policies will get us to that level in 2021.[23]

To put Reinhart and Rogoff's results in context, if the United States doesn't change course, in 2021 the United States economy could lose $200 billion in economic growth simply from an irresponsible level of debt.

Reinhart and Rogoff are not the only scholars warning about the damaging impact of increasing debt ratios on economic growth. In their *Long Term Budget Outlook*, the CBO makes the same predictions.[24] It writes: "CBO's analysis suggests that delaying action for 10 years—and thus allowing the debt-to-GDP ratio to rise by an additional 30 percentage points under the assumptions of the analysis—would cause output to be about 2 percent to 4 percent lower in the long run than it would be if the ratio was stabilized earlier at lower levels, depending on the policy used to stabilize the debt."

Why does this contraction happen? Economists use the term "crowding out" to refer to the contraction in economic activity associated with deficit-financed spending. The Mercatus Center at George Mason University's Matt Mitchell and Jakina Debnam explain, "Though the costs of borrowing may be less-conspicuous than the costs of taxing, they are no less real."[25]

How does the crowding out happen? Robert Barro explains that when members of the economy view increased spending financed by deficit, they assume that taxes will ultimately need to be raised.[26] As a result, they reduce their private consumption today and increase their savings to prepare for the increase in future taxes. But as the CBO explains, "the offsetting rise in private saving is generally smaller than the change in the deficit, so greater government borrowing leads to lower national saving."[27]

It means that if economic actors were completely rational (as assumed in the Barro paper) then deficit-financed spending will have zero impact on the economy. But if, however, the offsetting rise in private savings is smaller than the change in the deficit—which is what most studies seem to show—then deficit-financed spending can have a short-term positive effect on growth, but it will come at a longer-term cost because it will shrink the capital stock. Over the longer run, it also means that capital stock will be smaller and so future economic growth will be harmed.

In layman's terms, that means that the money the federal government borrows comes from Americans' savings as does the money that Americans invest in the private sector's growth. There comes a point where there just aren't enough savings to satisfy both masters. So if the government borrows more money, domestic investment will go down. In addition, the competition between public and private borrowing raises interest rates for all borrowers, including the government, making it more expensive for domestic investors to start or complete projects.

[23] Congressional Budget Office, *Long-Term Budget Outlook,* June 2010, Supplemental Data http://cbo.gov/doc.cfm?index=11579
[24] Congressional Budget Office, *Long-Term Budget Outlook.*
[25] Matt Mitchell and Jakina Debnam, "In the End, We're all Crowded Out," (working paper, Mercatus Center at George Mason University, 2010), http://mercatus.org/publication/long-run-we-re-all-crowded-out#cit7.
[26] Robert Barro, *Macroeconomics* (New York: John Wiley & Sons, 1987), 403.
[27] Congressional Budget Office, the *Long-Term Budget Outlook, June 2010,* page 18-19; and 20.

Concretely, this means American companies will build fewer factories, cut back on research and development, and generate fewer innovations. As a result our nation's future earnings prospects will dim, and our future living standards will suffer.

Of course, the government can borrow more money from foreign lenders. In fact, the theory is that higher interest rates attract more foreign capital to the United States and induce U.S. savers to keep more of their money at home, enabling the United States to afford more domestic investment today.

However, the U.S. government will eventually have to repay that money (plus interest). As a result, more of our future income will have to be sent overseas—and again, our living standards will decline.

There is just no way around it: The more money we borrow now, either from investors, foreign or domestic, the less we will have in the future.

Does it mean that spending should be paid for by increasing taxes? No, it doesn't: tax-financed spending cripples the economy too. An important paper by former Chairman of the Council of Economic Advisors Christina Romer and her economist husband David Romer shows that when taxes are raised by 1 percent of GDP to reduce the deficit will shrink the economy by 3 percent.[28]

3. Debt is very expensive.

The more we borrow, the bigger our interest payments are. In spite of historically low interest rates, by 2020, the federal government will spend a projected $866 billion each year just to pay interest on our debt.[29] That's more than what the U.S. spends right now on two wars, plus the Departments of Defense, Education, Energy, and Homeland Security combined.

The chart below shows the projected interest the government will pay on the federal debt as a percentage of GDP between 1962 and 2082. The projections follow what the CBO calls its "alternative" (and generally more realistic) scenario. It assumes, for instance, that George W. Bush's tax cuts will not expire. This chart also shows the CBO's projections for the cost of Medicare and Social Security as a percentage of GDP. As you can see, the cost of debt (net interest payments) rivals the cost of two of our nation's most expensive social programs.

---

[28] Romer & Romer, "The Macroeconomic Effects of Tax Changes."
[29] Congressional Budget Office, *Preliminary Analysis 2012:* 16, Table 2, http://cbo.gov/doc.cfm?index=12103.

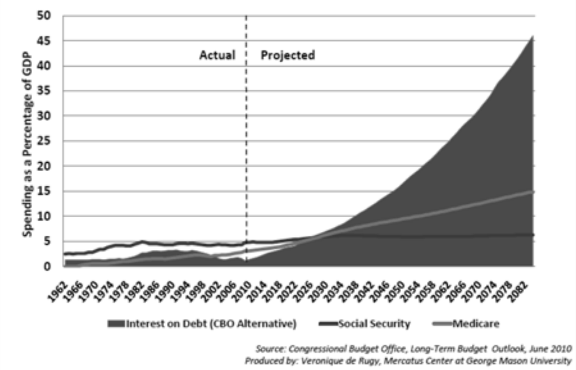


Figure 2: Interest on the Federal Debt Increases

Another way to put it is that deficit and debts have unfortunate tendencies to self-perpetuate. As our deficit grows, the interest on our debt grows too. Soon we end up in a situation where we have to borrow money to pay for the interest on our debt. That grows the deficit and the interest we owe thanks to compounding interest. If persistent deficits—through a combination of concerns about inflation and potential default and the potential of increasing government debt driving up market interest rates—lead to higher interest rates, those can magnify the power of compound interest. In other words, deficits financed at low rates today can lead to more deficits, financed at higher rates, in the future.

4. Things will get worse: A growing debt sends signals to investors that we are becoming riskier borrowers.

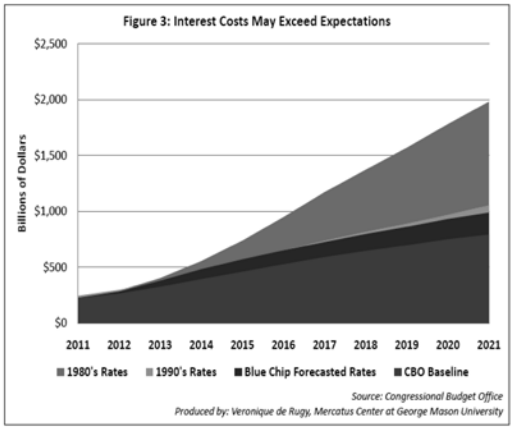
A growing debt exposes America to greater "rollover" risk. Much of U.S. debt is what we call short-term debt. The average maturity of the U.S. debt is 4.4 years, which is unlike most other countries'. For instance, according to the International Monetary Fund's latest *Fiscal Monitor* study, Portugal, Italy, Ireland, and Spain have maturities that range from 6.2 to 7.4 years; the U.K.'s average debt maturity is 12.8 years.[30]

What's good about having short-term debt is that, in good times, the United States has been able to roll over the debt and benefit from very low interest rates. That's the benefit of refinancing. The problem with short-term debt is that it must be refinanced regularly. Basically, the United States is constantly asking the financial markets to roll over its debt.

Over the long run, the real risk comes from a large exposure to sudden increase in interest rates. For instance, at some point U.S. lenders might wise up and increase the interest rates—which, on such a large amount of money, would be painful.[31]

[30] International Monetary Fund, Fiscal Monitor, http://www.imf.org/external/pubs/ft/fm/2010/fm1001.pdf.
[31] Thomas Stratmann and Gabriel Okolski, "Interest Payments of the Federal Debt" (working paper, Mercatus Center at George Mason University, 2010), http://mercatus.org/sites/default/files/publication/Stratmann_Int.%20Payments.pdf.

Using data from the CBO's "January 2011 Budget and Economic Outlook" and "Analysis of the Effects of Three Interest Rate Scenarios on the Federal Budget Deficit," [32] the chart below shows the changes that will occur when the CBO's interest-rate assumptions are modified three interest-rate scenarios: 1) a scenario similar to that experienced in the 1980s; 2) a scenario similar to that experienced in the 1990s; and 3) a scenario consistent with the ten highest projections found in *Blue Chip Economic Indicators*. Under each of these scenarios, the cost of servicing our debt exceeds the costs projected in the CBO baseline.



This suggests that CBO baseline projections, which already show an explosion in the cost of servicing our debt, may in fact be an *underestimate*.

For instance, if interest rates were modified to reflect the average rates in the 1980s — a time in U.S. history when interest rates were driven up by inflation and economic uncertainty — in 2021 our interest payments would nearly triple from CBO's projection of $749 billion to $2.0 trillion. Accumulated interest payments over this period would double from their current projected level of $5.7 trillion to $11.0 trillion.

In addition to the impact of higher deficit and debt listed above, higher interest rates would have a real impact on American families, and it would make it harder and more expensive for them to borrow money and invest. The economy would slow down further, and standards of living would be lower.

5. Inflation

To get deficits under control the federal government could cut spending, increase taxes, or do some of both. Neither of these policies is popular; hence the temptation to print money (or "monetize the debt") to pay the bills. The resulting inflation would reduce the value of each

[32] Congressional Budget Office, "Analysis of the Effects of Three Interest Rate Scenarios on the Federal Budget Deficit," February 24, 2011, http://www.cbo.gov/ftpdocs/120xx/doc12081/Ryan_Letter_Interest_Rates_2-24-2011.pdf.

dollar, and it would introduce high levels of uncertainty into the economy. Imagine what it would be like to try to calculate the net present value of your investment in an environment where you can't predict what your dollars will be worth tomorrow. Such circumstances mean less innovation and less entrepreneurship, and therefore less economic growth and more hardship.

The Federal Reserve is unwilling to take the inflationary route today. But investors know that other central banks have done so in the past and that such a scenario could happen again. In exchange for extending more loans to a federal government that has become a riskier borrower, lenders will ask for an inflation premium. American families and businesses will pay those prices, further hindering economic growth.

6. Deficit and debt make it harder to address emergencies and increase the likelihood of a fiscal crisis.

In December, the Congressional Budget Office released a study on "Economic Impacts of the Long-Term Budget Imbalance."[33] The CBO noted that, in addition to reducing the amount of saving devoted to productive capital and to increasing interest payments, higher debt would make it harder for policy makers to respond to unexpected problems—such as financial crises, recessions, and wars—and it would increase the likelihood of a fiscal crisis.

7. Deficits and debt will hinder economic growth, destroy jobs, and hurt American families

Deficits and debt matter for budgetary and economic reasons. However, they really matter because the real consequences will affect American families.

First, spending and its symptoms (debt and deficit) often signal to consumers, businesses, and investors that taxes are likely to go up in the future. This prospect tends to inject a significant amount of uncertainty into the economy and weakens confidence. That uncertainty means that investors don't invest; employers don't hire; and consumers save, rather than spend, money. People can't find jobs; unemployment grows. This, in turn, hurts an already sluggish economy and has a negative impact on job creation.

If and when interest rates go up—caused by a lack of investments, crowding out, and/or the lenders asking for a debt premium—they will also stunt growth. Increased interest rates mean that it will be harder for families and businesses to borrow money, lowering standards of living for everyone.

In addition, as mentioned above, a few programs will become overwhelmingly large, including interest on the debt and spending on programs like Medicare. Because resources are limited, even with the ability to run deficit, Congress will have to cut drastically all other programs, such as education, infrastructure, or defense. It also means that there will be less money to deal with emergencies like natural disasters or terrorist attacks.

Maybe even more importantly, future generations will have to pay today's deficits. We are about to embark on the most massive transfer of wealth from younger taxpayers to older ones in American history. It will be not just unprecedented but unfair: Our children will pay for the decisions we make today. The CBO for instance, explains that "[…] those generations born after

[33] Congressional Budget Office, "Economic Impacts of Waiting to Resolve the Long Term Budget Imbalance," December 2010, http://www.cbo.gov/doc.cfm?index=11998.

about 2015 would be worse off if action to stabilize the debt-to-GDP ratio was postponed from 2015 to 2025."[34]

Finally, while not everyone will be impacted by the fiscal crisis in the same way, everyone will be affected. When interest rates go up, taxes go up and spending is cut. These changes will affect everyone. In all likelihood, there won't be much time to adjust to the changes, which means that the measures required at that point will be harsh and inequitable.

SECTION III: THE QUESTION IS NOT IF DEFICITS WILL HAVE TERRIBLE CONSEQUENCES, BUT WHEN THEY WILL MANIFEST THEMSELVES.

Going back to Reinhart and Rogoff, as we get closer to the infamous 90 percent threshold, the United States is likely to start seeing a significant impact on our economic growth. What we don't know is the form the crisis will take. For instance, the fiscal crisis could be a slow, yet rampant, destruction of our economy. With the massive debt load standing in the way of a real economic recovery, general uncertainty would cause consumers and businesses to hold back from spending and investing. The crisis could also be more abrupt with creditors losing faith and pulling their money from the United States. Interest rates would spike, causing interest payments to grow, forcing the government to borrow more, which would push rates up even higher. The result would be a vicious debt spiral, another deep recession, and ultimately a lower standard of living in the United States and presumably around the world.

We don't know exactly either at what point these debt levels become unacceptable to global credit markets. Among other reasons, much of that timing depends on the characteristics of each individual country. For instance, the United States, despite a dangerous debt burden relative to GDP (69 percent) and a structural deficit among the highest of developed countries (almost 4 percent), has so far escaped investor censure, thanks to the fact that dollar remains the world's reserve currency (for now). Also, Japan has the world's biggest debt as a percentage of GDP at 227 percent. But it has gotten away with its carelessness without risking default because the country relies more heavily than most on domestic investors to fund its spending.

For a long time, economists argued that there was no evidence that deficits ever lead to higher interest rates. In 1993, North Carolina State University economist John Seater surveyed the literature on deficits and interest rates and concluded that the data "are inconsistent with the traditional view that government debt is positively related to interest rates."[35] But economist Arnold Kling argues that economists haven't seen a correlation between budget deficits and interest rates because foreign investment in U.S. assets has increased over the years, dulling the impact of fiscal policy.[36] The real question is what happens if that investment slows or stops.

Moreover, deficits have reached a level that economists haven't really studied before. Current circumstances remind Kling of "a guy jumping out of a building from the 10th floor, passing the third floor, and saying, 'It's all fine so far.'" Deficits do not matter up to a certain level. But at which level do we hit the ground with a splat? Ten percent of GDP? Twenty percent?

Economists do know that, while debt to GDP ratios are important indicators of a country's fiscal health, they are not the only factor investors use to judge sovereign default risks based on public debt as a percentage of gross domestic product. Instead, bond professionals grade countries on a

[34] Congressional Budget Office, *Long-Term Budget Outlook*, 20.
[35] John Seater, "Ricardian Equivalence," *Journal of Economic Literature* (March 1993): 176.
[36] Arnold Kling quoted in Veronique de Rugy, "When Do Deficit Matter?" *Reason* (April 2009), http://reason.org/news/show/when-do-deficits-matter.

curve, assessing one country's fiscal behavior against another's. When investors lose confidence in a government's fiscal rectitude relative to its competitors, they withdraw, and the snubbed country suffers. Capital being a scarce good, the result is increased interest rates and a higher price for debt. Economic literature dubs this phenomenon "the flight to safety."[37]

Luckily for the United States, so far world markets continue to regard U.S. Treasuries as the safest investment out there. The full coercive power of the United States government still backs treasuries; and the United States is still doing relatively better than other nations. As a result, this perceived safe investment became particularly attractive to investors during the recession.[38] Even as the Federal Reserve increased the supply of treasuries, interest rates went down further still. This anomalous behavior has suppressed the cost of servicing the debt. And in fact, a look at the Department of the Treasury's Daily Treasury Yield Curve Rates shows that interest rates are at extraordinarily low levels.[39] Once this anomalous behavior passes and we return to more normal economic times, it is actually likely that our borrowing terms will grow worse not better.

Another key signaling device for international investors is how a government behaves under financial duress—how it balances the demands of its debtors with those of the domestic recipients of government spending. Announcements of lower spending and higher taxes tell investors a country is willing to go to great lengths in order to avoid defaulting on its debt obligations. If the government instead focuses on preserving its high spending pattern and very generous public employee benefits, investors know default is more likely and will shy away from that country's bonds.

For that reason, the United States must signal early on to its investors that it is serious about addressing its fiscal imbalance. At the very least, it would be beneficial to signal to investors that when the time of a fiscal crunch comes, the US will prioritize its spending and will pay bondholders first.

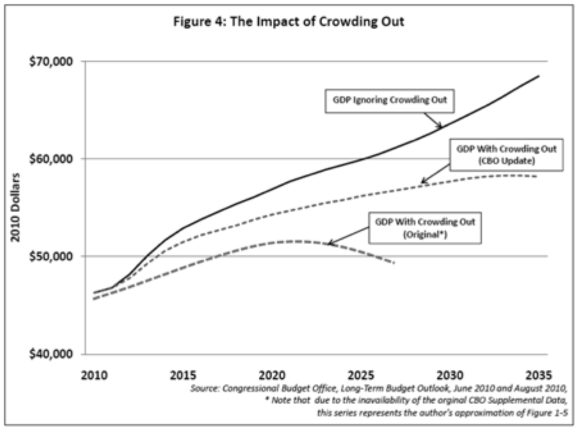
All these factors mean that things can change quickly. Europeans getting in better fiscal shape or some disaster happening in the United States that changes the way investors look at our ability to repay them may activate the flight to safety instinct. When that happens, our economy will suffer beyond the GDP losses due to the crowding out of private investments by government borrowing.

Perhaps more importantly, even if little happens in the short run and investors remain loyal to us for now, things will change in the long or even medium run. According to the CBO, driven by explosion in the autopilot programs like Social Security, Medicare, Medicaid, and interest on the debt, U.S. debt as a percent of GDP will reach 200 percent by 2037. However, these projections, while possible on a computer-generated paper, are unlikely to materialize in a world populated by people. In the real world, the economy could collapse before we could ever get to the levels of debt and deficits CBO is forecasting.

Even the CBO acknowledges that possibility. The chart below uses data from two CBO papers forecasting the effect on GDP per capita that crowding out may have and contrasting it with its commonly used projections. The data from a presentation to the Fiscal Commission in June 2010

[37] Bryan Noeth and Ragdeep Sengupta," Flight to Safety and U.S. Treasury Securities," *The Regional Economist* (July 2010): 18–19, http://research.stlouisfed.org/publications/regional/10/07/treasury_securities.pdf.
[38] Ibid.
[39] US Department of Treasury, Daily Treasury Yield Curve Rates, http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.

(red line) shows per capita GDP growth simply shrinking around year 2022 due to crowding out. The blue line shows another projection of the impact of crowding out that starts shrinking GDP per capita in 2034. The contrast with the data (black line) generally referenced by scholars and government officials is striking.



In other words, whether it is CBO's original or updated predictions that materialize, it is very likely that the people of the United States will feel the negative impacts of high debt and deficits driven by overspending long before the United States reaches a debt ratio of 200 percent. When that happens, our country will be caught in a downward, potentially unmanageable spiral.

CONCLUSION

Congress should care about addressing deficits and debt because of the effect they will have on American families. American families, American workers, and American children will be the first recipients of the bad things that will happen if Congress doesn't address the underlying causes of these deficits. They will suffer from economic uncertainty, higher interest rates, higher taxes, lower growth, higher unemployment rates, and lower standards of living. The children in particular will pay for the decisions we make today.

Congress is the representative of the American taxpayers and the steward of the nation's finances. As such, Congress must start cutting spending today. It should reform Social Security, Medicare, and Medicaid, which are the main drivers of the spending explosion. But these programs shouldn't the only ones targeted for evaluations and potential cuts. Rather, *all* spending should be on the table. Congress needs to make sure no areas of the budget are untouchable. Not entitlements. Not defense. *All* parts of the budget must be on the table for review and potential cuts. And of course, Congress needs to put into place *now* serious, strict, and unavoidable budget rules that tie Congress's hands and restore fiscal discipline.

Congress also needs to resist the temptation to address these deficits by raising taxes. First, no amount of taxes could address the phenomenal fiscal imbalance that our country will face in the future. But, raising taxes would also add to our problems by hindering economic growth,[40] which would reduce tax revenue and add to the deficit.

With the right reforms, Congress could avoid putting the United States in this terrible position and thereby give the American people some renewed confidence in their futures and place the country on the road to recovery and prosperity.

Thank you for your attention. I look forward to your questions.

[40] Christina D. Romer & David H. Romer, 2010. "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," American Economic Review, American Economic Association, vol. 100(3), pages 763-801, June.

Chairman CAMP. Dr. Lazear, last week you were among a group of bipartisan former Council of Economic Advisor Chairs that signed an op-ed calling on the administration and Congress to address the Nation's fiscal crisis. And I would ask unanimous consent that the op-ed that I refer to be included in the record without objection.

[The information follows:]

POLITICO

Unsustainable budget threatens U.S.

By: 10 ex-chairs of the president's Council of Economic Advisers
March 24, 2011 12:33 AM EDT

Repeated battles over the 2011 budget are taking attention from a more dire problem—the long-run budget deficit.

Divided government is no excuse for inaction. The bipartisan National Commission on Fiscal Responsibility and Reform, under co-chairmen Erskine Bowles and Alan Simpson, issued a report on the problem in December supported by 11 Democrats and Republicans — a clear majority of the panel's 18 members.

As former chairmen and chairwomen of the Council of Economic Advisers, who have served in Republican and Democratic administrations, we urge that the Bowles-Simpson report, "The Moment of Truth," be the starting point of an active legislative process that involves intense negotiations between both parties.

There are many issues on which we don't agree. Yet we find ourselves in remarkable unanimity about the long-run federal budget deficit: It is a severe threat that calls for serious and prompt attention.

While the actual deficit is likely to shrink over the next few years as the economy continues to recover, the aging of the baby-boom generation and rapidly rising health care costs are likely to create a large and growing gap between spending and revenues. These deficits will take a toll on private investment and economic growth. At some point, bond markets are likely to turn on the United States — leading to a crisis that could dwarf 2008.

"The Moment of Truth" documents that "the problem is real, and the solution will be painful." It is tempting to act as if the long-run budget imbalance could be fixed by just cutting wasteful government spending or raising taxes on the wealthy. But the facts belie such easy answers.

The commission has proposed a mix of spending cuts and revenue increases. But even this requires cuts in useful programs and entitlements, as well as tax increases for all but the most vulnerable.

The commission's specific proposals cover a wide range. It recommends cutting discretionary spending substantially, relative to current projections. Everything is on the table, including security spending, which has grown rapidly in the past decade.

It also urges significant tax reform. The key principle is to limit tax expenditures—tax breaks designed to encourage certain activities—and so broaden the tax base. It advocates using some of the resulting revenues for deficit reduction and some for lowering marginal tax rates, which can help encourage greater investment and economic growth.

The commission's recommendations for slowing the growth of government health care expenditures — the central cause of our long-run deficits — are incomplete. It proposes setting spending targets and calls for a process to suggest further reforms if the targets aren't met. But it also lays out a number of concrete steps, like increasing the scope of the new Independent Payment Advisory Board and limiting the tax deductibility of health insurance.

To be sure, we don't all support every proposal here. Each one of us could probably come up with a deficit reduction plan we like better. Some of us already have. Many of us might prefer one of the comprehensive alternative proposals offered in recent months.

Yet we all strongly support prompt consideration of the commission's proposals. The unsustainable long-run budget outlook is a growing threat to our well-being. Further stalemate and inaction would be irresponsible.

We know the measures to deal with the long-run deficit are politically difficult. The only way to accomplish them is for members of both parties to accept the political risks together. That is what the Republicans and Democrats on the commission who voted for the bipartisan proposal did.

We urge Congress and the president to do the same.

Martin N. Baily

Martin S. Feldstein

R. Glenn Hubbard

Edward P. Lazear

N. Gregory Mankiw

Christina D. Romer

Harvey S. Rosen

Charles L. Schultze

Laura D. Tyson

Murray L. Weidenbaum

Martin N. Baily, a senior fellow at the Brookings Institution, served as the chairman of the Council of Economic Advisers in the Clinton administration, 1999-2001. Martin S. Feldstein, an economics professor at Harvard University, served as chairman in the Reagan administration, 1982-4. R. Glenn Hubbard, dean of the Columbia University Graduate School of Business, served as chairman in the Bush administration, 2001-3. Edward P. Lazear, economics professor at Stanford University's Graduate School of Business, served as chairman in the Bush administration, 2006-9. N. Gregory Mankiw, an economics professor at Harvard University and influential blogger, served as chairman in the Bush administration, 2003-5. Christina D. Romer, economics professor at the University of California, Berkeley, served as the chairwoman in the Obama administration, 2009-10. Harvey S. Rosen, an economics professor at Princeton University, served as chairman in the Bush administration, 2005. Charles L. Schultze, a senior fellow emeritus at the Brookings Institution, served as chairman in the Carter administration, 1977-81. Laura D. Tyson, a professor at the Haas School of Business of the University of California, Berkeley, served as chairwoman in the Clinton administration, 1993-95. Murray L. Weidenbaum, honorary chairman of the Murray Weidenbaum Center on the Economy, Government and Public Policy at Washington University in St. Louis, served as chairman in the Reagan administration, 1981-82.

Chairman CAMP. Why does such a distinguished and bipartisan group of economists think it is crucial that we act now to address our Nation's fiscal crisis?

Mr. LAZEAR. Is this working yet?

Chairman CAMP. I don't think it is working yet.

Mr. LAZEAR. Thank you. Can you hear me now?

Chairman CAMP. Yeah, I can.

Mr. LAZEAR. I think the problem is obvious to all of us. Those of us who have been CEA chairs have had to put together forecasts every year. We had a committee called TROIKA inside the administration. We look at these numbers on a frequent basis, and it is quite apparent when you start looking at these data that the problem is overwhelming and it is a problem that is immediate. We are adding 10 percent, 10 percentage points to the debt to GDP ratio every year and that number is really a frightening number. So I think that is what has stimulated all of us to try to work together and to think about these issues together.

Now obviously we don't all have the same solutions for the problem. We differ on some of the things that we like, and some of the things that we don't like, but we all recognize that if the problem goes unaddressed that it will be a problem that threatens the country and threatens our economic livelihood. And in particular what we are concerned about is that a couple of things will happen, first of all it will become very costly for the U.S. to borrow.

It will be difficult to service our debt, but more important will be the effect on the private sector. When borrowing costs go up, it makes it difficult to invest. It also means that other investors from around the world will loose confidence in the United States, and those are the things we are most concerned about.

Chairman CAMP. I notice that you all agree that we do need to find measures and ways to deal with our deficit and our debt. And I think it is unprecedented, I have never, in my time in Congress, seen a letter of this kind from both Republican and Democrat Counsel of Economic Advisor Chairs. These are all former chairs of that group that advises the President.

There is a significant debate obviously occurring in the Congress right now about the best way to promote economic growth and job creation. And I would ask you, your testimony seems to say that we need to begin to reduce government spending. And can you walk me through how reducing government spending is connected to job creation?

Mr. LAZEAR. Sure. Again, if I use the President's numbers, which I think are probably the easiest way to start, use the numbers that OMB puts out. The big problem that we have as we go into the future is that we just can't get to the situation that we want to be at by raising taxes; we are just never going to get there, it is simple arithmetic. If you look at the gap that the President is projecting out a couple of decades, we are talking about deficits somewhere in the order 8, 10, eventually 12 percent of GDP per year. To raise taxes enough to close that gap would mean that we would be raising taxes by about 50 percent. I just don't see that happening in this country. I surely hope it does not happen in this country. It would be a tremendous drag on the economy.

So the problem that we face then is one of controlling spending. Now if we don't control spending, I really see it more as a negative. It is not so much that if we control spending, there will be this magical increase in economic growth; it is rather the reverse. If we don't control spending, what we will be doing is putting ourselves in a situation where we will have such strong impediments to economic growth that the economy will struggle. And we had examples of this, Japan has lost decade, now lost 2 decades, hopefully not 3 decades, is case in point.

Chairman CAMP. All right. Dr. Biggs, do you care to comment on that?

Mr. BIGGS. Well, I think I would reiterate what Professor Lazear said, that we are facing with a number of bad choices, particularly in entitlements. If we addressed these issues 10 or 15 years from now we would have a much smoother glide path towards bringing the budget back into balance. We have much more leeway today in terms of the fiscal policy and the avenues we have available to us to address joblessness and fiscal stimulus in the short term.

As it stands, though, we have to do two things at once: We have to both address deficits both in the short term and long term, and we have to think about how to stimulate the economy and keep the economy healthy going forward. And of course, those two things are linked. The stronger your economy, the more easily it can bear the debt that it has more easily it can bear government programs.

So I think we have to say what steps together will both help us effectively address deficits and debt and will do it in a way that is, at the very least, neutral with regard to the economy, but we hope may be helpful with regard to the economy. The research that we have reviewed, and there is a fairly large body of it, indicates the best approach to that would be through reductions in government outlays rather than increases in revenues.

Chairman CAMP. All right. Thank you. Dr. de Rugy, would you like to comment on the connection between reducing government spending and the promotion of jobs, job creation.

Ms. DE RUGY. I would agree with Ed Lazear and Andrew Biggs about the connection that exists. And I would like to add to show that in the last 10 years, during President Bush's presidency, Federal spending has grown in real term by 60 percent. We have had massive increase in spending in the last 3 years, whether you think it was justified or not. We have tried the routes of stimulating the economy through massive spending and it hasn't worked.

In fact, I would argue that it has hurt us more than anything else. And what we know is that we are at a time where basically—actually, economists have not really studied the situation in which we are. A situation where actually not only do we have unprecedented level of debt, but they are not about to end in the foreseeable future because of the explosion of spending on Social Security, Medicare and Medicaid. We have not studied this. I mean, like all the examples that economists have studied after the Second World War, where I agree the situations were different, there wasn't this massive extension already forecasted and projected.

So we are at a situation where pretty much we know the consequences of spending more, we also know the consequences of taxing more. What we don't know is when we are going to reach this tipping point where things could absolutely really be bad for our economy. That will mean a slowdown of economic growth in a situation that we are already today, but in any case, means a destruction of jobs.

Chairman CAMP. Thank you. Mr. Levin is recognized.

Mr. LEVIN. Thank you and welcome. You know, there is no question of if there needs to be deficit reduction. The issue is how we do it. No one is saying do it by raising taxes alone. No one says that. I just want the record to be set straight. The private sector job losses from January 2001, to January 2009, total 650,000 private sector jobs lost. From February 2010 to February 2011, 1,526,000 private sector jobs increase. Those are the facts. A loss of 653,000 from 2001 to 2009; 1.5 million increased in the private sector from February 2010 to February 2011. And everybody who constructs an economic theory needs to look at those facts.

So now, let me just ask each of you what you think of the estimates of job losses from H.R. 1. I mention Chairman Bernanke, 200,000; Mark Zandi, 700,000; Goldman Sachs, a reduction in economic growth of 1½ to 2 percent in the second and third quarters of this year. Mr. Lazear, do you challenge those?

Mr. LAZEAR. Let me just say two things, Congressman. The first thing I would say is that I certainly agree that we should be looking at the facts on job loss, but normally, what one does when one looks at the facts is you look from peak of a business cycle to peak of a business cycle or trough of a business cycle to the trough of the business cycle. You don't look from the peak of one business cycle to the trough of another. If you do that, you get a very distorted picture. And I would argue that is probably accounting for a good bit of the numbers that we saw.

Mr. LEVIN. So even if you use that argument, the facts are striking in terms of the job loss for 8 years, and the job increase in 1 year.

Mr. LAZEAR. Well, my argument would be that if you want to understand job growth, what you need to do is you need to correct for the business cycle. And if you correct for the business cycle you can get a very different picture.

Mr. LEVIN. Well, send us something on how different it would be.

Mr. LAZEAR. You would essentially see job decline during the recession that started in 2001, continue job growth from 2003 to 2008 and then job decline from 2008 thereafter. So that is essentially the picture.

Mr. LEVIN. Okay. We will be glad to look at those figures, but they don't change the basic fact.

Mr. LAZEAR. But let me get to your more important question, which was do I believe in the numbers in terms of the effects.

Mr. LEVIN. Is Bernanke right or wrong?

Mr. LAZEAR. All right. I would say that I don't believe those numbers and I will tell you why I don't believe those numbers. I was also the chair of the committee that did exactly those numbers at the White House, and we did that for 3 years, and here is how those numbers are created. The way you create those numbers is you base them on a model, you do not base them on evidence. You base them on a model that says we know that if we spend so much in GDP, that will have a particular effect on GDP. And historically, there has been a relation between GDP and job growth.

Mr. LEVIN. Let me say, my time is up. That is maybe what you did.

Mr. LAZEAR. That is what Zandi does, that is what Goldman does, that is what CBO does.

Mr. LEVIN. That is what Bernanke did?

Mr. LAZEAR. That is what Bernanke does.

Mr. LEVIN. So you don't give any credibility to his critique?

Mr. LAZEAR. No. You asked me if I believe the numbers, I told you why I don't believe the numbers. The numbers are model-based rather than evidence-based.

Mr. LEVIN. So you just dismiss all of the statements about the impact of H.R. 1 in terms of economy growth?

Mr. LAZEAR. What I dismiss is those as evidence of the effect of a bill on jobs. What I don't dismiss is that they still——

Mr. LEVIN. Let me—Ms. Boushey, quickly, would you respond to that?

Chairman CAMP. Quickly, because his time has expired so you have a few seconds.

Ms. BOUSHEY. Well, I mean, economists use models and so there is a bit of a challenge there. Especially looking at the Goldman Sachs estimate, these people did that estimate for their investors to help them determine how to invest and how they thought they were going to make money in the years to come. I take that very seriously, because if they think that this will be bad for growth, then that is how they are advising their clients. I mean, economists use models. We all agree there is some wiggle room in there, but certainly, we need to take these very seriously.

Mr. LEVIN. Thank you.

Chairman CAMP. Mr. Herger is recognized.

Mr. HERGER. Thank you very much, Mr. Chairman. I want to thank you for holding this hearing. Certainly it is incredibly important what we are talking about now. We are in a very serious recession that has taken place not only in my district, but throughout this Nation. There is a concern of stability and whether or not we have the policies that are going to bring us out of it. Certainly the spending, this massive spending is at the heart of much of the concern that I hear when I am in my northern California district.

Mr. Lazear, according to the CBO, in 6 of the President's proposed budgets over the next 10 years, the deficits will be in excess of $1 trillion. During that period of time our debt would more than double. I would like to ask you what are the likely economic consequences of this massive accumulation of debt envisioned by the President?

Mr. LAZEAR. Well, again, I think I would use the word that I used before, I think it is frightening. And the reason I think it is frightening is that if we add that kind of debt to our fiscal situation, we need to service that debt. If we service that debt, we can only do it in one of two ways. Either we have to raise taxes, or we have to borrow even more. Raising taxes, we know, is not good for the economy. There are many, many studies that document that. Across countries, over time periods, I referenced some in my formal testimony. But in addition to that, if we try to borrow, what we will end up doing is driving up interest rates. We are already starting to see that at the long-term of the Treasury structure right now.

When we start driving up interest rates, what that does is it imposes costs on businesses that are trying to borrow and trying to invest. And the one thing we do know is that investment is a huge driver of economic growth, and job growth depends on economic growth. So I guess I am very concerned about the effects of long-term deficits and the kinds of high deficits that you referred to, sir, on both economic growth through interest rates and through confidence in the United States as a place to invest.

Mr. HERGER. I have to mention another concern that I have. As we look around the globe, we look at what has taken place in Greece, what has taken place in Ireland, some other countries, we can see that an economic crisis, a fiscal crisis can develop very suddenly. And my concern is with what we have seen take place, how quickly it can happen with, again, this incredible debt that we are seeing taking place here in the United States. In your opinion, are we currently on the fiscal path that could trigger a crisis similar to what we have seen in some of these countries, only on a much more substantial scale considering the size and importance of our economy?

Ms. BOUSHEY. Can I take that one?

Mr. HERGER. Dr. Biggs.

Mr. BIGGS. In my written testimony, I quoted the well-known economists Ernest Hemingway who said that people go bankrupt two ways, gradually and then suddenly. And we are in the gradually phase now, we are accumulating more and more debt. For the moment we can bear that burden. We have been advantaged by the fact of financial instability in other parts of the world that has sort of a flight to safety approach and it helps the U.S. in the short term.

Over the long term, though, both the history and theory of financial crisis isn't going to happen very quickly, they are like a bank run you don't know exactly what causes it, but once panic sets in and confidence is lost, these things can happen very, very fast.

So the point is you don't want to get yourself into the region where that can happen. You can't say precisely when or what will trigger it, once you are in the region, that can be a very difficult place to be.

Mr. HERGER. Would you say we are in the region again looking at the region that Greece was in?

Ms. BOUSHEY. I would look at——

Mr. BIGGS. I think we are entering the region now.

Ms. BOUSHEY. I would look at what has happened in Ireland.

Chairman CAMP. Would you please suspend? The gentleman will direct a question to you, thank you.

Mr. HERGER. Dr. de Rugy.

Ms. DE RUGY. One of the things we know is that investors rate a country on a curve, so basically, and this is why there is so much uncertainty and we can't tell you and pinpoint exactly when the crisis will happen. But one of the things that we know is that there will be a moment where it is really possible, and this is one of the things that keeps me up at night, where our investors are going to look at the U.S. and they are going to think that we are not as safe as we used to be, and they are first going to start to ask for a premium for potential risk of inflation, and they are also going to ask potentially for premium and that could happen.

Chairman CAMP. All right. Thank you. The gentleman's time has expired. Mr. Levin is recognized. I am sorry. Mr. Rangel is recognized.

Mr. RANGEL. Thank you, Mr. Chairman. The staff reports that the Bush tax cuts cost us about a loss in revenue of $1.6 trillion, and the extension for the 2 years, $500 billion. Do any of you contradict that this increased our debt that we owed to have a negative impact? Or is that accepted? Silence means you agree.

Mr. BIGGS. If I could quickly note. One of the points I made in my written testimony is that the fiscal gap, the CBO projects over the next 25 years and beyond is entirely a result of higher spending. The historically income taxes or total taxation has been about 18 or so percent of GDP, the CBO projects that going over the next 25 years taxes will equal 20.7 percent of GDP.

Mr. RANGEL. Let me try the question then. We had a deficit then and after the tax cut, you would agree that we didn't have the money to pay for it, we have to borrow the money to pay for it, the same way we have to borrow money for the $500 billion extensions of the President Obama continuation and extension of it. I don't think anyone wants to challenge, if you don't have the money and you reduce the revenue that the tax system says you can get, that you borrow that money——

Mr. LAZEAR. I guess I would——

Mr. RANGEL [continuing]. By short term.

Mr. LAZEAR. I would respond to you two ways, Congressman. The first thing I would say is that the Bush tax cuts were in effect primarily throughout the Bush administration, that was a relatively benign period in terms of both——

Mr. RANGEL. If we borrowed the money in order to do it, the answer is yes.

Mr. LAZEAR. Excuse me, Congressman.

Mr. RANGEL. What I am trying to say is, do you believe that we can raise any revenue now and it would help us to close the deficit?

Mr. LAZEAR. That was my second point.

Mr. RANGEL. Well, that is my first point.

Mr. LAZEAR. All right. Sorry, sir. Which is that there is a short-run effect and a long-run effect. And I think what I think we are concerned about primarily is the long-run effect on economic growth. Whether we can get a year or 2 of additional revenue by increasing taxes right now, that is possible. I wouldn't deny that, there is some ambiguity there.

Mr. RANGEL. If I was to share with you where we would get that money would be in closing tax loopholes that technically some people would say——

Mr. LAZEAR. Yeah.

Mr. RANGEL. They are getting a tax increase, but most economists agree that our corporate tax rate is too high at 35 percent, but that the actual tax rate that corporations is closer to 20 in terms of what it should be in the first place. If you cut out all the preferential treatment and brought more equity to the table, that it would be perceived that America's the place to invest and that high corporate taxes would not be negative, do you agree with that?

Mr. LAZEAR. I certainly agree with you.

Mr. RANGEL. So you don't mind reducing revenues by reforming the system?

Mr. LAZEAR. I think I better not start my statement with "I certainly agree with you" because you are going to cut me off right there. But go ahead, sir.

Mr. RANGEL. But you do believe that having tax reform could make it easier to reduce the corporate rate?

Mr. LAZEAR. I absolutely agree there is tremendous room for reform if our tax structure and corporate reform would be part of it.

Mr. RANGEL. And reduce the rates?

Mr. LAZEAR. Well, that is not my preferred solution. I was on the President's tax panel for a year before being chair of the council.

Mr. RANGEL. You think rates should stay at 35 percent?

Mr. LAZEAR. We had a different plan.

Mr. RANGEL. I know, I am only talking about the rates. I know you know more about this than me, that is why I want to find out.

Mr. LAZEAR. Well, I thought that was why you were asking me.

Mr. RANGEL. The corporate rate is now 35 percent, right?

Mr. LAZEAR. The corporate rate is 35 percent.

Mr. RANGEL. And you support reform, right?

Mr. LAZEAR. I do.

Mr. RANGEL. And I am only asking would you support a dramatic reduction in the corporate rate at the same time?

Mr. LAZEAR. I would prefer to see reductions in the corporate rate to the current rate, but there are alternative ways to do that that I would prefer than reducing the corporate rate.

Mr. RANGEL. Okay. Well, when you talk about reducing or cutting back and spending, and everyone says it that way, that doesn't necessarily mean that you are saving money, does it?

Mr. LAZEAR. It doesn't necessarily mean that you are saving money. What our concern is, again, that we need to have a tax-and-spend structure that is healthy for the economy in the long run. I don't see us getting to that by the solution that you are proposing, sir.

Chairman CAMP. All right the gentleman's time has expired. Mr. Johnson is recognized.

Mr. JOHNSON. Thank you, Mr. Chairman.

You know, one aspect of the current fiscal debate which I don't think has received enough attention is foreign holdings of U.S. debt. As you may know, foreign-held debt has doubled during the last 5 years from just over $2 trillion to nearly $4.4 trillion. During this time, China has become the number one foreign holder of U.S. debt. In fact, China holdings have more than tripled to $1.16 trillion. In response to these developments, I introduced last year the Foreign-Held Debt Transparency and Threat Assessment Act, legislation aimed at raising awareness of the threat to our economy and national security of our exploding debt.

So with that said, what would be the economic consequences, especially with respect to job creation if China decided to significantly cut back its holdings of U.S. debt, one? And what would this mean for Main Street, small businesses, especially with respect to access to affordable credit? And I would appreciate Lazear, Biggs and de Rugy to answer first, and then Ms. Boushey as time permits.

Mr. BIGGS. Sure. I will start quickly. Obviously, a large portion of the debt that has been issued and is currently being issued by the United States is held by overseas investors, including China. I am not an expert on foreign policy, but obviously, it does constrain our foreign policy choices. There was a New York Times story I remember a year or so ago when President Obama was visiting China, and the point of the story was that ordinarily our American President can go over to China and speak very forthrightly about human rights issues or national security issues, but in this case, we are now talking to our largest creditor. So that constrains us on non-economic policies.

In terms of if China or other foreign holders were to essentially give up their holdings of American debt, I think the likely outcome then will be a devaluation of the dollar, which would have disruptive effects on the economy here in terms of jobs, job dislocations.

Mr. LAZEAR. We did a study, sir, in 2007, again, at the Council of Economic Advisors and we looked at this. It was a big concern then, it is a much bigger concern now. At that time, we estimated that if China were to get rid of their treasury holdings, it would cost about 100 basis points in terms of an increase in interest rate, which is not enormous, but it is certainly significant and would have a significant impact on the economy.

I think the more important point, though, is not the immediate impact on the economy, the more important point is the one that Dr. Biggs just talked about, which is the long-run impact.

The United States enjoys a special position in the world of having the reserve currency, and that is a very important position for us. We have that status not by right, but because we have earned it, and we can certainly do things that will earn someone else the right to have that status in the future. So I think the big concern is that we need to show that we have our house in order so that others in the world will be willing to continue to hold our currency as the reserve currency.

Mr. JOHNSON. Thank you.

Ms. DE RUGY. I agree with my colleagues. I would add, though, that I think Lauren Kaines is the one who said if you borrow $1 from your bank, your bank owns you, and if you borrow $1,000 from your bank, you own the bank. And I want to believe—even though I agree with you guys—that China, I mean, by choice, should have our best interests at heart. The problem is what happens if China gets into a recession of its own and actually starts slowing down the amount of capital that it sends our way? Just that could actually throw us into disarray and raise interest rates. This is the concern I have.

And one of the problems we have, I mean, even though it is in theory, not that much of a concern, is this amount of money that foreigners have, I mean, they are less loyal to American interests than domestic investment. And this is the reason why Japan, for instance, has been able to actually have these level of debts is that 95 percent of their debt held by the public is held domestically. You have lesser of a flight instinct in theory.

And so, yes, it does expose us to significant risk, even though I just don't think it would be just in order to hurt us, it would be to protect their own investment. And if China gets in a serious recession, they will have no other choice than to stop sending that much money our way.

Mr. JOHNSON. Go ahead, Ms. Boushey, if you wish.

Ms. BOUSHEY. I agree with many of the comments up here. I want to focus on one thing that Dr. Biggs said, which is that that would lead to a devaluation. One, it is highly unlikely that China would do that because it would make their goods more expensive. We import a lot from them. But number two, if that were to happen, that would make our exports cheaper. So in many senses, some of the outcomes of that would be good for American manufacturing and for goods that we export. So there is a pro and a con there.

Mr. JOHNSON. Thank you very much. I appreciate that.

Chairman CAMP. Thank you.

Mr. Stark is recognized.

Mr. STARK. Thank you, Mr. Chairman.

I would like to address this to Ms. Boushey. The Republicans have been busy over the last couple of months. They have passed legislation that would end foreclosure assistance programs with no alternative solution, they have repealed the Affordable Care Act with no alternative, they have moved to defund National Public Radio, to end public financing of campaigns so corporate money will have more influence on elections. They voted to extend the PATRIOT Act and make gradual cuts in domestic programs such as education, public safety, environmental protection.

Today we are going to vote to spend $300 million on a pet project of the Speaker to use taxpayer dollars to subsidize private schools. And next week we will vote to restrict safe access to abortion.

Now Ms. Boushey, will any of these bills create jobs?

Ms. BOUSHEY. Well, it is a long list, and my instinct is that many of them may not. But let me just focus on a couple that you mention on that list. One thing that a number of the panelists up here have spoken about is the long-term health care costs are a critical piece of this long-term——

Mr. STARK. I asked you a question; will any of those bills create jobs?

Ms. BOUSHEY. I don't think any of those appear, of the list that you mentioned, focused on job creation.

Mr. STARK. I don't think they will either. So do any other panelists have estimates on how many jobs will be created if these bills became law? Go ahead.

Ms. DE RUGY. I mean, I don't think—you are probably right that this is not the point of this job. But I think there is the case to be made that the Federal Government should probably not be involved in absolutely everything that concerns our lives, and maybe there will be some very positive impact on having the Federal Government scale back its intervention on Americans lives.

Mr. STARK. And how will that create jobs?

Ms. DE RUGY. The less intervention and the less you tie Americans' hands, the more you help them actually do what they are good at, which is investing, entrepreneurial, create wealth, and help the economy grow.

Mr. STARK. Any other panelists have any idea how those bills will create jobs?

Mr. LAZEAR. Sir, I would comment on one of them, and that would be the health care legislation.

Mr. STARK. I didn't mention that.

Mr. LAZEAR. I am sorry, I thought you did.

Mr. STARK. No, I didn't.

Mr. LAZEAR. Okay. Then I withdraw my comment.

Mr. STARK. Okay. You want to talk about health care legislation? I would be happy to do that. It is entitlement reform, it reduces Medicare spending, it extends solvency of Medicare for about 12 years.

Mr. LAZEAR. The health care legislation, while scored by CBO as deficit reducing—and I will accept that as a given, also——

Mr. STARK. What do you know about health care? You are not a very good economist, but I wonder what you know about health care? We have a group of second-rate economists here. And I don't know where they dragged—scraping the bottom of the barrel.

Chairman CAMP. I would say to the gentleman, I think if we could confine our remarks to the topic at hand and not personally disparage the witnesses——

Mr. STARK. It seems like the topic at hand is where you found these clowns.

Chairman CAMP. Well, one of them is a Democrat witness.

Mr. STARK. I understand that.

Chairman CAMP. So they are not all Republican witnesses. It is the gentleman's time to proceed.

Mr. LAZEAR. I am sorry. Would you repeat the question, sir?

Mr. STARK. Well, I just wondered about your expertise in health care.

Mr. LAZEAR. Oh. Well, you probably recall that I was the President's chief economic advisor for 3 years. We spent a lot of time talking about health care. The 2007 State of the Union address was all about health care, and I was instrumental in devising that.

So I have certainly thought a good deal about health care over my career. But I don't think my credentials are really all that relevant at this point, the Senate has already confirmed my credentials.

I think what I would like to talk to you about is the health care legislation. If you want to hear about it, I am certainly happy to talk about it, because as it concerns job creation, which I thought was your question, recall that the expenditures in the health care bill that we are talking about are about $1 trillion——

Mr. STARK. Let's hear from Ms. Boushey about this. What do you think; health care have anything to do with this?

Ms. BOUSHEY. Well, health care does have something to do with the long-term deficit, and so we do need to take steps and did take stops in the Affordable Care Act to get health care costs under control over the long term. And I would encourage you to continue to focus on that because if we care about the deficit—which is what this panel is about—then we should care about thinking about that in the long term?

Mr. STARK. Thank you very much.

Thank you, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Brady is recognized.

Mr. BRADY. First to the panel, let me apologize to you for Mr. Stark. We may disagree on conclusions, but your credentials, lifetime of credentials in economics is so very impressive, and we appreciate you taking your time today to share that with this committee, and therefore with Congress.

I think we are hearing a lot of Draconian projections about job losses due to minor spending reductions. But those same economists got it so wrong in the stimulus. Here we are 2 years later spending over $800 billion, we have 2.2 million fewer jobs today in America than when the stimulus began. We were told at this point the unemployment rate would be 6.9 percent—off by a mile. Mark Zandi, who was cited earlier today, he predicted we would create 4 million new jobs by the end of 2010, we actually had 3 million fewer. He was off by 7 million jobs. It is time to stop listening to the economists who got it wrong and start listening to the economists who got it right.

I want to pull up two charts, if I may, that follow on the testimony we heard today from our panelists. This chart follows the last 40 years in America. The blue line charts Federal Government spending from here in Washington. The red line charts job growth in the private sector, jobs along Main Street. As you can tell from the chart, there is no correlation between higher government spending and job growth in the private sector. In fact, for each of the four decades, there is a negative correlation between higher Federal spending and job growth in the private sector.

The next chart tracks as—again, inspired by the testimony we have heard today—this tracks business investment, private business investment in America the last 40 years versus job growth in the private sector. What it shows is a very strong correlation in each of the last four decades; when businesses large and small buy new equipment, new software, invest in new buildings, jobs along Main Street grow.

And so for Dr. Lazear and Dr. Biggs specifically, one, I would like your comments on the role of private investment in creating private sector jobs. And secondly, because, Dr. Biggs, the Joint Economic Committee report, "Spend Less, Owe Less, Grow the Economy" cited your study that our international competitors who got themselves in debt trouble, and reduced their debts credibly through spending cuts, not by tax increases, were able to grow their economy in the short term as well as the long term. So I would like both Dr. Lazear and Dr. Biggs' comments on these points.

Mr. LAZEAR. Yes, sir. Congressman, let me start. I certainly agree that investment is a key component to both economic growth and job growth. In the short run, the chart that I showed is quite consistent with the one that you are showing now, which is that we do know that you just don't get job growth in the short run without seeing growth in economic activity. So the question is, how do we get growth in economic activity? I have never been a strong believer in the notion that the government can create a lot of economic activity. Occasionally, we can move it around—I think the government has done that in the past couple of years—but I don't see a lot of effect on aggregate economic activity from the kind of government programs that we have seen.

In the longer run, the more important effect of investment is actually not on the number of jobs, it is on wages. And the reason it works on wages is that wages are very closely linked to productivity growth. And in order to get productivity growth, you have to have investment. And I would include in that, by the way, investment in human capital as well as investment in physical capital.

Mr. BRADY. Thank you. Well said.

Mr. BIGGS. Well, since Professor Lazear discussed investment, I will try to focus on the second part of your question since time is short.

The study you referenced, and obviously the literature that I reviewed in my testimony has found that countries that attempt to get on top of their budget problems through reduced spending tend to be both more successful at cutting their deficit and debt, but also have better economic outcomes than those who try to address their budgets through increased taxes.

For anybody who is doubting this, that is just my opinion. My testimony includes a large number of references to these findings in peer review journals that come to the same conclusion.

I discuss there is a controversy among economists about to what degree fiscal consolidations will spur economic growth to help the economy. One number I cited from an IMF study found that a spending-based fiscal consolidation would produce unemployment half a percentage point lower than a tax-based fiscal consolidation 3 years after it took place. That was from a study that people cite as being a more pessimistic one in terms of these outcomes.

So I can't promise you that cutting spending is going to rapidly increase growth, but given that you have to get on top of your budget, the research seems clear that going at it on the spending side seems to be more successful and better for the economy than going at it from the tax side.

Mr. BRADY. Thank you. I yield back.

Chairman CAMP. Thank you.

Mr. Nunes is recognized.

Mr. NUNES. Thank you, Mr. Chairman.

Ms. Boushey, in your testimony you mention two wars that were unpaid for. Were you referring to Iraq and Afghanistan, or . . .

Ms. BOUSHEY. I was.

Mr. NUNES. How about Libya; is that unpaid for? Paid for? How does that fall?

Ms. BOUSHEY. I was referring to the run-up in spending over the 2000s alongside tax cuts. So I was trying to make the point that the deficit was something that we inherited at the end of the last administration.

Mr. NUNES. Right. I just want to clarify that the two wars you were referring to are Iraq and Afghanistan.

How does Libya compare, what is happening in Libya today, compared to those two wars being paid for or not paid for?

Ms. BOUSHEY. We are making choices about how we are spending scarce resources. I am not an expert on foreign policy, but as an economist who cares about job creation—and we are having this national conversation about deficits, it certainly is important for you to consider how those two pieces fit together. I would prioritize job creation here in the United States.

Mr. NUNES. So the tax cuts that you are referring to that went alongside with the two wars, I assume those are the George W. Bush tax cuts of '01 and '03?

Ms. BOUSHEY. Yes, sir.

Mr. NUNES. And also supported by President Obama for a 2-year extension last year?

Ms. BOUSHEY. As a part of a compromise that also extended unemployment insurance, yes.

Mr. NUNES. So President Obama has basically carried forth not only going into wars that aren't paid for—right? In Libya, you agree with that?

Ms. BOUSHEY. Wars in times of deficits, so yes.

Mr. NUNES. And also supporting the extension of the tax cuts. So you disagree with the Obama administration's positions on wars that are not paid for and extending Bush tax cuts.

Ms. BOUSHEY. Again, because I am an economist who doesn't focus on foreign policy, I don't want to comment on the war in Libya. However, on the tax cuts, that was a compromise where, in my professional opinion, those extensions to the unemployed were necessary, that was the price of getting it passed through Congress. So yes, I think we had to do it. But those tax cuts for the wealthy did not lead to the kinds of employment, investment, and wage gains that we would like to see, so I don't think that those—those are not what is going to be helping our economy right now.

Mr. NUNES. So you sit around and you think about these things, you spend a lot of time researching this. So you don't support the current tax rates. I would just be interested to know, before this committee—since it is the tax writing committee—what rate should the tax levels be at? Let's take income tax and corporate income tax; what would you like to see those rates at?

Ms. BOUSHEY. Well, one of the things that we talked about here on this panel this morning is the appropriate level of taxation. One of the ways that you can look at it—there are two points I would like to make. One is that the periods after which we have cut taxes for the wealthy over the past few decades—in the early 1980's and the early 2000's—and then in the early 1990's, we raised taxes, if you look at the recoveries to economic performance in the years after those different tax——

Mr. NUNES. I understand the point that you are making, but what I am really interested in, since this is the committee that will take testimony and then we will begin to craft legislation, the chairman is looking at fundamental tax reform, so I think it is pertinent to this because tax reform is job creation. So do you have a range of what you think the tax rates should be on both the corporate side and the income tax side? Can you give us any number at all of what we should be looking at?

Ms. BOUSHEY. I can't give you one number because it is complicated, but I do think that certainly higher would be my first answer. And second, one idea would be thinking about, the United States is one of the most lowest income tax countries in the OECD. If we just bumped up to the revenue generation strategies of Canada—our neighbor to the north who hasn't seen the same economic turmoil that we have—we would still be in the bottom third of all OECD countries, but we would be able to solve our deficit problems.

Mr. NUNES. So you would like to see us at 25 percent of GDP?

Ms. BOUSHEY. I can get back to you on a specific number. I am hesitant to say something without sort of doing some calculations that are hard to do at this moment.

Mr. NUNES. I would assume that is probably what Canada is, roughly?

Ms. BOUSHEY. I can't remember off the top of my head, but I am happy to get back to you.

Mr. NUNES. But you will get back to me what percentage of GDP the tax rate should be at?

Ms. BOUSHEY. Yes, sir.

Mr. NUNES. And I know we are at a limited time here, but Mr. Lazear, what rate do you think the tax rate should be at that would get us to a point where we could get into job creation where businesses would be willing to invest?

Mr. LAZEAR. Well, again, I don't think of the tax rate as generating jobs in the short run, and I don't think of expenditures as generating jobs in the short run. I think that the steps that we took in late 2008, early 2009 to get ourselves through the financial crisis are the steps that were appropriate in creating the job growth. We are going to see it, unfortunately, slower than I think we all had hoped, but that is where it is going to go.

What I would say is that historically, our tax rate has been at 18 percent. We have been able to do quite well in terms of supporting the economy, growing the economy, supporting the government and doing the necessary things that government has to do with an 18 percent tax revenue over the past 30 years. That also means we have run about a 2 percent deficit. So at a 2 percent deficit, we are bringing down the ratio of debt to GDP.

Mr. NUNES. Mr. Chairman, I would also like to associate my comments with Mr. Brady's, that I don't think any of you are clowns or second-rate economists. I apologize for that.

Chairman CAMP. Thank you.

Mr. McDermott is recognized for 5 minutes.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I would ask unanimous consent to enter into the record, March 29, 2011, a letter to Harry Reid, Boehner, McConnell and Pelosi from 34 chief executive officers of alternative energy companies.

Chairman CAMP. Without objection.

[The information follows:]

March 29, 2011

The Honorable Harry Reid
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, DC 20510

The Honorable John Boehner
Speaker
United States House of Representatives
Washington, DC 20515

The Honorable Nancy Pelosi
Minority Leader
United States House of Representatives
Washington, DC 20515

Dear Leader Reid, Speaker Boehner, Leader McConnell and Leader Pelosi:

As the Senate considers a Continuing Resolution (CR) to fund the government for the remainder of the 2011 fiscal year, we urge you to continue funding the Department of Energy's (DOE) renewable energy loan guarantee programs (Sec. 1705 and Sec. 1703). In addition, we request your support for program changes that would allow viable Sec. 1705 project applications to transfer into the Sec. 1703 program. As chief executive officers of 34 companies, we are investing in projects with pending loan guarantee applications based on the good faith notion that the DOE programs would function as stipulated in law and as Congress intended. We are deeply concerned that eliminating funding for this critical program will not only destroy thousands of pending jobs and hinder the growth of critically-needed U.S. domestic energy production, but also defeat America's effort to compete with China, Germany and others in the clean technology marketplace.

Our companies represent a wide range of renewable energy technologies that produce electricity and liquid fuels – solar, wind, geothermal, biomass, biofuels – as well as critical technology to transmit electricity from wind and solar production. The DOE loan guarantee program represents the best and often only way to cross the barrier from developing clean domestic energy technologies to deploying those technologies commercially here in the U.S. and around the world.

The loan guarantee program is a win-win-win for taxpayers, American clean technology and the communities and states where these investments are being made. The program's real costs are paid for by the companies that submit applications, and each federal dollar of loan guarantees leverages $13 in private capital investment.

This program has already proven its ability to deliver: It has committed more than $26 billion in loans and loan guarantees to projects that represent $42 billion in investment in our still-struggling U.S. economy. These investments represent an estimated 58,000 direct and indirect jobs across 19 states. Projects still in the pipeline for approval that would be killed or put at risk by the proposal in H.R. 1 to take away the funding for the program represent an additional $24 billion in near-term investment in America's energy infrastructure that would put another 35,000 Americans to work in good, high paying jobs. These are not hypothetical jobs of the future. These are jobs on projects that are ready to begin construction ***this year***—as soon as their loan guarantees are concluded.

The projects for which our companies have applied – all of which are ready to begin construction between now and September 30th of this year -- represent over $13.3 billion of investment in 28 states and will generate 15,600 construction jobs and 10,200 permanent operating jobs as well as thousands of additional jobs for equipment and services provided by suppliers.

As part of our applications, our companies have already spent tens of millions of dollars to meet the government's stringent requirements for a loan guarantee. Our companies have hired engineers, acquired land, complied with environmental reviews, and negotiated power purchase or other off-take agreements. Eliminating funding at this late stage would literally pull out the rug from under our projects, just when we are about to break ground.

Unless the full year CR protects funding for the program, our economy could sacrifice a generation of our best clean technology opportunities - delivering a devastating blow to the US renewable energy industry. Longer-term, future projects that will seek private sector lending once they are proven commercially with the help of the Loan Guarantee Program would be jeopardized, damaging U.S. competitiveness and domestic manufacturing and a supply chain that is dependent on the large-scale deployment of renewable projects in the U.S.

We hope you will support the Department of Energy's loan guarantee programs and ensure these private sector investments are made to build our domestic clean energy infrastructure.

ABENGOA SOLAR
Santiago Seage, CEO

ABENGOA BIOENERGY
Science. Solutions. Service.
Christopher G. Standlee, Executive VP

AMONIX
Brian Robertson, CEO

aspen aerogels
Donald R. Young, CEO

Biomass Gas & Electric
Glen Farris, CEO

Bottle Rock Power LLC
Brian Harms, President

BrightSource Energy
John Woolard, CEO

CALISOLAR
Sandra Beach Lin, CEO

CSOLAR DEVELOPMENT, LLC
Jerry K. Crouse, CEO

First Solar.
Robert Gillette, CEO

FloDesign Wind Turbine

Lars Andersen, CEO

Jose Benjumea, CEO

FRONTIER

Steve Hicks, CEO

Fulcrum BIOENERGY

E. James Macias, President and CEO

KiOR

Fred Cannon, CEO

Gary L. Hebener, President

nanosolar

Geoff Tate, CEO

NORDICWINDPOWER

Thomas M. Carbone, CEO

Pattern

Mike Garland, CEO

POET Energy inspired.

Jeff Broin, CEO

RED RecycledEnergy Development

Thomas R. Casten, Chairman

Sea Breeze Power Corp.

Paul Manson, CEO

RENTECH

D. Hunt Ramsbottom, CEO

Soitec

Andre-Jacques Auberton-Herve, CEO

SolarCity

Lyndon Rive, CEO

SOLARRESERVE

Kevin Smith, CEO

SOLAR TRUST OF AMERICA

Uwe T. Schmidt, CEO

STION

Chet Faris, CEO

SUNPOWER

Tom Werner, CEO

BIOMASS

James Taylor, CEO

U.S.Geothermal Inc.

Daniel Kunz, President and CEO

SOLOPOWER

Tim Harris, CEO

SAGE
ELECTROCHROMICS, INC.

John Van Dine, President and CEO

ce+p

Jeffrey Lee, President and CEO

Mr. MCDERMOTT. I put that in because I want to commend you on having brought to us today the architect of the Bush failure and a representative of the Koch Institute's ideas about the economy. It is important.

I want to ask both of you a question. This letter says, "We urge you to continue funding the Department of Energy's loan guarantee program for Section 1705 and 1703"—and I am sure, Mr. Lazear, you know what those are about. And it says, "We are investing in projects with pending loan guarantees based on the good faith action that the DOE programs would function as stipulated in the law as the Congress intended. We are deeply concerned that eliminating funding for these critical programs would not only destroy thousands of pending jobs and hinder the growth of critically needed U.S. domestic energy production, but also defeat America's effort to compete with China, Germany, and others in the clean technology marketplace." They go on to talk about the fact that they have already invested $26 billion, and that has led to another $42 billion in investment.

Now listening to you, one would think that any investment by the government in anything in the private sector was bad. Do you think these 34 executives are wrong in asking for loan guarantees from the United States Government? Do you think President Obama's plan to give them loan guarantees to create a clean energy industry is wrong?

Mr. LAZEAR. I guess I would make two comments. One is, first of all, I am not an anarchist, I don't think that government investment is always a bad thing.

Mr. MCDERMOTT. So you think the CR that is being considered by the Tea Party Members of the House of Representatives is bad for the economy because it kills jobs?

Mr. LAZEAR. No, I didn't say that. And I am not familiar with that legislation, so I won't comment on it. But what I did say was——

Mr. MCDERMOTT. Don't you work at the Hoover Institute? I mean, you are looking at the economy. You are not paying attention to what these guys are doing?

Mr. LAZEAR. I am trying to pay attention to what you guys are doing, and I hope that I am doing that in a fair and accurate way.

The question that you asked in terms of do I think that the CEOs are justified in making their case? I certainly think they are justified in making their case for the industry——

Mr. MCDERMOTT. No, no, no. You sat at the Bush table and created this thing.

Mr. LAZEAR. Which thing is it that you are referring to?

Mr. MCDERMOTT. These loan guarantees. I mean, you put this economy together, so you are saying they have a right to make their case. Of course they do.

Mr. LAZEAR. I wish I had such power, sir. But what I believe we can do is I believe we can move resources around. I am less convinced that we can have an effect on aggregate economic activity. So my concern is not that we cannot create incentives for one industry to take off perhaps at the expense of another industry. I think the issue that we are concerned with today—and I am sure it is the issue that you are concerned with as well, sir—is creating jobs at the aggregate level, not simply moving them around. And I am not convinced that the kinds of stimulus activity that we have done has done much more than move jobs around.

Mr. MCDERMOTT. I asked you about a specific program, a green energy program to compete with China.

Mr. LAZEAR. I thought I answered your question.

Mr. MCDERMOTT. Do you think aiding that industry in this country is a good idea?

Mr. LAZEAR. Again, I am not a person who believes that it is good to pick industries and to invest in particular industries. I don't think that any government does a very good job of that. Occasionally, we do make decisions like that. For example, we do make decisions to fund education, we do make decisions to fund research. We have to make those decisions at the level of government. Sometimes we make mistakes, but I think——

Mr. MCDERMOTT. Do you think, then, that the programs we have aiding the oil industry and the write-offs we give them, are they useful?

Mr. LAZEAR. Again, I am not in favor of picking industries and aiding particular industries?

Mr. MCDERMOTT. So you would end the oil subsidies as well?

Mr. LAZEAR. As I said, I believe in policies that are as industry-neutral as possible.

Mr. MCDERMOTT. I would like to hear from the Koch brothers.

Ms. DE RUGY. Well, are you asking me whether anyone has put these words in my mouth? I am here just to talk about my research. And at Mercatus, we have a strict policy of separation and independence research. So I am talking about myself.

Chairman CAMP. The time has expired, so if you could just very quickly comment. All right.

Mr. NUNES. Mr. Chairman, would you yield? I just think that the committee has asked these panelists to come here, and I would just hope that both sides of the aisle would refrain from lobbing personal insults to the panelists.

Mr. MCDERMOTT. Mr. Chairman, it is not an insult to say that the institute for which this woman works is funded by the Koch brothers. That is not an insult, that is a statement of fact.

Chairman CAMP. All right. Why don't we continue on in regular order.

Mr. Tiberi is recognized.

Mr. TIBERI. Thank you, Mr. Chairman. I, too, apologize for the name calling today, it is just unwarranted.

Ms. Boushey, just to comment—and I am not asking a question—in your exchange with Mr. Nunes here, you blamed the 2001 tax cuts, the 2003 tax cuts, in part for our structural deficits. It is interesting to note that in February, just last month, we had a higher deficit than we had the entire year of 2007, years after both tax cuts were in place. That is not my question. My question to you, ma'am, first; your research with respect to this debt that we have, the structural debt that we have today, what would it do to solve, in part, that debt problem—which the President's budget just punts on—if we just raise taxes to do it? What impact would that have on our economy and job creation in the private sector?

Ms. DE RUGY. Well, I mean, I think it will have—I think we have already said it, it will probably have long-term disastrous consequences for economic growth. I mean, in order to get tax revenue, you need a thriving economy. And if you increase taxes to the point where there creates your disincentive to work, you will not get the revenues that you get. In fact, I would like to mention the research by Christina Romer, the former Chair of the Council of Economic Advisors, and her husband, David Romer, that has shown that if you raise taxes by 1 percent point of GDP in order to reduce the deficit, what you get is a decrease in GDP by 3 percent. And her research is very consistent with a lot of the economic research on this issue, so it would just not be a good idea.

I would like to add one more point, which is that every solution that members of this committee design has to be realistic. I mean, in the history, in the last 60 or 70 years, as Mr. Biggs has said, the average rate of tax collection has been roughly 18 percent of GDP. Whether we like it or not, whether we think it should be higher or not, it is a reality and this reality is nonnegotiable.

So any solution that we design should actually have a realistic expectation about what the government can do. For instance, the Deficit Commission, unfortunately, its solution rested on the government being able to raise 21 percent of GDP consistently. It has never happened before, and there is no reason to think that it would. That is why I am begging you to—whether we like taxes or not, to at least design solutions that are consistent with what the government can do based on how people respond.

Mr. TIBERI. Thank you.

Mr. Biggs, kind of to tail on what you just talked about in your research, when the private sector looks—from what I have heard back in my district from small business owners—looks at things that we do or don't do, whether it is uncertainty on what the Tax Code is going to be or a health care bill that is going to add cost to employers, they say that it causes them to kind of stand in place, not hire. Does your research indicate, whether it is the health care bill or the uncertainty of the Tax Code and the structural debt that they believe will cause us to increase taxes significantly, impact behavior in the research that you have done?

Mr. BIGGS. Well, the research I have reviewed shows that one of the reasons why getting on top of your budget problems in the near term can spur economic growth is because it resolves these sorts of doubts that people have. Any investor dislikes risk. Risk reduces the value of your investment. Similarly, if you know that you are going to have higher costs in the future because taxes are going to decrease, that makes you less likely to invest as well. So resolving these issues in the near term helps both individuals, businesses and financial markets have confidence in the activities they are undertaking, and as a result they seem to undertake more of them. So there is a connection between getting on top of our fiscal problems in the right way and helping the economy recover over the long term.

Mr. TIBERI. Mr. Lazear, I see you have a comment?

Mr. LAZEAR. I completely agree with the points my colleagues raised. I still think that what we need to do is get—the kinds of things the government does and does effectively is not pick sectors, not try to grow particular programs, not try to grow particular jobs, but rather to create the kind of environment that is conducive to private businesses, the ones to which you referred, and allowing them to do the growth. And what that means, we really only know one way to do this, and the way we know to do this is to keep taxes low to allow for an open economy and to make sure that markets are free and open. And that is the best that the economists, I think, can advise you.

Mr. TIBERI. Thank you. My time has expired.

Chairman CAMP. Mr. Lewis is recognized.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Dr. Boushey, the Bush tax cuts have been in place now for almost 10 years and they have not created a single job. During the Clinton administration, we created more than 22 million new jobs. In fact, we have lost hundreds of thousands of jobs, the budget is no longer balanced, the deficit increased under the Bush administration, and we all know the unemployment numbers. Despite this failed policy, Republicans want these tax cuts to continue and claim they will create jobs. What is your response to this argument? What would you suggest we do in terms of a tax policy to create jobs?

Ms. BOUSHEY. I have two comments on that. Number one, the kinds of tax cuts that happened at the beginning of the Bush administration were focused on the highest income earners in the country, not necessarily people that invested that money in job creation, but just rich people in America. The evidence shows that that was not something that led to an increase in investment. We saw the slowest investment growth of any recovery in the recovery that happened in the 2000s after those tax cuts. The logic was you give more rich people their money back, they were going to invest and create jobs. Quite frankly, we know now that they didn't.

At the same time, what you saw happening over the 2000's was a squeeze on the middle class. Again, that was the only economic recovery in the post-World War II period where middle class families had less income at the end of it than they did at the prior peek before the recession in the early 2000's. That, again, is failure, and that, of course, is part of the economic stability picture that we have seen in the ensuing years, families lost income, they put more people in the labor force, they took out more loans. And that, of course, was a piece of the housing bubble and the ensuing crisis.

Then the third point I want to make is that, one of the things that we haven't talked enough about this morning is that we continue to be in a unique economic situation. The models that economists have about taxes and spending are, for the most part, research done in "normal" economic times. But we are in a moment where interest rates are at zero, they have been for a number of years now; we are in what is called a liquidity trap, where even if the government continues to spend, it is not crowding out private investment. There is no evidence that that is happening right now. And a piece of that is how we get to this output gap and how we need to keep spending. So while we may need to sort of deal with this deficit in the long term, in the immediate term, if we do that, we will probably experience the kind of contraction that the U.K. and Ireland are now experiencing after their austerity packages.

Mr. LEWIS. Now, Dr. Boushey, I grew up in a little place in southern Alabama called Troy. And back then, a long time ago, when I was growing up—and up until some years ago in Alabama and many other parts of our country—people could kind of get a solid, dependable job at one of the local plants or factories. But our economy has changed now, hasn't it, Dr. Boushey?

Can you explain why cutting investment in education will only lead to worse unemployment? What effect will reducing investment in transportation have on our economy? How are goods and freights supposed to be moved across our country if we do not take care of our roads, our bridges?

Ms. BOUSHEY. Definitely. I mean, we have seen a decline in the middle class for decades now. And economists have tracked this polarization in the U.S. labor market with a growth in jobs at the low end, at the high end. But over the 2000's, we didn't even see the kinds of growth at the high end. You have really just seen a bottoming out of our labor market, and that has been hard on families. A piece of that right now, something that we can be doing is making these investments in infrastructure, in education, that would get people in jobs now, but it would also lay the foundations for long-term economic growth.

The American Society of Civil Engineers estimates that we can spend trillions of dollars just to repair our fraying infrastructure. And that has real consequences, not just for workers, but for small business owners. I live here in the District of Columbia on 18th and U, and across the street from me is a small business owner who has seen his water main break three times in the past few years, and each time leading to his business closing. Now, thanks to the recovery dollars, they are replacing the 100-year-old water main breaks on my street and so that small business owner won't see that kind of challenge moving forward. So these investments are not only good for job creation now, but they are what keep our economy moving forward.

Mr. LEWIS. Dr. Boushey, the last question; I am sure you have heard the reports that the Republican CR will cost our economy 700,000 jobs.

Chairman CAMP. Very quickly, because the gentleman's time has expired.

Mr. LEWIS. If you were Speaker Boehner, what would you do? What would your response be to the thousands of people who will lose their jobs?

Ms. BOUSHEY. I think I would encourage him to focus on job creation and building a strong middle class. And I would ask whether each of those items in the cuts he is making would actually accomplish those goals. And I think the answer is many of them are not focused on that goal.

Chairman CAMP. Thank you.

Mr. Davis is recognized.

Mr. DAVIS. Thank you, Mr. Chairman.

A recent report by the Committee for a Responsible Federal Budget suggests that one of the groups most likely to be hurt by massive debt are the poor. That is because, as the report puts it, "the poor and working poor already facing tough living conditions are particularly vulnerable to any deterioration in the economy which will reduce limited employment and income opportunities. Debt-related higher interest rates, whether through crowding-out pressures or a fiscal crisis, will make conditions even worse. Chances are that the fiscal pressures and political battles will mean less safety net resources available."

I would like to ask the panel whether they agree with that view. And if we don't get the debt under control, who will suffer the most when it comes to undermining job creation, the rich, the middle class, or the poor? Who is the most at risk, and what are the lasting impacts? And we can begin with Mr. Lazear.

Mr. LAZEAR. Well, again, I would refer back to the letter signed by the 10 CEA chairs because the scenario that you are talking about is exactly the one that we feared and that we were trying to speak to. If we encounter another crisis of the sort that we have now or one that is potentially worse, we do expect to see very high rates of unemployment, very low rates of GDP growth. And we know that when unemployment goes up, the groups that suffer the most are the ones who are most vulnerable.

So certainly to your question, I don't think there is any doubt that if you see high rates of unemployment, the people who can't easily carry through that period of tough times are the people with the least resources. So obviously, my concern would be for those individuals.

Mr. DAVIS. Thank you, Mr. Biggs.

Mr. BIGGS. I would agree and echo Professor Lazear's remarks. In a weak economy, where you are facing financial instability, higher income people, better educated people, people with some assets, they have the greater ability to whether that, to hedge the risks, to adjust things to get through tough times. People who don't have that ability are just in a much more difficult situation. So the point here is that you want to strengthen the economy, in particular, for the people at the bottom who really do need the help over the long term.

Mr. DAVIS. Thank you.

Ms. Boushey.

Ms. BOUSHEY. We are already in a crisis for those families. And I agree with you that we should be focusing on them. What we need to be doing is focusing on getting them back to work now. And once we do that, then we can deal with our long-term debt. We are sort of putting the cart before the horse.

And again, I point to the situation in Ireland, for example, which bailed out its banks, did an austerity package, and now has seen its bond rates double. The austerity has actually worsened the economic situation. So focusing on the debt before you have gotten your labor market in order is only going to add to the woes of America's working class.

Mr. DAVIS. Ms. de Rugy.

Ms. DE RUGY. One of the reasons why low-income people and their families are hurting is because for many years this government hasn't been doing the right thing. And when I hear the conversation about tax cuts costing the economy, there might be something to this, but it is comparing oranges and apples because there is also the, during the Bush years, a 60 percent increase in real term of spending, and we should not forget this. And it was unfunded, a large part of it.

But to your direct question, one of the reasons we need to act today is if we don't get our debt under control, if we don't get our spending under control, we are going to find ourselves in a situation where it is going to be a dramatic change right away. And we are going to find ourselves in a situation where we won't be able to actually sell assets in an organized fashion, but we are going to have to cut things across the board, like a fire sale type of thing, and we won't have enough time to actually set our priorities and make sure that the neediest people in our society are taken care of.

Mr. DAVIS. Thank you.

As a follow up, when it comes to choosing between maintaining the status quo of out-of-control spending or protecting the opportunities for Americans to achieve self-sufficiency, I think it becomes obvious that that needs to go. There is a direct correlation between increasing debt and reduced opportunities, particularly the unwillingness or pensiveness of employers to hire people or create new jobs because of the economic uncertainty.

Is there any additional collateral damage that will be caused by not addressing our debt issues, that it will impact those primarily the most in need? And we can start with you and go back across.

Ms. DE RUGY. Absolutely. I mean, I think we all agree that the most vulnerable people in society are poor people, and they are the one paying the brunt of all of the downturn of the economy. One of the reasons why we need absolutely to reform Social Security today is so that the program can actually be reverted to actually its original purpose, which is take care of the neediest of society. And the problem is if we don't do anything today, by the time the trust fund assets run out, the Social Security program is going to cut benefits across the board by 22 percent, and the people who are going to be hurt the most are low-income people. So, yes, absolutely we need to do things right now.

Mr. DAVIS. Thank you.

Chairman CAMP. The gentleman's time has expired.

Mr. Neal is recognized.

Mr. NEAL. Thank you very much, Mr. Chairman.

I want to thank Professor Lazear for saying that it was a good idea today to retrace our footsteps. Do you think in retrospect, Professor, that it was a good idea to cut taxes by $2.3 trillion and invade Iraq?

Mr. LAZEAR. I am sorry.

Mr. NEAL. I don't think that question could be any more clearer.

Mr. LAZEAR. I just didn't hear the last three words. Oh, and invade Iraq.

Mr. NEAL. Do you think, in retrospect, to cut taxes by $2.3 trillion and invade Iraq?

Mr. LAZEAR. And invade Iraq. I am sorry. Well, I certainly won't speak to the invasion of Iraq, that is outside of my area of expertise.

Mr. NEAL. That is where the money has gone; $250 billion annually we are being asked to come up with and it is all borrowed money.

Mr. LAZEAR. I understand that, sir. But again, if you look at the spending pattern during the Bush administration, what you will see is that spending average, 19.6 percent of GDP, which is the lowest level of spending——

Mr. NEAL. You come back to those numbers. I am asking you a policy question, Professor.

Mr. LAZEAR [continuing]. Relative to any recent President. So that doesn't mean that there aren't things that we could do that would improve the situation.

Mr. NEAL. Were you in the room with Paul O'Neill, the Secretary of the Treasury?

Mr. LAZEAR. No, I was not there.

Mr. NEAL. You weren't there. Are you familiar with Lawrence Lindsey?

Mr. LAZEAR. I didn't overlap with Lawrence Lindsey.

Mr. NEAL. Do you accept now, in retrospect, his recommendation that we should have budgeted substantially greater dollars for the invasion of Iraq?

Mr. LAZEAR. In terms of the accuracy of the budget, I think Larry was right, that it did cost more than I think they were projecting at the time, but again——

Mr. NEAL. Well, good God, that is something we can all agree on in this room today.

Now let me ask you this along the same line of reasoning here. President Obama mentioned on Monday night in his comments to the country that the war in Iraq was now going to cost $1 trillion. Do you agree with that?

Mr. LAZEAR. I haven't tallied up the exact number, so I can't testify to that right now.

Mr. NEAL. Do you want to take a wild guess? That is frequently what economists do.

Mr. LAZEAR. I prefer not to.

Mr. NEAL. Do you agree with this following statement, that because of our VA system, for the next 40 or 50 years for those young men and women who have served us honorably, that they are going to be in need of a substantial amount of increased dollars for their health care?

Mr. LAZEAR. I certainly think that we should take care of those who have served this country and take care of them well, absolutely, sir.

Mr. NEAL. What is interesting about the commentary from our panelists today is Ms. de Rugy, she is of, I think, a similar mind to you on many of the policies here, but she is intellectually honest about what happened during the Bush years with spending. You haven't mentioned that.

Mr. LAZEAR. I thought I did. I thought I gave you the exact numbers, sir.

Mr. NEAL. Do you think that spending got out of control during the Bush years?

Mr. LAZEAR. I thought I just told you—I stand by my statement.

Mr. NEAL. Why don't you say it again.

Mr. LAZEAR. The statement is, during the Bush years the average spend-to-GDP ratio was 19.6 percent——

Mr. NEAL. All right. Let me come back to make perhaps a more simple statement. Are you arguing this morning that there was greater economic success during the Bush years than there was during the Clinton years?

Mr. LAZEAR. I didn't say that.

Mr. NEAL. I hope you didn't.

Mr. LAZEAR. What I said was the economy certainly was doing very well during the period of 2006/2007. We had 4.4 percent unemployment. Those were very good times for the economy. We hit, obviously, one of the toughest financial situations we have had in this country in many, many years.

Mr. NEAL. It needs to be acknowledged that TARP took place in October of 2008.

Mr. LAZEAR. Correct.

Mr. NEAL. Who was the President then?

Mr. LAZEAR. President Bush.

Mr. NEAL. Okay. That is a very important consideration as you lay out these dates.

Now are you suggesting to me that on January 19, 2001, that the economy was ailing?

Mr. LAZEAR. On January 19, 2001? Absolutely.

Mr. NEAL. The economy was ailing?

Mr. LAZEAR. Absolutely. We were in the beginning of the dot.com crash.

Mr. NEAL. Let me take you back to this; do you think that it is accurate, as Mr. Lewis pointed out, that there were 22 million jobs created during the Clinton years?

Mr. LAZEAR. I understand that, but your question was, was the economy ailing in 2001? It certainly was ailing. We were going into a recession. We were going into the recession that started the Bush administration. We had just——

Mr. NEAL. The Wall Street Journal says today that the economy began to tank in 2007.

Mr. LAZEAR. Excuse me, sir. In 2000, we had two negative quarters of GDP growth. We were going into a recession.

Mr. NEAL. This is the difficulty with witnesses coming here like this. I gave you some very basic numbers and you were evasive on them. And Ms. de Rugy, she was not evasive on those numbers. She was very clear; she said spending got out of control during the Bush years.

Mr. LAZEAR. Sir, I am trying to answer your questions honestly, I am happy to do that. You posed a question, you said, do I think that we were in trouble in January of 2001? And I said absolutely. That is an honest answer. We were going into a recession. The data are clear on that. We had two negative quarters prior to that.

Mr. NEAL. I am going to close on the statement with which I opened; do you think it was a good idea in retrospect to cut taxes by $2.3 trillion and invade Iraq?

Mr. LAZEAR. I think that the Bush tax cuts in 2003 were absolutely a good idea. The investment tax credits stimulated investment and got the economy going again.

Mr. NEAL. Thank you, Mr. Chairman.

Chairman CAMP. Thank you.

Mr. Reichert is recognized.

Mr. REICHERT. Thank you, Mr. Chairman. And thank you all for being here today experiencing this pleasant discussion.

I have a simple question first for Dr. Lazear. The administration has stated that we will reach the statutory debt limit sometime this spring. The current limit is $14.2 trillion, or nearly equal to the value of every good and service produced in the United States. How do you think the financial markets and the broader economy would react if Congress simply increased the debt limit and there was no credible commitment or action taken in addressing our current fiscal crisis?

Mr. LAZEAR. Well, I think that the debt limit, to my mind, is more of a symbol than a reality. The reality comes earlier, I would say. So the front line of defense against increasing expenditures is not so much the debt limit, it is the actions that you and your committee in particular can take and take now in thinking about appropriations in the future budget.

So I would actually urge action at an earlier stage rather than at the debt limit stage. I think that is really where the action has to be had in order to make a credible commitment to reducing future spending. I believe that that is where you are headed, I believe that is where you are trying to go, but I am not convinced that simply dealing with the debt limit would be an effective mechanism at this point.

Mr. REICHERT. Anyone else on the panel care to comment?

Mr. BIGGS. I agree with Professor Lazear. I think the symbolism in terms of the debt limit matter, things like dealing with the debt limit, things like do we take up the recommendations of President Obama's Fiscal Commission, does the administration's budget try to tackle deficits over the long term? My concern for the financial markets is when opportunities to get on top of these problems are pushed aside. When we say we appointed a debt commission, but we are going to ignore what they did. We have a debt limit, but we are going to raise it without taking any reforms. We have various opportunities to fix these problems and we push them aside.

My fear is eventually financial markets may say they no longer have the will to get on top of these problems. And when financial markets begin to doubt you, that is when you enter a pretty dangerous zone.

Ms. DE RUGY. If I can add something. I agree. I think this is a sign of where we stand with our reputation abroad. I think there is a lot of talk about how the bond market will get rattled if we don't increase the debt limit. But I actually think that if we increase the debt limit and then either with the debt limit legislation, which is not necessarily the right place to do it, but also later, if we increase the debt limit without signaling that we are going to be seriously committed to changing the path on which we spend, it will rattle the bond market too. This is one of the signs that the U.S. is really at the cusp of a potentially very grave situation where do or don't, you are dammed.

Mr. REICHERT. Thank you.

Dr. Boushey, did you want to comment on that?

Ms. BOUSHEY. Certainly, thank you.

I mean, I agree that the debt limit is an opportunity for us to have this conversation about getting our long-term fiscal house in order. However, in the short term, we need to be cognizant of the reality of our economic situation, that we do need to continue to keep spending to help boost job creation. And we don't want to be cutting back on making investments in long-term economic growth. So in the short term, that is a very important thing to do, to increase the debt limit.

Over the long term, we do need to have a plan in terms of raising taxes and addressing the spending moving over the long term?

Mr. REICHERT. Thank you.

Let me ask one more question real quick. At the end of 2008, our country had a total debt of $10.7 trillion, it is now $14.2 trillion, a 32 percent increase in a little over 2 years. And due to our current projected spending levels, no one expects this debt level to decrease. In fact, the President has submitted a $3.6 trillion budget, revenue projections have been $2.6 trillion, so we are $1 trillion in debt going into 2012.

If I understood Dr. Boushey correctly, she agrees with this sort of math because it is a job creator. Dr. Lazear, what do you think about another $1 trillion deficit added to our country's debt 2012 as it relates to job creation?

Mr. LAZEAR. Well, I guess I have a different view than Dr. Boushey. I was never a firm believer that the stimulus programs did much to increase jobs; and as a result, I don't think that cutting expenditures right now would have much of a negative impact on jobs.

My concern is really for the longer run. I think that if we do add another $1 trillion to the deficit and then to the debt, we are talking about approaching numbers that are really going to have a significant detrimental effect on economic growth and on our long-term ability to borrow.

Chairman CAMP. All right. Thank you. The gentleman's time has expired.

Mr. Becerra is recognized.

Mr. BECERRA. Thank you, Mr. Chairman. And thank you to all the witnesses for your testimony.

We have been talking quite a bit about debt long term, the existing deficits, and how we want to get all of that under control. And interspersed in this conversation is how we get ourselves back on track. What I keep hearing is the more we do private sector investment, the more we see productivity increases for our workers, the better things will be. It sounds like at the end of the day what we are saying is the more we create jobs for Americans to take, the better off we will be. The more Americans can go to work, the more they can pay their fair share of taxes. And if we pay our fair share of taxes, our revenues will increase so we can cover some of our investments in education and defense and the rest.

So it seems to me the more we have this conversation, the more we should talk about the fact that the worst deficit we face is the jobs deficit, is how we put those 14 million Americans who are still looking for work back into a good-paying job. And so when you see that during the Bush recession we lost 8 million jobs, and when you see that we had a turnaround, a situation where economically we were hemorrhaging close to three-quarters of 1 million jobs per month—that was the case in January, 2009, when George Bush handed the keys over to Barack Obama.

Now that we are gaining jobs—in the last month, close to a quarter of a million new jobs—that is all great, but we have to still continue to do more. But as you talk about making cuts to our Federal investments, I think some of us are concerned that we are not really targeting the main contributors to these massive deficits.

I have a chart on the screen that pulled together what the biggest contributors have been over the last decade or so toward our deficits, incoming deficits. And obviously the biggest is, as we would expect, the recession, naturally occurring at times that we have the cycles and the down cycle. Obviously, the cycle contributes quite a bit. But we also see that the Bush tax cuts from 2001 and 2003, if you continue to extend them forward, you can see the size of the contribution to the deficit that we get from those Bush tax cuts. You see there, the discussion has it centered a bit on the two wars that have not been paid for as well. You can see the other things that help contribute to these massive deficits.

I am wondering if I could ask those of you who are here, if we were to make cuts and if we were to make investments, would it be wise to target the principal causes of our deficits before you start making cuts to investments to our kids, to our seniors, to our workers and to our veterans? Ms. Boushey.

Ms. BOUSHEY. Certainly. I will start and I will leave time.

Certainly, I mean, if we look at your chart, which the blue is the Bush tax cuts?

Mr. BECERRA. That is correct.

Ms. BOUSHEY. Certainly. You are asking us to think about what our national priorities are. And you are sort of forcing us to think about the role of job creation and investment in those priorities and how the Federal budget actually represents those. It doesn't seem to me that tax cuts for the wealthiest—that did not lead to strong investment or employment or gains for the middle class—should be a national priority over job creation in building a strong middle class. Yet the kinds of things that are being cut in H.R. 1 are those very investments that middle class and working class families can't buy out of. They can't send their kids to private school because they can't afford it. We need food safety, we need bridges and transportation, all the things that are going to be cut in this piece of legislation. So I think that is the right priority and what we should be thinking about.

Mr. BECERRA. You mentioned H.R. 1, which is the Republican budget bill for 2011, the continuing resolution. That bill, H.R. 1, makes a cut of $1.1 billion to Head Start, which would leave 200,000 children without a Head Start program to attend as they get ready to go on to kindergarten. It would also probably lead to pink slips to about 55,000 Head Start teachers. That doesn't seem to be like a way to make investments for people who are currently working, teaching our children in Head Start programs who would ultimately be fired. Does that, Ms. Boushey, sound like a way to reduce our deficit in a smart way?

Ms. BOUSHEY. Certainly not. It is kind of cutting off our nose to spite our face. We need to be making those investments in education and in teaching America's children. We also need to make sure that those people that have jobs can keep them. Programs like Head Start or the childcare programs or home health aides that we are cutting as a part of these budget cuttings both here and in the States make it harder for people who have those care responsibilities to keep their jobs. So we are harming America's families and making it harder for people to work, while at the same time, not investing in our future.

Chairman CAMP. All right. Thank you. The gentleman's time has expired.

Mr. Buchanan is recognized.

Mr. BUCHANAN. Thank you, Mr. Chairman. And I want to thank our panelists today for being here.

A couple of questions. One is, our debt is at $14 trillion, and you don't have to project far down the road we are going to be at $20 trillion. Money is almost historically free today, the cost of money, I think the interest debt is maybe a couple hundred billion. But if you have a normal rate, 4 or 5 percent, you are looking at $1 trillion a year in interest before you pay anybody anything in the very near future, say 5, 7 years, pick a time frame, but they are projecting trillion dollar deficits.

When I was in Tampa last week talking to business people, that is one of the things, the reason we are not getting the job creation is because of the uncertainty around our debt and deficit and looking forward and Washington's inability to deal with it. So I guess, Mr. Lazear, what is your thought, first off, on the $1 trillion a year in interest—which could be very quickly down the road in the next 5 to 7 years—and then the uncertainty that is created by that possibility and where we are at today? So I guess it is a two-point question.

Mr. LAZEAR. Thank you, Congressman. I think that is an excellent question.

The point about interest rates going up I think is an important one. I think Dr. Boushey referred earlier to the liquidity trap, the fact that we are at low interest rates today—low, by the way, for the short term, not necessarily so low at the longer term—but absolutely true. And I think most people do expect that we will not see these interest rates being sustained into the long run, that we do expect the kinds of changes we are talking about which will place additional burdens on the budget.

I guess my concern, you mentioned the word "uncertainty," and one of your colleagues did as well, my concern is actually not the uncertainty, my concern is the certainty of the deficit and this high debt problem that we have now. That is the problem that is plaguing the economy and that will plague business investment in the future. It is not the uncertainty, it is the fact that unless we do something, unless you, our elected officials, do something and do something pretty dramatic and pretty soon, we are going to be in the certain situation where our debt is so high relative to GDP that we are going to be placing very significant pressures on our economy.

Mr. BUCHANAN. Thank you.

Ms. Boushey, would you like to comment on that? If we don't do something substantial in the very near future, $1 trillion in interest that we are going to have to pay out, taxpayers' money? I can just tell you, talking with people, a lot of business people, there are health care issues they are concerned about in the cost of hiring an employee, but also the uncertainty with spending and debt is very real. I have been in business for 30 years, and I can tell you it is not comfortable. But I would like to get your thoughts on it.

Ms. BOUSHEY. Certainly. I want to make three points. One is that every month the National Federation of Independent Businesses comes out with a survey and they ask small business owners what they are worried about. And month after month they do say sales. They are worried about customers coming in through their doors. I think that one of the big uncertainties that has hit people really hard is that people didn't expect this financial crisis to happen, they didn't expect the devastation that we have seen in our economy. Are we taking the steps now to make sure that it doesn't happen again? Are we moving forward? And so there certainly is uncertainty certainly about that and what Congress will do.

But I think I want to reiterate, in the short term, we do need to make sure that we get people back to work. That is the foundation of having a strong economy. We need customers, we need people in charge.

Mr. BUCHANAN. Let me just say, let me mention getting people back to work is important for us as leaders to deal with this issue in a real way on a bipartisan basis.

Let me go to my next question because I haven't been here 30 years, I have been here 4.

Mr. BUCHANAN. One the things that concerns me is people like to talk about Bush, Obama, Clinton. But if you look back over 50 years the Democrats and Republicans have only balanced the budget five or six times in the last 50 years so there is plenty of blame to go around. You can come up with whatever rationale you want to come up with. I was here when the Democrats came up with

PAYGO. I voted for it. When they had the Commission on looking at the deficit, I applauded that. I think it is a great opportunity.

But again, we talk about it, but we don't do anything. But 49 out of 50 States have a constitutional balanced budget amendment. Doesn't that make sense, I mean you have to—if you think of a family or if you think of a business. I have been in business, created a lot of jobs over 30 years. You have to be able to make a budget and pay your bills. But it forces Washington, the Congress to say, look, we take in 2.7 trillion, we give the taxpayers the best value we possibly can for the money. That is it, make the hard choices.

The State of Florida, for example, has cut their budget every year, it seems like 2 or $3 billion, they have made hard choices. There is much shared pain that goes around. But doesn't a constitutional balanced budget amendment that phases in over time give some certainty to people in America as well as the right thing to do for Americans? I mean, Mr. Biggs, what do you think.

Chairman CAMP. Very quickly, because the gentleman's time has expired.

Mr. BIGGS. You can make the argument that a balanced budget amendment constrains Congress's ability to conduct countercyclical fiscal policy, and there is a cost there. But there is benefit in terms of restraining the natural impulse to overspend. And so I think on balance, it is something I would support because the problems we face going forward are so difficult.

Chairman CAMP. Thank you. Mr. Thompson is recognized.

Mr. THOMPSON. Thank you, Mr. Chairman. And I want to thank all the witnesses for being here today.

Dr. Lazear, in your statement, you said that policy is primarily responsible for the large deficits that are projected to be sustained into the near and distant future. Now in regard to that policy, does this include borrowing to fund two wars? Borrowing to pay for Medicare Part D? And borrowing to finance a tax cut?

Mr. LAZEAR. Yes. I would say legitimately that including policies of the Bush administration did add to that. Now, that was not the policy to which I was referring in that statement, but I would not deny that there were things that——

Mr. THOMPSON. That is policy. Irrespective of when that tax cut was borrowed, when we borrowed to pay for that tax cut, it still adds to the problem.

Mr. LAZEAR. Well, again, we have to be careful about the tax— when you say the tax cut. Remember there were three, as I recall, tax bills during the Bush administration, 2001, 2002 and 2003. The 2003 was quite different from the other two, so I would distinguish those.

Mr. THOMPSON. So I agree that our debt and our deficit is a huge problem, and it is a problem that we need to tackle, but I also believe that we are in a very fragile recovery right now in this economic recovery. And do you agree that with Senator Simpson and Erskine Bowles who chair, cochair the Debt Commission that we really need to be careful here, and this is something that we need to tackle, but we need to do it in a way that doesn't disrupt this fragile recovery.

Mr. LAZEAR. Well, I agree that we need to do it in a way that doesn't disrupt the fragile economy, no question about it. Again, my guess is that you and I have different views of what that would mean in terms of the disruption of the current economy. As I said earlier, I have not been an admirer of the stimulus program. I don't think it has done much to create jobs.

Mr. THOMPSON. I am asking you about the stimulus program, I am asking your about Debt Commission's proposals that actually get to the problem, they deal with it in a tough but responsible way, and they are very clear in pointing out that we need to do this in an appropriate way. Now Mr. Neal pointed out the third-party analysis, their disinterested party analysis, if you will. Other economists from around the country who point to H.R. 1. And if that were to go into effect, it would be the antithesis of what the Debt Commission is talking about when they say watch out for the fragile economy, that it would lose—it would cost us 700,000 jobs. That was the only point that I was trying to make.

Dr. Boushey, again, I agree we have got fiscal problems and we need to deal with them, but at the same time, I think it would be penny wise or pound foolish, whatever that is, if we ignored appropriate government responsibilities and appropriate investments. And one of the areas where I think we are really, really lacking is in infrastructure, because bad and unsafe roads, bridges, rail lines, overpasses, our harbors, I believe is, in fact, a tax on American businesses.

And that tax increase on American businesses means higher prices to American people, many of whom are unemployed, many of whom can't afford to pay that. These are the same American people as I say who are unemployed and who could be put back to work, if, in fact, we did make that investment in infrastructure to do away with this hidden tax that is there. Do you have any comments on that?

Ms. BOUSHEY. Certainly. I think that those are exactly the kinds of investments we should be making right now. Interest rates are low, it is a good time for municipalities and for us to be sort of borrowing to pay for those necessary investments and getting our economy on the right road to recovery. We have an enormous backlog of projects that need to get done, an enormous backlog of unemployed workers who need jobs, many of whom lost their jobs in the construction industry. So it makes sound economic sense. It also will help push our economy into the 21st century, we have infrastructure in the country that is 50 to 100 years old in many places. I already gave the example of the water pipes here in D.C. I mean, this is something that is unsustainable. We are gong to have to make that investment at some point. If you look over the course of an economic cycle, now is the perfect time to do it.

Mr. THOMPSON. It is not just in D.C. There is not a congressional district in this country, every one of us represents a district that is woefully behind in our infrastructure investment. I don't care if it is clean water and sewer, healthy, safe, and passable bridges and roads. So thank you very much.

Chairman CAMP. Thank you, Ms. Jenkins is recognized.

Ms. JENKINS. Thank you, Mr. Chair, and thank you all for being here. I think we can all agree that America's financial situation, as it stands today, is unsustainable. Yet the President sent Congress a $3.7 trillion budget proposal with a record $1.6 trillion deficit that continues a very aggressive agenda of more government spending, more taxes, more deficits and more debt. The CBO predicted the national debt under Obama's proposals would double in 10 short years. The President refers to this as investing in our future. I consider it robbing our kids of their future.

I think Dr. Boushey has made her position well-known this morning, agreeing with the President that it is an investment, but I would like the other panel members to comment on how you would characterize a proposal that doubles our national debt in this budget window.

Mr. BIGGS. Well, I would fully acknowledge that President Obama entered office in a very difficult economic time, just as President Bush entered office in a difficult time. The thing that worries me about the administration's budget proposal is the lack of ambition over the medium in the long term. You would like to think they could say well, we have large deficits today because of the economy, but over 10 years, we are to bring ourselves back to balance. Their argument, well we will go through a down payment, which is we will bring ourselves back to primary balance, which is a lower standard. The CBO scoring of the budget proposal says they come under best year, about $175 billion short of that.

So an answer I made to an earlier question is lost opportunities are the sorts of things that give people doubt about our will power to get on top of these problems. We have certain opportunities handed to us, where we can stand up and say yes, we are willing to make these difficult decisions. Each time we pass is another opportunity for people to say they are not serious about this.

So, really the short-term problems, I think, are indeed an issue. What worries me more is there is no plan on how to get out of them.

Ms. DE RUGY. I agree with you that a lot of the time we hear the word "investment" mentioned when really what we are talking about is just government spending. And giving it the label "investment" doesn't make its consequences any lesser. In fact, I would argue that it is time for everyone to think that yes, if our roads are in dire need of repair, what is this Congress willing to actually cut in the budget in order to make the necessary investments? And the problem is each time you heard the word "investment," it is oh, this investment is necessary, but so is everything else.

I agree, one of the things that is extremely worrisome with President Obama's recent budget is the actual lack, first of creativity or willingness to even address the future. And this is, as we have all said, worrying us because it will have consequences. We talk about the budget but we don't talk about the fact that our investors have got to be looking also at the financial statement of the United States the way we do and see the massive amount of unfunded liability. They must be knowing when the Social Security trust fund runs into a cash flow deficit forever, we are going to have to come up with money for this. Either in the form of taxes or more borrowing. So it is not even just what is on paper, it is all the things that are not on paper that adds up to the bill.

Mr. LAZEAR. I certainly agree. I think the point that I would raise is one that we probably haven't talked enough about, and that is again, let's use the President's numbers, because you referred to the President and his budget. If you use the President's projections and you look at his charts, the charts I showed earlier, what you see is even with the kinds of tax increases that the President is proposing, we are nowhere near close to solving this problem. So this is not a situation where we can get there with the President's arithmetic, it is just not going to happen.

The kinds of concerns that you have about your children's future, I think are concerns that I have as well and concerns that we need to address in ways other than the ones that the President is suggesting, simply because his budget, his own numbers acknowledge that this is just not going to do the job. So it is going to take some additional creativity on your part to get us there.

Ms. JENKINS. Thank you. I believe, in today's testimony, we have proven that the Nation's debt and deficits are an immediate concern and that they are not a result of Americans paying too little taxes. Some of us believe that we really need to cut spending now. President Obama, through his proposed budget, however, has suggested that we merely freeze some discretionary spending at today's inflated levels as his solution to solving the Nation's problems. I see I am about out of time. Perhaps——

Chairman CAMP. Time has expired. Mr. Pascrell is recognized for 5 minutes.

Mr. PASCRELL. Thank you, Mr. Chairman. It is good to be here, to listen to a lot of things that have been repeated and repeated. I would like to jump right into questions. I know I only have 5 minutes but there is always time.

Mr. Biggs, you were associate director of the National Economic Council for the White House in 2005. In your testimony before the committee today, and I respect your academia, I respect your research ability, but I have to ask you this question. You used the word gradual, these things sneak up on us, they don't happen usually over night, they don't happen all at once. What did you see in 2005 gradually happening to the economy, since we knew that the balloons were inflating. And we knew what was basically coming down the road, there were a few economists who warned us. What were you warning the White House about in 2005?

Mr. BIGGS. My time at the National Economic Council in 2005 was focusing on Social Security reform, which is a period of which President Bush proposed to reduce the rate of growth of benefits over the long term for medium and high income retirees while protecting benefits for low income individuals who need those benefits the most. That proposal that I worked on would have reduced the long-term Social Security deficit by somewhere around 60 percent, and I think, given considerable fiscal relief over the long term, in terms of reducing debt, that was the issue I focused on the time, I was not there given general economic advice to the President.

Mr. PASCRELL. In order to give specific advice, you would have to see the clouds coming, there are distant early warning signals. We weren't paying for anything, Mr. Biggs? What was your position on not paying for two tax cuts, not paying for two wars, not paying for the prescription drug recommendation that was passed

3 o'clock in the morning when it was passed 8 years ago? What were your recommendations about those things?

Mr. BIGGS. I did not make any recommendations on those things. I believe most of them took place prior to the time I was at the NEC, so it is not something I made any recommendations on at all.

Mr. PASCRELL. Thank you.

Ms. de Rugy, am I pronouncing your name correctly?

Ms. DE RUGY. Yeah.

Mr. PASCRELL. Thank you. The debt versus the Gross Domestic Product, you talked about that. You said it was the highest in 2011, did you not?

Ms. DE RUGY. Well, I mean, since the Second World War.

Mr. PASCRELL. The highest was in 1947.

Ms. DE RUGY. I said "since."

Mr. PASCRELL. The debt versus the Gross Domestic Product in 2008, it was already 82 percent under President Bush. It was 56 percent under President Clinton. So I want us to try to, in some manner, shape or form, get out of this amnesia we have about those 8 years. I think there is really systemic amnesia about what happened between 2001 and 2008. We know, for instance, that revenues as a percent of the Gross Domestic Product in 2000 were 20.6 percent; in 2010, 2010, 14.9 percent, projected by CBO to be 20.8 percent; and between 2012 and 2020–2021, rather, 19 and 9 percent.

We are talking about paying off our debt, it is a very serious problem. I think you all enunciated it quite well. But we must remember what happened, compared to what happened in the 1990's or what happened in the 8 years preceding Clinton's administration. We created in the 1990's, 27 million jobs. That is a fact. You are entitled to your opinions, but you are not entitled to your own facts.

Now what we did in 2001 and 2003 was to cut taxes, that is clear. We know what the record is. I am entitled to my own opinion but I am not entitled to Pascrell's facts. These are the facts. If you look at the jobs that continue, they went down from that period of time, cutting taxes automatically produces jobs. No, they don't. When you are spending frivolously, when you are not paying for anything you could cut taxes all you want. Because there is a revenue situation here we need to talk about, and I think it is very important that we do talk about it. The highest level at our best times, we had the revenues at the highest, highest levels——

Chairman CAMP. The gentleman's time expired.

Mr. PASCRELL [continuing]. When Clinton was the President. So don't blame this whole situation——

Chairman CAMP. Regular order.

Mr. PASCRELL [continuing]. On 2 years of the Obama administration.

Chairman CAMP. The gentleman from Minnesota is recognized, Mr. Paulsen.

Mr. PAULSEN. Thank you, Mr. Chairman. And first of all, thank you for taking the time to come and testify. I think hearings like this are very helpful. What is interesting to me is that as I travel around my district and I have met with a lot of small business people, and sure they talk about the tax environment, they talk about the regulatory environment. But increasingly, there are more and more of them that are talking about—actually, their concern about government's role in spending and the national debt and what that means in terms of that fiscal responsibility or lack thereof, eroding confidence in their investment decisions.

And that is something that has been growing more and more in number over recent months, and especially over the last year, which is very interesting. And so I think this conversation is important because the chairman started out, unemployment levels are predicted to be fairly high for the next couple of years still, which is not a good situation which we all absolutely want to change.

And in a global economy you can allocate capital at a click of a mouse so easily, anywhere you would like. I would like to obviously have this committee continue as the chairman wants to make the United States destination number 1, to create ideas, to generate economic growth and make it an opportunity, if you have an idea in the garage or in the backyard you can turn it into a company that is successful.

I will start with Dr. Lazear. Do you believe that maintaining our current levels of spending where they are now, will help make the economy the number 1 destination for new ideas and innovation down the road where we have been and where we need to go.

Mr. LAZEAR. No, I don't. And I think, again, that is my major concern and also the major concern of the other CEA chairs who signed that letter. The reason that we have that concern is that we believe if we allow the current situation to continue and to get out of hand, investors not only American investors, but investors around the world will lose confidence in the United States as a primary investment destination. If that happens, if that happens, we will find that the cost of funds goes up, we will find that the cost of doing business goes up. And with it, investment will decline, with that, productivity will decline, and with that wages and job growth will decline, so that is certainly my concern.

Mr. PAULSEN. And Mr. Biggs, maybe you can elaborate too, because you cited studies that have suggested that cutting spending versus raising taxes in terms of rehabilitating our country's economy or their budget situation because some countries have approached a balanced approach from raising taxes, but looking at that proposition through the innovation lens, which option, cutting spending or actually raising taxes as a part of the equation might be more beneficial to those who have new ideas to create companies or create jobs?

Mr. BIGGS. The interesting thing in the empirical research that we have reviewed is how overwhelming the case is that balancing your budget on the spending side is more likely to be successful than balancing it on the tax side. Study after study you can cite, they all come to very similar conclusions. What was still a little bit of a mystery is why that takes place. One of the reasons, I think, is especially if you do it in a large way, if you are sending a message that this is a place where your future is stable, and where you can make the kinds of investments, and you can take the kinds of risks that help make an economy vibrant over the long term.

So you are not simply doing a bookkeeping exercise of reducing your deficit debt. You are also sending a message to individuals, to businesses, to financial markets that the country is open for business, and it is the place where you want to be. Ultimately, over the long term, that is an extremely important thing to do.

Mr. PAULSEN. And Ms. de Rugy, you can comment as well, but let me ask you this as well, because I think you have got some part of your testimony, you raised some issues about the debt burden we have and the interest payments that we will have as a part of our debt. And obviously, a lot of my colleagues, we have been through tough economic times. And I am pretty brand new to Congress, but the fact is, if interest rates do climb, as the bond markets react as they will at some point that is going to consume a larger portion of our budget as paying interest.

Ms. DE RUGY. Yes. It is—already you can see it in the CBO projection. And the CBO projections are already built in some level of interest increase, but they don't build in the type of increase and interest rate that we may see the day our investors get completely rattled, and we can actually see interest rates being way bigger. And when that happens, the debt can get out of control because we are going to be starting to actually pay—borrow money just to try to pay interest and it could get out of hand.

I would like to add something which, we have been focusing a lot on investors and how they will look at us. One of the important things about tackling our problems today and signaling to the American people that we are not continuing on the path that we are because—I mean, the American people is smart. They understand that when we spend today and we don't have this money, it is going mean that taxes are going to go up. And also, it is in the news all the time that interest rates are going to go up. So that is why demand is low, and that is why they are not going to shop. It is not because the government isn't investing enough. It is because they actually want to pay down their line of credit. They want to save money for when the really hard times hit again.

And I think it is important to understand that the more government spends, or actual at least not change its path, the more it paralyzes investors and the American people, business owners and potential shoppers.

Chairman CAMP. Thank you time has expired. Mr. Larson is recognized.

Mr. LARSON. Thank you, Mr. Chairman. And I want to thank the panelists for their fine testimony today. I just have a brief question for Dr. Lazear and Dr. Boushey. We are all concerned about reducing government spending in the short term, I share those concerns. We are also concerned that we have to deal with the raising of the debt ceiling. My question is very specific, do you believe that it is wise to hold the full faith and credit of the United States hostage to deep cuts in order to deal with the issue of raising the debt ceiling?

Mr. LAZEAR. Well, as I already testified, I think that the debt ceiling is one more symbol than substance. And I don't believe it would have significant impact one way or the other on markets right now. With that said, I don't feel that using the debt ceiling as a mechanism to control spending is probably the most effective way to do it. I would like to see your committee get ahead of that. I think that the appropriations process, the process that you go through is the appropriate one. And I hope that you will take our testimony seriously and work on those problems.

Mr. LARSON. Dr. Boushey.

Ms. BOUSHEY. I think the answer would be no. That I don't think that we should be held hostage to the debt ceiling in terms of making significant budget cuts that will significantly harm the economy.

Mr. LARSON. Well, with regard to Social Security, I would just like to point out, and have this for the record that over time, Social Security has raised 14.6 trillion and spent 12 trillion and people continue to pay into it. And I would concerned, Mr. Biggs, could you define nor me what you mean by middle earners?

Mr. BIGGS. People in the middle of the earnings distribution.

Mr. LARSON. And what would that be? If I am a middle earner in America, what portion of my benefit are you going to reduce?

Mr. BIGGS. I think the average wage index now is about $42,000 per year.

Mr. LARSON. So a person earning $42,000 per year should expect a decrease in their benefits in Social Security in your opinion, in order to make it more secure for the future?

Mr. BIGGS. Well, if we don't take certain steps on Social Security that same individual and everybody else is going to get a 22 percent across-the-board benefit cut when Social Security becomes insolvent.

Mr. LARSON. So the idea is that person in the middle that the middle class once again, a person that earns $42,000 a year will see his benefits shrink. And what does that do to that person? And what does that do to the economy? And what does that do in terms of this large group of Baby Boomers that will be coming through here? What do they do with income that they are going to spend in an economy if we are reducing that rate?

Mr. BIGGS. What I have discussed is not reducing benefits for current retirees in any way, so the Baby Boomers really wouldn't be affected at all. And also to the degree you would reduce for higher earners, they would be done on a progressive basis. So somebody at the middle of the distribution would have a very, very small reduction in the growth of their benefit.

Mr. LARSON. One man's tea is another man's poison. And when you say very small reduction, and you are living on that, the average that people are living on Social Security is something like $14,000 annually, these are very modest benefits.

Mr. BIGGS. Why is one reason——

Mr. LARSON. Why is it always the only way to help out a beneficiary is for them to take the cut?

Mr. BIGGS. You can't——

Mr. LARSON. We have got billionaires that aren't paying any taxes all over this country, we have everyone sheltering money offshore and we are going to have the middle class, a $42,000-a-year person bear that burden. That is what is an outrage, that is what is wrong when we have a program, one of the best programs in the world that is working for people. And we are preparing to look at a road map that privatizes Social Security and vouchers Medicare for these people in the middle. Thank you.

Mr. BIGGS. Should I respond?

Chairman CAMP. I think the gentleman has yielded back his time. Mr. Marchant is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman. Depending on what publication you believe today in the United States, we have—corporations have about $2 trillion in liquidity set aside, not spending it. The Federal Reserve has expanded its balance sheet to $2.5 trillion. And it is arguable, depending on what numbers you believe, that there are hundreds of billions of dollars of profits that are still abroad that have been earned and have not been brought back to the United States.

So as a Ways and Means Committee, it looks to me like one of the big opportunities that we have is to find a way to persuade that large amount of capital, that is a historic amount of capital, that is sitting on the sidelines now, persuading them, incentivizing them and trying to find a way to help them convert that capital to jobs. They could do it today if they wanted to, but there is a tremendous reluctance on their part to take that capital and create jobs with it. A country that has combined austerity, budget cutting with job creation has been Germany in the last 2 years. They have gone through a significant austerity program. Yet their economy has started to grow. They are creating new jobs and their economy has recovered.

One of the fears that I have is that very soon in the next year or so, these companies that are sitting on these assets will begin to, and you have seen it in just the last week, instead of creating new jobs, they will begin to look at mergers and acquisitions. When you look at a merger and acquisition situation, you don't really look at job expansion first. You look at consolidation of redundancy, you look at—you try to exploit every inefficiency that is in the business, and usually there is not a new net job creation.

What do you think that this committee should be looking at in the theme of creating jobs, which creates economic activity, which creates additional income, which you combine with austerity to bring the economy back and put us back on the footing that we have? What can we do as a committee to reach out to this liquidity and say create jobs, help us back by creating jobs. Mr. Lazear.

Mr. LAZEAR. Well, that is a tough question, so let me try to get at it in a couple of different ways. You talked a little bit earlier in your question about capital overseas and how that capital could be brought back to be productive. Repatriation of overseas capital is a big issue. Much of this has to do with a complicated set of international tax issues having to do with whether we have a worldwide or a territorial tax structure. That, to me, should be embedded in a more general picture of tax reform that we ought to be talking about taxes that are more friendly to investment, and there are a number of different ways to get at that. But again, I think that the lesson that we learn from looking at the economic literature, and there is a lot of it on this particular issue, is that the best way to enhance an economy's ability to grow and to create jobs and higher wages, by the way, is through low and efficient taxes, through an open economy, and through flexible and free markets. That is really the only way we know that works and that is the only way we know that works historically. And so I would stick with those three prescriptions and just push everything you can do to get in that direction.

Now I know you have been talking about tax reforms, significant reform, I hope you do push down that path. I have spent much of my career thinking about it and I think it would be a very good way to go. Thank you, sir.

Mr. MARCHANT. Yield back.

Mr. JOHNSON. [Presiding.] The gentleman's time has expired. Mr. Berg, do you care to question?

Mr. BERG. Thank you, Mr. Chairman. It has been a very interesting hearing today for the last 2½ hours. And we have gone down a lot of different trails and different tracks. Clearly, I guess, one of the observations that I had in North Dakota, if we have a prairie fire, everyone comes together and tries to get it put out. We don't waste any time figuring out who to blame the fire on. And it seems like today we spend a lot of time trying to blame who started the fire. I think we all agree there is a fire. And we all agree, I hope, that we need to get our economy back. And it seems that we have two separate views on how to do that.

The view that was laid out was we would reduce spending. We encourage private sector growth through freezing or reducing taxes and regulation. And I am not quite clear on what the other alternative is, but it appears the other alternative would be not to reduce spending, possibly increase spending, possibly increase taxes, maybe increase some borrowing, which, again, from my perspective, that was something we did last year.

So that is my first question for Ms. Boushey, is there any place that you can say this country, or this is the policy that we follow, was followed and historically look at the facts and say this policy of increasing spending and increasing taxes has resulted in a stronger economy and more jobs?

Ms. BOUSHEY. The kind of economy we are in right now is one where interest rates continue to harbor near zero and we need to encourage people to invest that are not doing it. We have a lack of demand in our economy. So that is why, at this moment in time, you don't want to cut back government spending because that will reduce the amount of demand.

Mr. BERG. I understand your argument.

Ms. BOUSHEY. Oh, I am sorry, that what I thought you wanted me to——

Mr. BERG. No, what I am asking for is are there any facts? We have facts laid out that said this country did this to reduce spending, they didn't cover their debt by increasing taxes. So I guess what I am looking for are specific examples where, again, some similar economy increased spending, increased taxes or increased debt and that created jobs.

Ms. BOUSHEY. Japan, when it tried fiscal stimulus, saw improvements in its economy growth and performance, the United States.

Mr. BERG. What years would that have been?

Ms. BOUSHEY. Oh, now you are—I will get back.

Mr. BERG. I am not trying——

Ms. BOUSHEY. Let me go to the United States example. When Obama took office, we implemented, you implemented a massive stimulus proposal that then did lead to a sharp immediate reversal in job losses. The nadir of job losses in terms of jobs losses per month were in winter of 2008 and then it started going up, so that each month you saw fewer and fewer, and it was a very, very sharp reversal. And that is clear evidence above and beyond the kinds of analysis we have seen of the Recovery Act, that that certainly took things out of free fall and pushed them in the right direction. We have seen economic growth for 6 quarters now after——

Mr. BERG. I just don't have much time and I know a lot of people are hungry. So the two examples you have are Japan and then the United States.

Ms. BOUSHEY. Sweden, Germany. The example that Congressman Marchant just brought up of Germany. Germany saw larger output——

Mr. BERG. Let me just ask you another question. Again I would be more than happy if you have specific time periods on these countries again, of U.S., Japan and Germany, I would love to have that. The other question again is everyone is saying we need a government program that creates jobs. Has there been a government program that has passed in the last 10 years that you can say this program created 2 million jobs?

Ms. BOUSHEY. I can't think of one specific program, but let's try the chains of emergency dollars, they created a quarter of a million jobs last year in public private partnerships.

Mr. BERG. You can get back to us on that. I would like to know what specific government program passed in the last 10 years that had the impact clear and direct of 2 million jobs, or, say, a million jobs or more.

Again, Mr. Chairman, my belief, and of course, the other thing I would like to say is I did not vote for the stimulus. I was enjoying life in North Dakota when the stimulus passed. I am here because of that stimulus and because of a lot of other things, which brings me back to one question, that is the health care debate.

Mr. Lazear, could you explain the job impact of the health care law? I know you were cut off several times, but very quickly, what that impact will have on jobs?

Mr. LAZEAR. I would say there is a direct impact of some of the taxes that are associated with the health care bill. One primarily, the tax on employers of $2,000 if you don't have a health care bill. So those kind of taxes are never good for creating jobs, we know that. I was more concerned about the long-term implications of very large increases in spending. Whether we cover it with tax increases or not, it is still a huge increase in spending, and that means, to my mind, that we are going in the wrong direction.

Mr. JOHNSON. The time of the gentleman has expired.

Mr. BERG. I yield back.

Mr. JOHNSON. Thank you. Ms. Black, you are recognized for 5 minutes.

Mrs. BLACK. Thank you, Mr. Chairman and thank you panel members. I am the last one here standing, and I appreciate others that are standing behind me but I especially appreciate you all.

I certainly agree with my colleague from North Dakota that it will not do us any good to litigate the past and we should learn from the past.

And I also agree with my colleague from the other side of the aisle that said that there was some amnesia, because I think there is some amnesia here when we talk about President Bush and the Congress. And at that point in time when we started seeing all of this happening, I want to remind my colleagues that while President Bush was at the helm, there was also a Congress that was a Democrat-controlled Congress. So I think if we want to sit here and start throwing these things back and forth we ought not to have amnesia on all levels.

I do want to say, as I have been back in my district in the last 100 days, it has been my goal to get to every one of my counties and to visit industry, to also do town hall meetings, and to visit with the elected officials. And without a doubt, the top two issues have been jobs and the spending. There is no doubt that that is the issue. But what I am hearing from those that are creating jobs is that they are scared. They are scared about what we are going to do to them next with regulation, with mandates. They are very uncertain about the economy and what is happening in the economy and the amount of debt.

And you know what else they tell me, is they have the money, they have the capital. And not only that, there is also the demand for them to grow their businesses and to create jobs. If we want to help the middle class people to get back to work, that is what we need to do is make sure that we are helping those who are creating those jobs to have an environment where they can grow. And certainly piling up more debt is not giving them certainty that they can use their capital, this hard-working capital to put into their business to find out that they are not going to be able to reap a return on it.

Ms. Boushey, you continue to talk about the rich. Can you define for me who are the rich?

Ms. BOUSHEY. In the context of what I was talking about in terms of the tax cuts? Certainly.

Mrs. BLACK. Yes, you talk about the rich and wealthy continually in both your testimony and also in your written.

Ms. BOUSHEY. In that case, I would define it probably as the top fifth percent of earners in this country.

Mrs. BLACK. Can you give me what that salary would be?

Ms. BOUSHEY. That would be probably over around $250,000 a year, but I am probably getting the math a little bit off, but I am happy to——

Mrs. BLACK. So someone who has invested everything that they own, put their life on the line and they go into business as a small business entrepreneur, and they finally make it. And they make $250,000 a year, which, by your definition that is rich, but I would argue with you, if you were to ask some of my businesses who have really worked hard to get there, and they finally are making a good salary, a good income, they would not probably consider themselves rich, but you consider them wealthy, you consider them rich. So what we should do is we should tax them at a very high level and punish them for being successful.

Ms. BOUSHEY. Let's go back to the tax rates of the 1990's where we saw strong employment gains for everyone and we saw growth for incomes across the board. So that is actually what I am recommending, is that we reverse those tax cuts that gave the bulk of the tax benefits to people at the very top of the income distribution but that didn't help the rest of us, it didn't help our economy.

Mrs. BLACK. Ms. Boushey, I think that what you are doing here is you are trying to just isolate one thing and not look at everything else that was going on around that time that may have affected what was happening at that time. But what I would like to do is I would like to hear from the other panelists. Now, I will tell you if I think there are tax loopholes for people who make millions and billions of dollars as have been used, then yes, we need to take a look at that if those people in those income brackets are not paying what we would consider to be their fair share.

But to say that we want to punish those who have been entrepreneurs and done well, and they truly are the American dream, I mean that is what we want, we want the American dream. I would like to hear from the other panelists, what do you think about that?

Ms. de Rugy. Can I add just a very short point? The fact, we always talk about the 1990's and how it was great and how it is always used by the other side by saying look marginal tax rates were increased. But I would also like to remind people that during the Clinton administration's year, spending in real terms only grew by 12 percent, 12 percent. And that was a significant impact, because when you increase spending, people understand, when you increase spending massively people understand that there will be tax increase in the future and that actually creates a lot of uncertainty and forces them to stay home.

Mr. BIGGS. I would just give an example, I will say good things about my in-laws. My father-in-law is retired, but he was small businessman in rural Oregon, and when you are the owner there, you work hard for a long time, you sacrifice, you take the risk. If profits are low, you go without because you still have to pay your employees. When things turn out well, then you get the rewards. They are taking a risk in sacrificing at certain times in order to get that in later days. When they do succeed the more you penalize, or the higher tax that, it reduces the incentive to do the sacrifices that are needed to make the economy grow.

Mrs. BLACK. Mr. Chairman, I know that I am out of time but I really want to make the point here since this committee hearing today was about how we create jobs, that we do not lose sight of the way we create jobs and that is by entrepreneurs, because 80 percent of our economy of businesses are created by entrepreneurs. And if we really want to encourage our entrepreneurs to take the risk, we need to also say to them we understand you take the risk, we are not going to take from you, but thank you very much.

Mr. JOHNSON. Thank you. Your time has expired. I want to thank the panelists; all of you for your perseverance, and maybe you have got time for some lunch now. Thank you so much for being here. This committee stands adjourned.

[Whereupon, at 12:45 p.m., the committee was adjourned.]

[Submissions for the Record follow:]

Submission for the House Ways and Means Committee Hearing,
"Impediments to Job Creation"

Taxes, Congress & Lobbyists

By Bobby L. Austin
A private citizen
6224 Rime Village Drive # 101
Huntsville, Alabama 35806
256-971-4081
austin 5299@BellSouth.net
6 April 2011

Introduction – The people of America, the land of the free, are not really free because of high taxes and oppressive business regulations. Two major impediments to job creation are the IRS tax system, which is commonly accepted as being completely broken, and antibusiness regulations. This presentation will address the first of these, taxes. The tax code is too long, incomprehensively complex, unfair, prone to tax evasion, susceptible to political manipulation by lobbyist, and the tax rate for both corporations and individuals are excessive. Administrative, compliance, and enforcement costs are excessive.

U.S. Highest Corporate Tax Rate -- "Dozens of countries around the world – including many of the United States' closest trading partners – have realized that sky-high corporate tax rates are an economic dead end." Unfortunately, as of April 2011, America has the highest corporate tax rate of all industrialized nations. "Now more than ever, Americans want to see policies that will help create increased growth, more jobs, and higher standards of living – exactly the things that a lower and more streamlined corporate tax system can help achieve." Tax Foundation president and study author Scott A. Hodge, March 11, 2011.[8]

Reducing Tax Rates – For the past 20 years America has stubbornly held the average federal, state, and local U.S. corporate tax rate at 39.2% while other countries have been reducing their corporate tax rate. "Since 2006, some 75 nations have cut their rates, many multiple times."[8, 17]

Between 2000 and 2010, nine (9) countries cut their corporate tax rates by double-digit figures including: Germany (22 points), Canada (13 points), Greece (16 points), Turkey (13 points), Poland (11 points), the Slovak Republic (10 points), Iceland (15 points), and Ireland (11.5 points). The Canadian government has explicitly set the goal of having the lowest corporate tax rate among the major G-7 nations.[8, 17]

"Here's the truth, Britain used to have the third lowest corporate tax rate in Europe," George Osborne said in his budget speech." 'It now has the sixth highest... So I can today announce that from April this year corporation tax will be reduced not just by 1%

as I previously announced but by 2%..... Companies have naturally responded favourably to the move."[13]

High U.S. Taxes Moves Jobs Offshore -- 3M moved its plant abroad in order to reduce the tax load.[10]

Low U.S. Taxes Will Create American Jobs -- Two independent studies concluded that U.S. exports will increase by 18%, and $100 billion annually, respectively, if the corporate taxes based on income were eliminated. Much of the $12 trillion dollars American multinational companies hold off shore, rather than pay 35% tax, will come flooding to America. Thus, creating millions of American jobs.[5]

Transfer Pricing -- American companies with offshore earnings are taxed at a total rate of 35% if funds are brought to the United States. Consequently, many multinational companies take advantage of a process called "transfer pricing." Companies with facilities in countries with high tax rates use paperwork transactions to doubled transfer funds through Ireland or the Netherlands to countries such as the Cayman Islands and Bermuda, which depend primarily on tourist trade and have no corporate tax, in order to avoid most taxes in all countries. Google reduced its taxes by $3.1B using this method and Facebook is working on implementing the process.

Decreasing Taxes Increases Revenue -- Contrary to popular belief, reducing taxes actually increases revenue rather than reducing revenue and creates American jobs.

Referring to the 2003 tax reduction legislation the Joint Economic Committee, United States Congress, Report, January 2007 states, "This research paper presents the case that JGTRRA played a key role in the turnaround in investment and the turnaround in the economy."[21]

"Every time in American history that we've lowered the tax burden, the American people have responded with energy, imagination, and innovation. The standard of living has improved, better jobs were created, and government revenues have gone up, not down." Former Presidential candidate Steve Forbes.[3]

Economist Victor Canto, Ph.D. explains it this way.

> "On paper, a lower tax rate collects less per dollar of taxable income. But what politicians fail to see is that lower taxes bring more earners above ground while increasing the incentives to save, work, and invest. The net result is that both the economy and the tax base expand, which in turn allows for the provision of additional services and/or a further reduction of tax rates."[11]
>
> **(I suggest debt reduction)**

Example 1 -- Increased Revenue and Increased Business Investment -- American companies hold an estimated $12 T in off shore accounts rather than pay a total of 35% tax on funds brought to the United States.5 The *Wall Street Journal* reported that

Congress passed the American Jobs Creation Act of 2004, reducing the 35% rate to 5.25% for one year only, 2005, estimating that $200 B would be repatriated, generating $2.8 B in revenue. The IRS reported that 800 companies actually repatriated $362 B (1.8X estimate) generating $18 B (6.4X estimate) in revenue. Business investment increased 9.6%, the highest in ten-years.[12] Former Federal Reserve Chairman, Alan Greenspan, said that most of the offshore funds would come to America in months if the tax rate were reduced to zero.[5]

Example 2 -- Increased Business Investment – in 1998, Ireland with its 50% corporate tax rate and near 20% unemployment rate initiated a phased reduction of the tax rate to 12.5% over five years. The GDP increased by 9.6% the first year.[16]

High Costs -- Compliance cost is huge both in absolute terms and relative to the amount of tax revenue collected. The IRS estimates Americans spend 6.6 billion hours per year filling out tax forms—including 1.6 billion hours on the 1040 form alone. [2, 7]

IRS researchers estimate the monetary compliance burden of the median individual taxpayer (as measured by income) rose from $220 in 2000 to $258 in 2007, an increase of 17 percent.[18]

The IRS annual budget (administrative, and enforcement) is $12.5 billion. According to The National Taxpayer Advocate's (TAS) **2010** analysis of IRS data, U.S. taxpayers and businesses spend about **6.1 billion hours a year complying** with the filing requirements of the Internal Revenue Code, not including preparation for audits. That is **equivalent to more than 3 million full-time workers**.[18]

In **2002** Americans spent roughly $194 billion dollars on tax compliance. That amounts to **20 cents of compliance cost for every dollar collected** by the tax system.[7]

The Tax Advocate Service (TAS) estimates that the costs of complying with the individual and corporate income tax requirements for **2008** amounted to $163 billion – or a staggering **11 percent of aggregate income tax receipts.**[18]

IRS Unfair and Not Transparent -- Taxpayers worry that they are missing tax breaks while others are benefiting from too many breaks. Tax compliance rates are low among taxpayers whose income is not subject to withholding or reporting. Individuals who would never consider stealing from a local charity have little compunction about cheating on his taxes.[2]

The IRS tax code is filled with a rapidly growing number of exceptions and exclusion for special-interest groups perpetuated by more than 34,000 lobbyists. There have been approximately 4,428 changes to the tax code over the past 10 years, an average of more than one a day, including an estimated 579 changes in 2010 alone.[7]

Congress and Lobbyists -- There are more than 34,000 registered lobbyists in Washington. That is more than 60 lobbyists per legislator, all vying for some special consideration, frequently in terms of tax breaks. In 2009 federal lobbyists' clients spent more than $3.47 billion to influence political issues, an increase of more than 5% over 2009.[19]

Lobbyists' Influence -- Here is an example of tax avoidance that really ticks American taxpayers off. "GE's ability to generate $14.2 billion in profits, $5.1 billion in the US, and end up getting back $3.2 billion from taxpayers due to its political connections and favorable tax breaks and loopholes it has pushed through congress.... A review of company filings and Congressional records shows that one of the most striking advantages of General Electric is its ability to lobby for, win and take advantage of tax breaks. While the financial crisis led G.E. to post a loss in the United States in 2009, regulatory filings show that in the last five years, G.E. has accumulated $26 billion in American profits, and received a net tax benefit from the I.R.S. of $4.1 billion."[15]

GE, and many other companies, have gamed the IRS tax system during administrations by both political parties; however, it is presently particularly egregious. The fox is in the hen house. President Obama has designated G.E.'s chief executive, Jeffrey R. Immelt, as his liaison to the business community and as the chairman of the President's Council of Jobs and Competitiveness, and it is expected to discuss corporate taxes.[15]

Summary -- So, it is very clear that **major tax reform is urgently needed**. The IRS tax system is completely broken and beyond repair. It is also clear that the corporate tax rate dramatically affects economic growth, the movement of jobs, and government revenue.

Former presidential candidate Steve Forbes stated very plainly. " We can't thinker with this tax code monstrosity or try to reform around the edges. The only thing we can do with this hideous beast is kill it, drive a stake through its heart, bury it, and hope that it never rises again to terrorize the American people.[3]

The Solution -- Thus, the question becomes, what is the optimum tax policy. A Georgia commission studying taxation for the state said this, "We currently tax the wrong things (income) versus taxing consumption and personal choices in discretionary spending."[23]

The Americans for Fair Taxation (AFFT) spent $22 billion of privately funded research to develop the "optimum" tax system. It is totally NON-PARISAN...No politicians and no lobbyist involved. Eight outstanding economists of the country led the research, starting with a blank slate and let the research lead them where it would. Extensive input by the American people was included in the research. The result is legislation now pending before Congress, The Fair Tax Act of 2011, H.R. 25 and S.13.[1, 5]

<u>The FairTax replaces</u> all taxes based on income, for both businesses and individuals, [income, Social Security, capital gains, gift, estate (death), corporate, self-employed, and value-added (VAT)] with a 23% national retail sales tax at the point of final consumption only, for new goods and services only, which, unlike state sales tax, is

included in the retail price and clearly **shown on the sale receipt**. No business-to-business tax. Production is NOT taxed and consumption is taxed only once.

Who ultimately pays tax? Consumers pay tax. Corporations collect tax but, they do not pay tax as taxes are business expenses passed on to the consumer.[5] Thus, it is logical to implement a consumption tax, i.e., a national sales tax.

Research of literature reveals 18 criteria that have been put forth for the fundamental requirements for a new tax system. [2, 3, 4, 19] The FairTax addresses 17 of the requirements. It is up to Congress to insure that the 18th is met.

1- **Minimize Costs --** The IRS with its $12.5 billion annual budget is abolished and is replaced with a small contingency within the Treasury Department. The 11% to 20% cost compliance is replaced with 1/4% to the retailer and 1/4% of tax collected paid to 45 states for administrative fees.1 The federal government will have to collect for five states that do not already have a sales tax. There will be no cost to companies or individuals for record-keeping or filing annual forms. Thus, enforcement costs will be reduced as well.[1]

2- **Low Marginal Tax Rates --** The corporate tax rate will be zero and the tax rate for the great majority of individuals will be reduced over remaining lifetime. The tax rate is negative up to the poverty level, zero at the poverty level, 11.5% at twice the poverty level, 15.3% at 3X, 17.25% at 4X, and capped at 23% regardless of expenditures.

3- **Broad Economic Base --** The **tax base is doubled** as now all consumers pay tax, including: drug dealers, prostitutes, those in the underground cash economy, and 30 M to 40 M annual visitors to America.[5]

4- **Reduce Disincentives to Work, Save, and Invest --** With no withholdings individuals take home more pay. Only expenditures are taxed; thus, savings and investments are not taxed, this eliminating the disincentives to work, save, and invest. At an income of 3X the poverty level, save and / or invest 10% and reduce the effective tax rate by 10% of 17.25% or 1.725%. Used goods are not taxed. Education is considered an investment therefore, tuition for education and training are not taxed.

5- **Progressive… No increase on mid-income families --** While the tax rate paid is the same for all individuals, the **effective tax rate** is progressive due to a monthly pre-bate of the taxes owed on expenditures at the poverty, level for legal residents. The poverty level is $10,830 for one adult, 2X for two adults, and $3,740 for each child. A Boston University economist examined 42 combinations of income, family size, and age. He concluded that low income families benefit from implementation of the fair tax by 26.7%, mid- income families by 10.9%, and high income families by 4.7%.[9]

6- **Avoid Unintended Consequences of the AMT --** The AMT, along with all other income base taxes, are replaced with the retail sales tax.[1]

7- **8, 9- Simple, Fair, and Industry Neutral –** The 70,000+ pages of IRS tax code is replaced by approximately 130 pages and limited implementation instructions. It is fair and industry neutral as all businesses are treated the same, and all legal residents are treated the same, no exemptions and no exceptions.[1, 5]

10-**Revenue Neutral --** The 23% rate was calculated to be revenue neutral during the first year of implementation. [5] However, due to economic growth and job creation, revenue will increase in future years as the economy will grow significantly.

11-**Engage Taxpayers for Best Results –** The FairTax is based on extensive market research. Preliminary meetings, attended by hundreds of private citizens, were held in four cities. More than 20,000 individuals attended rallies in three cities. Over 1 million private individuals signed a petition of support prior to implementation of the FairTax website.[5]

12-**Requires Support by Taxpayers** – Today, there are FairTax support groups in all 50 states, urging their representatives and senators to support H.R 25 and S.13. I have personally talked with more than 200 individuals and only three (3) have objected to the FairTax concept. Eighty economists signed a letter of endorsement to the President, Congress and the American People.[20] The November 20, 1997 Congressional joint committee on taxation report states that 12 government, university, and professional economist conducted extensive analysis of the benefits of a retail tax. All twelve concluded that a consumption tax would increase long-term economic growth.[21]

13-**Address Revenue Neutrality Tax Code Separately from Spending –** The FairTax only addresses the issue of **revenue neutral** taxation. It is up to Congress to address the issue of decreased spending.[1]

14-**Abolish the IRS --** The IRS is abolished and repeal of the 16th amendment, upon which the income tax is based, is required in order to prevent dual taxing.[1]

15-**Long Term Stability --** Implementation of the FairTax provides long-term stability that companies can plan long term. The basic policy and philosophy of the retail sales tax remain intact, even if the tax rate is adjusted.

16-**Transparent –** The FairTax eliminates the 22% hidden tax imbedded in the cost of products and services. The tax consumers pay is clearly shown on the purchase receipt.

17- **Border Neutral –** The 22% hidden tax is removed making American companies more competitive on the international market.

18-**Must be honestly evaluated by CBO --** The CBO evaluates proposals based on data and instructions from the Congress. Therefore, it is up to Congress to ensure that realistic data and instructions are provided for analysis of tax options.

Conclusion -- It is doubtful that any legislation ever presented to Congress has been based on more extensive research. Developers of the FairTax, national retail tax concept have met 17 of the 18 criteria. It is up to Congress to ensure achievement of the 18th criteria.

There is a widespread belief that the influence of "special interests" is the biggest roadblock to comprehensive tax reform. Steve Forbes stated this way, " the dirty little secret in Washington: what the politicians really fear from tax relief and tax simplification is not a loss of revenue. What they really fear is a loss of power."[3]

While less than 2% of more than 200 people with whom I have talked to about the FairTax have objected to the concept; all too often the comment is, "You'll never get Congress to pass it." That is an exceeding sad testimony of public confidence in our elected representatives. Legislators are elected to represent the people of America and make decisions in the best interest of the people, not the best interest of the politicians for getting political contributions from lobbyists and special interest groups.

It is my sincere hope that legislators, as individuals and the collective Congress, will have the moral courage to do what is best for America and our future generations.

Recommendation -- Implement the Fair Tax legislation, H.R 25 and S.13, as soon as possible in order to expedite dramatic job creation for American workers and national economic recovery.

Impediments to Job Creation – References

[1] The Fair Tax Act of 2011, H.R. 25 / S. 13

[2] "Nina Olson, National Taxpayer Advocate: Standing Up for Taxpayers," The National Taxpayer Advocate Report 2010; "Time for Tax Reform is Now" http://www.taxfoundation.org/research/show/27021.html

[3] New Birth of Freedom, Neal Boortz & John Linder, Harper Collins Publishing, NY, 2008 Interview with Rep. Dave Camp, The Tax Foundation podcast. http://taxfoundation.org/research/show/25703.html

4 Interview with Rep. Dave Camp, The Tax Foundation podcast. http://taxfoundation.org/research/show/25703.html

5 FairTax: the truth, Neal Bortz and John Linder, Harper Collins Publisher, NY, 2008

6 The Road to Riches Is Called K Street, *Washington Post*, 22 June 2005

[7] "The Time for Tax Reform is Now" http://www.irs.gov/advocate/article/0,,id=233846,00.html

[8] "Countdown to #1: 2011 Marks 20th Year That U.S. Corporate Tax Rate Is Higher than OECD Average," Scott A. Hodge, Tax Foundation Fiscal Fact No. 261 http://taxfoundation.org/publications/show/27100.html

[9] A FairTax White Paper; The impact of the FairTax on small business http://us.mg204.mail.yahoo.com/dc/launch?.partner=sbc&.gx=1&.rand=cif3a1g9fe0ld

[10] "To help reduce tax load 3M to move plant abroad," Wall Street Journal, October 10, 2007

[11] Victor Canto, Ph.D., founder of La Jolla Economics, an economics research and consulting firm in La Jolla, California. March 04, 2005

[12] Corporate Tax-Cut Windfall," *Wall Street Journal*, July 1, 2008

[13] International Tax Review, UK business welcomes surprise corporate tax cut, Salman Shaheen, 23 March 2011 http://www.google.com/search?q=intenrational+tax+review+Uk+businesses&sourceid=ie7&rls=com.microsoft:en-us:IE-SearchBox&ie=&oe=&rlz=1I7PRFA_en

[14] "Tax loopholes let Google save $3.1B," *Huntsville Times* (AL) 25 Oct 2010

[15] "Obama's favorite CEO gets GE out from paying any US taxes"
http://hotair.com/archives/2011/03/25/obamas-favorite-ceo-gets-ge-out-from-paying-any-us-tax

[16] "The Emerald Isle," *The Washington Times,* March 21, 2008
http://www.washingtontimes.com/news/2008/mar/21/the-emerald-isle/

[17] "U.S Corporate Tax Rate Soon to be Highest In Industrialized World," Richard Morrison, The Heartland Institute,
http://www.heartland.org/full/29528/US_corporate_Tax_Rate_Soon_to_be_Highest_in Industrialized_World.html

[18] "Compliance Costs & Tax Complexity"
http://www.taxfoundation.org/blog/topic/96.html

[19] Democratic Leadership Letter to President Bush December 15 2004
www.democraticleader.house.gov/media/press.cfm?pressReleaseID=976

[20] "An Open Letter to the President, Congress, And American People Concerning Reform of the Federal Tax Code" –
www.okfairtax.org/Open_Letter.pdf

[21] Joint Committee on Taxation, Joint Committee on Taxation Modeling Project and 1997 Tax Symposium Papers (JCS-21-97) November 20, 1997
http://house.gov/jct/s-21-97.pdf

[22] "Federal Lobbying Climbs in 2009 as Lawmakers Execute Aggressive Congressional Agenda" February 12, 2010
http://www.opensecrets.org/news/2010/02/federal-lobbying-soars-in-2009.html

[23] "2010 Special Counsel on tax Reform and Fairness to Georgians," D. Fraser, Chair, December 14, 2010
http://fiscalresearch.gsu.edu/taxcouncil/index.htm

Submission for the House Ways and Means Committee Hearing,
"Impediments to Job Creation"

Witness

Bobby L. Austin

I am a volunteer member of the local, Huntsville, Alabama, FairTax support group; however, I have no official capacity. I submit this document as a private citizen, not as an official representative of Americans for Fair Taxation, or any other special-interest group.

National Roofing Contractors Association
Washington, D.C. Office
324 Fourth Street, N.E.
Washington, D.C. 20002
202/546-7584
Fax: 202/546-9289
http://www.nrca.net

March 30, 2011

The Honorable Dave Camp
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
1139-E Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Camp and Ranking Member Levin:

The National Roofing Contractors Association (NRCA) commends you for holding a hearing of the Committee on Ways and Means to discuss government policies and actions that provide impediments to job creation. Like you, we at NRCA believe Congress needs to take steps to ensure the government is not impeding the ability of businesses to create jobs and grow the economy. As the Committee moves forward with tax reform proposals that will seek to address concerns arising from today's hearing, we urge you to consider legislation that provides for pro-growth tax policies that enable entrepreneurs to grow their businesses and create jobs within our industry.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. NRCA's approximately 4,000 members are located in all 50 states and typically are small, privately held companies, with the average member employing 45 people in peak season and attaining sales of about $4.5 million per year.

Unemployment in the construction industry remains alarmingly high at 21.8%, according to recent data from the Bureau of Labor Statistics. Clearly, the construction industry has been one of the hardest hit sectors of the economy over the past two years and our members continue to struggle in very difficult economic conditions. As such, pro-growth tax policies are needed now more than ever, and NRCA urges Congress to pursue the following initiatives in tax reform legislation going forward.

Commercial Roofing Depreciation Reform

Small businesses within the roofing industry are uniquely positioned to play an important role in creating high-quality jobs for American workers. Congress should facilitate the creation of an estimated 40,000 jobs annually within our industry by passing legislation to reduce the depreciation schedule on commercial roofs from 39 years to 20 years. In addition to creating 40,000 jobs among contractors and manufacturers, such legislation would also enhance the energy efficiency of our nation's commercial buildings and simplify taxes for small businesses in many industries.

Passage of depreciation reform legislation is necessary because between 1981 and 1993 the depreciation schedule for nonresidential property was increased from 15 years to 39 years. However, the current 39-year depreciation schedule is not a realistic measure of the average life span of a commercial roof. A study by Ducker Worldwide, a leading industrial research firm, determined the average life expectancy of a commercial roof to be 17 years.

The large disparity between the 39-year depreciation schedule and average life span of a commercial roof is a major incentive for building owners to delay the replacement of failing roofs. This is slowing economic activity and the adoption of more advanced energy-efficient roofs, because an owner who replaces a roof before 39 years have elapsed must continue to depreciate that roof for tax purposes even though it no longer exists. A Treasury Department Report to Congress on Depreciation Recovery Periods and Methods corroborated this problem by finding "…a 'cascading' effect, where several roofs are being depreciated at the same time, even though only one is physically present." Given this situation, many building owners choose to do only piecemeal repairs, most often with older technology, rather than replace a failing roof in its entirety with new, more energy-efficient materials.

In the 111th Congress, several bills (H.R. 426 and H.R. 5396) were introduced with bipartisan support to rectify this situation. This legislation would reduce the depreciation schedule from 39 to 20 years for commercial roofs that meet a benchmark energy efficiency standard. This would facilitate job creation in our industry by accelerating demand for energy-efficient commercial roofs by eliminating the disincentive in the tax code for building owners to engage in such economic activity. Enactment of this legislation would also benefit small businesses of all types by mitigating the "cascading effect" of having to depreciate more than one roof in instances where a roof must be replaced before the 39-year depreciation schedule has been completed.

According to the Ducker Worldwide study, this legislation would produce the following benefits by accelerating demand for energy-efficient commercial roofs:

- Create 40,000 new jobs within the roofing industry;
- Add $1 billion of taxable annual revenue to the economy;
- Provide savings to small businesses of all types through a simpler and more equitable system of taxation and lower energy costs; and,
- Reduce U.S. energy consumption by 13.3 million kilowatt hours annually and cut carbon emissions by 20 million lbs. per year.

Given the unique combination of job creation and energy efficiency benefits, this legislation enjoys support of a diverse array of businesses, manufacturers, labor and energy efficiency groups. The bill will create jobs not through a special tax incentive, but by the removal of an obstacle in the tax code which restricts economic growth and impedes the movement towards more energy efficient buildings.

Extension of Bush-Era Lower Tax Rates

NRCA supports the *permanent* extension of pro-growth tax rates on individual income, capital gains and dividends originally enacted by Congress in 2001 and 2003 and recently extended for two years, through the end of 2012. These lower tax rates were instrumental to our emergence from the 2001 recession with strong economic growth. The extension of pro-growth tax rates is particularly critical during a time of prolonged weak economic growth which our economy, and the construction sector most acutely, is currently experiencing.

With the lower individual tax rates set to expire on Jan. 1, 2013, NRCA urges Congress to pass legislation to permanently extend the rates in order to provide long-term certainty for "main street" small businesses, many of which are S-corporations and other flow-through organizations that are taxed through the individual rates. Currently, the vast majority of the tax code is temporary, with taxes set to increase dramatically without further congressional action. The prospect of future tax increases hangs like a dark cloud over many small businesses, our nation's primary job creators.

The prospect of future higher taxes on small businesses and the entrepreneurial sector of the economy is particularly troubling to NRCA. The growth of small businesses is absolutely vital to creating the millions of jobs needed for economic recovery, and failure to move forward in the future with pro-growth tax policies will surely impede the recovery.

Three Percent Withholding Tax on Government Contracts

NRCA urges the immediate repeal of the three percent withholding on government contracts mandated in Section 511 of the *Tax Increase Prevention and Reconciliation Act of 2005* (TIPRA) through the prompt consideration of the Withholding Tax Relief Act of 2011 (H.R. 674). Repeal of the withholding law is vital to job creation and economic growth in the roofing industry. If the tax withholding law is not repealed, roofing contractors performing government work are due to face serious repercussions:

- The three percent of the payment that is withheld is taken off the total value of the contract, not the profit earned on the project;
- Given that three percent or less of the total contract is the average profit margin in our industry, withholding could eliminate contractors' profits on many projects, thus severely limiting the ability of contractors to grow their business and create jobs;
- While the contractor may collect the remaining three percent at the end of the year, cash-flow and operating capital disruptions caused by withholding will be a tremendous burden, particularly for small businesses;

- This disruption in operating capital will also negatively impact a company's ability to become bonded, which is required for bidding on many government projects;
- Bookkeeping systems are not set up to account for amounts withheld from invoices. Withholdings will also complicate tax filings and the need to accurately determine tax liability. This new complexity will create added compliance costs on businesses and thus will further impair efforts to create jobs;
- Many roofing contractors will be forced to stop bidding on government contracts. Also, contractors continuing to perform government work may be forced to pass additional costs created by withholding along to the government and taxpayers;
- Without immediate action by Congress, withholding will begin impacting contractors soon, as the provision takes effect at the beginning of next year.

Completed Contract Method Reform

NRCA supports bipartisan legislation (H.R. 6097) introduced last year by Reps. Herger and Berkley to modify the tax code to expand the number of construction contractors who may utilize the completed contract method (CCM) of accounting when dealing with long-term construction contracts. Under current law, construction contractors cannot use the CCM if average annual gross receipts exceed $10 million, a threshold that has not been adjusted for inflation since 1986. Contractors who cannot utilize CCM must use the percentage of completion method (PCM) of accounting, which often does not accurately reflect results due to the required use of cost estimates.

H.R. 6097 would increase the threshold for using the CCM to $40 million, index it for inflation, and also provide relief from the Alternative Minimum Tax and "look-back" provisions in the tax code. NRCA commends Representatives Herger and Berkley for their leadership on this legislation and looks forward to working with Congress on this issue of importance to the construction industry.

Conclusion

Again, NRCA believes that any tax reform legislation considered by Congress must provide for pro-growth tax policies that enable entrepreneurs to grow their businesses and create jobs within our industry. NRCA looks forward to working with members of the in support of such policies during the 112th Congress.

Thank you for your consideration of NRCA's views on tax reform as it relates to small businesses. Please contact NRCA's Duane Musser or Brandon Audap at 202-546-7584 if you have questions or need more information about NRCA's position on these important issues.

Sincerely,

T. Allen Lancaster
President, Metalcrafts Inc., Savannah, GA
President, NRCA