CHAPTER 1

FROM CRISIS TO RECOVERY AND GROWTH

The recession that began at the end of 2007 was both the longest and the worst since the Great Depression more than 75 years ago. By some measures, such as the total jobs lost, it was as deep as the past three recessions combined.

It was a breathtaking moment of free fall in the private sector. Capital markets collapsed. Credit to businesses froze. Banks failed. Foreclosures soared. National output fell at rates not seen in decades. And millions of people lost their jobs.

Policymakers in the Administration, Congress, and the Federal Reserve responded with aggressive, concerted actions to stop the crisis. Although there will likely be debates over the impact of each of those responses for decades to come, few can dispute that the economic climate has improved substantially from the darkest days at the end of 2008 and the beginning of 2009 in large part because of these actions. And the Nation's economy did not fall into depression.

As gross domestic product (GDP) has been recovering, and as the private sector has added more than 1.1 million jobs since the beginning of 2010, economic policy has shifted from crisis to recovery and fostering growth.

This year, the *Economic Report of the President* puts its primary focus on the particular moment in which the Nation now finds itself—a moment when the most important priority is reestablishing the primacy of broad-based growth to ensure the well-being of the American people and to keep America the premier economy on Earth.

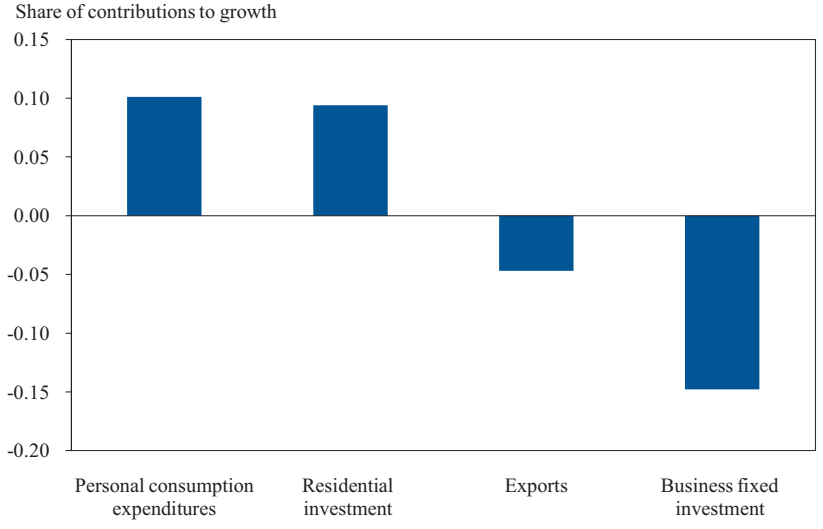
Without question, growing our way out of the hole left by the crisis will take a determined effort across industries, states and localities, and the Federal Government. Data from many countries over many years document how painful the emergence from a deep financial crisis can be. The

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

challenges today have been heightened by the need to confront multiple pressures, many of which are lingering effects of the crisis itself: financial woes in Europe, continued weakness in the U.S. housing market, depleted state and local government budgets, and the need to improve the Nation's long-term fiscal situation. And yet the American economy has now been growing for more than a year and a half. The private sector, as of this writing, has added jobs for 11 consecutive months. The economy must grow faster, but certainly this is movement in the right direction.

The challenge will be to shift the focus of the U.S. recovery away from the boom-and-bust cycles of the recent past toward more sustainable growth. In particular, from 2001 to 2005, the two overwhelming drivers of growth were increased consumer spending and investment in residential real estate. Each was unsustainable. Consumption spending grew faster than income, and the personal saving rate fell dangerously close to zero. The bursting of the housing bubble left millions of vacant homes and lowered home prices such that investment in the housing sector is still struggling to recover.

Figure 1-1
Unsustainable Expansion: Recent Boom vs. Past Booms



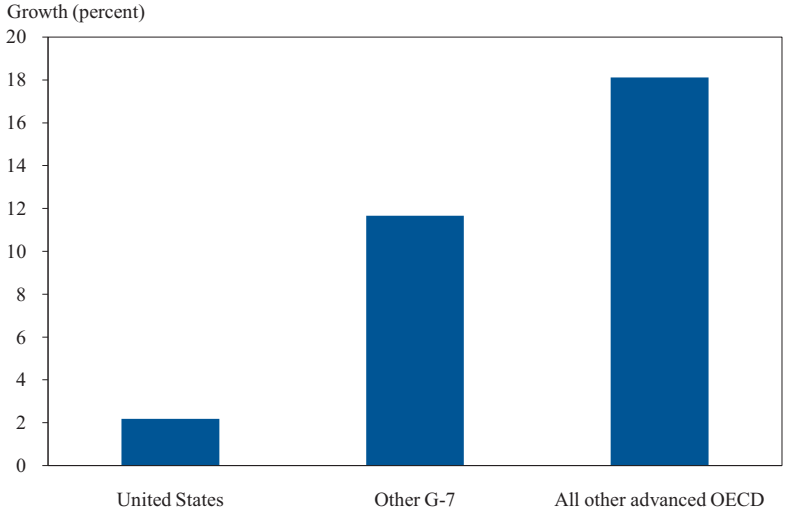
Note: The figure shows the share of contribution to GDP growth from 2001:Q1 to 2005:Q4 minus the share of contribution to growth from 1953:Q2 to 2001:Q1.
Source: Bureau of Economic Analysis, National Income and Product Accounts.

Figure 1-1 shows how imbalanced the early 2000s were relative to normal expansions in the second half of the 20th century. It illustrates the share that personal consumption, residential investment, exports, and

nonresidential business fixed investment contributed to GDP growth during the five years following the business cycle peak in 2001:Q1, relative to the past averages. Consumption and residential investment were dramatically outsized contributors to GDP growth during the recent boom compared to the past. Business investment and exports were dramatically undersized.

U.S. nonresidential investment and exports during 2000–2005 were weak not only relative to our own history, but also relative to other major economies. Figure 1-2 shows that U.S. nonresidential investment barely grew at all over those years. Nonresidential investment grew faster in other G-7 countries than in the United States and grew even faster in a broader set of advanced economies.

Figure 1-2
U.S. Investment Growth Lagged Other Major Economies, 2000–2005



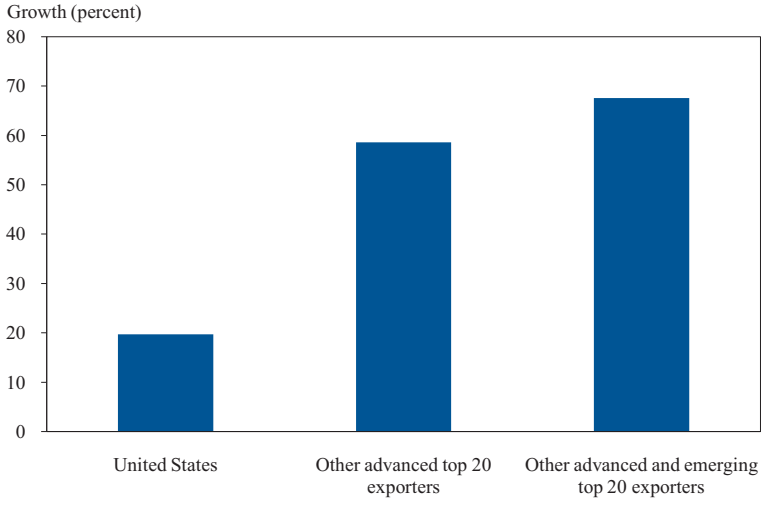
Note: Cumulative growth in real gross private nonresidential fixed capital formation, 2000–2005.
Sources: OECD Economic Outlook no. 88, Annex Table 6; CEA calculations.

Figure 1-3 shows the cumulative growth of exports from the United States during 2000–2005, compared with export growth in other high-income economies and other major exporters. Clearly, U.S. export growth in the early 2000s was weak relative to export growth in other major economies.

The Nation can do better, and the Administration has outlined a plan to enable it to do so. It is important to remember that the recent consumption and residential booms were aberrations. The goal now is to return to more sustainable sources of growth, where nonresidential business investment and exports take a more central role. To help business investment reclaim this role as a key driver of growth, the Administration has made extensive

efforts to encourage businesses to invest at home—through tax policy, credit policy, and the public investments that make the United States an attractive place to do business. With the momentum of the recovery building among our trading partners, the Administration also believes that we should turn to greater exports as an important source of growth going forward.

Figure 1-3
U.S. Export Growth Lagged Other Top Exporters, 2000–2005



Notes: Cumulative growth in exports of goods and services, 2000–2005. This analysis of the top 20 exporters excludes Belgium due to lack of data prior to 2002.
Sources: World Bank, World Development Indicators; CEA calculations.

The United States established itself as the premier economic power in the world based on the energy and ingenuity of its people, and the Administration will continue to reinforce this foundation of our growth—educating workers, investing in science, and building the infrastructure that American companies need to succeed. As the President says, with the policies in place to support innovation and sustained economic growth, the United States will "win the future."

This *Economic Report* follows these themes in greater detail and also examines other key aspects of the economy, as described below.

The Year in Review and the Years Ahead

Coming out of the deepest recession since the 1930s, the economy completed its sixth consecutive quarter of recovery by the end of 2010, as described in Chapter 2. Real GDP grew 2.8 percent during the four quarters of 2010, up from 0.2 percent a year earlier. During 2010, stress in financial

markets eased, the stock market gained 13 percent, and the economy added 1.1 million private sector jobs.

Recent growth in consumer spending reflects improvements in sentiment, in the stock market, and in banks' willingness to lend to consumers, thus easing many of the adverse shocks received during the recession. The increase in consumer spending has been achieved without a significant decline in the personal saving rate.

Housing prices have stabilized, but construction activity and most aspects of the housing market remain weak, about one-quarter of mortgages are under water, and the foreclosure rate remains high.

Equipment and software investment grew rapidly during 2010, but investment in business structures did not. Cash flow is strong. The inventory investment contribution to real GDP growth has moderated. Export growth has been strong.

Government policy has supported the recovery during 2009 and 2010, and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act, the compromise tax framework signed into law by the President on December 17, 2010, will help the economy in 2011. The position of state and local governments, however, remains difficult. At the same time, long-run fiscal responsibility is crucial, and the Administration has taken a number of steps to reduce deficits in coming years.

Private sector employment grew in each of the final 10 months of 2010, and the unemployment rate fell during 2010. The Recovery Act, the Hiring Incentives to Restore Employment Act, and the Education Jobs and Medicaid Assistance Act all helped to increase employment.

The Administration's economic forecast reflects the view that the U.S. economy is operating substantially below its potential level, as indicated by the elevated unemployment rate. Although the Administration estimates that the potential growth rate of real GDP is 2.5 percent, it believes that real GDP can grow faster over the next six years as the gap between actual and potential GDP declines. Reflecting this above-trend growth, the Administration projects that the unemployment rate will continue to fall over time.

The Foundations of Growth

As the United States begins to shift from crisis to recovery and growth, the Nation needs to make critical investments in innovation, infrastructure, and skills. Chapter 3 details Administration policies in these areas that are designed to deliver rapid, sustained, and broad-based economic growth and quality jobs in the years ahead.

The historical rise in American standards of living, in broad measures of income per person, in health and longevity, and in the variety of goods and services that Americans consume, demonstrates the power of long-run trends over short-run economic cycles in determining Americans' economic prosperity. Physical capital (investment), human capital (skills), and innovation are the primary sources of economic growth but have been neglected for years. To foster innovation, the Administration is proposing critical investments in basic research, intellectual property rights, antitrust enforcement, research tax credits, entrepreneurship, and national priority areas, such as biotechnology and nanotechnology, health information technology, and clean energy. These investments work to ensure that the private sector, the Nation's engine of innovation, is not saddled by market failures but can forcefully and efficiently drive America's economic growth. Chapter 3 also discusses the role of infrastructure—including 21st-century transportation, electricity, and information networks—as a critical platform for growth.

Emphasizing the core importance of skills to U.S. economic growth and to the quality jobs of today and tomorrow, Administration policy focuses on enhancing early childhood education, elementary and secondary schooling, higher education, and job training. These efforts not only help U.S. citizens live up to their potential and compete in a global economy, but also work to reverse the Nation's rising wage inequality and declining rates of educational attainment relative to other countries.

The World Economy

The world economy saw sustained progress toward economic recovery in 2010, but growth during the recovery has been unevenly distributed between advanced and emerging economies.

As part of a broader shift toward growth in the United States that relies more on exports and investment, the President has set a goal of doubling nominal U.S. goods and services exports in five years: from $1.57 trillion in 2009 to $3.14 trillion a year by the end of 2014. Through the first three quarters of 2010, exports increased by 17 percent relative to the same period in 2009, representing a significant step toward that goal. A sizable portion of that growth came from increasing exports to emerging markets. Chapter 4 details the ways in which a changing world economy will affect this goal, as well as the U.S. role in the world economy.

The President's National Export Initiative has identified several areas in which U.S. trade policy can complement the forces already at work in the evolving global economy to help achieve this export goal. The Administration is committed to a trade policy that opens new markets for U.S. exporters by reducing foreign government–imposed tariffs and nontariff barriers. The

Administration is also actively enforcing commitments taken on by its trading partners and assisting U.S. exporters with gaining access to trade credit and streamlining the exporting process.

Health Reform

A signature effort of the Administration has been to ensure the security and affordability of health insurance coverage while extending coverage to millions of uninsured Americans. The Affordable Care Act, which President Obama signed into law in March 2010, is the latest chapter in nearly a century-long history of efforts to ensure comprehensive health insurance coverage for more Americans, coupled with major steps in the quest for high value in health spending. For decades, the policy problem posed by tens of millions of uninsured Americans has overshadowed the underlying economic challenge of how to control costs while preserving the high quality of the American medical care system. In addition to implementing policies to cover the uninsured, the Affordable Care Act introduces a framework for moving the medical care system toward high-value care.

Chapter 5 describes how the Affordable Care Act controls costs and improves quality by strengthening physician and hospital incentives to improve the quality of care and provide care more efficiently. These delivery system reforms are paired with reforms that create new coverage options through competitive state marketplaces for insurance, ensure access to affordable coverage through the provision of tax credits for small businesses and individuals, and put in place individual and employer responsibility requirements. Over the next decade, these reforms are expected to expand coverage to 32 million Americans, make health care more affordable, and improve the quality of care. The Affordable Care Act is also fiscally responsible. The Congressional Budget Office has estimated that the law will reduce projected deficits by $230 billion during 2012–21 and by more than $1 trillion in the subsequent decade.

Energy Policy

Energy plays a critical role in the economy, and Chapter 6 outlines key steps the Administration is taking to transition the Nation toward cleaner sources of energy that have the potential to support new industries, exports, and high-quality jobs; to improve air quality and reduce the dangers of climate change; and to enhance America's energy security and international competitiveness.

As an initial step, the Recovery Act directed over $90 billion in public investment and tax incentives to increasing renewable energy sources such as wind and solar power, weatherizing homes, and boosting R&D for new

technologies. Looking forward, the President has proposed a Federal Clean Energy Standard to double the share of electricity produced by clean sources to 80 percent by 2035, a substantial commitment to cleaner transportation infrastructure, and has increased investments in energy efficiency and clean energy R&D.

These programs are interconnected in important ways. They are all motivated by the fact that the national benefits from clean energy go beyond its immediate producers or consumers. The programs focus on different parts of the clean energy supply chain—innovation, manufacturing, generation, and use—and thus complement one another. And in the end, the Administration's clean energy programs are linked by the goal that in coming years Americans will breathe cleaner air, enjoy better health, face reduced risks from climate change, and work and do business in an economy based on a safer and more secure energy supply.

Supporting America's Small Businesses

America's small businesses are an essential building block to economic growth and prosperity, in part because entrepreneurs create a disproportionate share of net new jobs in the U.S. economy. Chapter 7 examines the heavy toll the recession took on small businesses, dramatically reducing the availability of credit and capital needed to add capacity, hire more workers, and develop new products. In response to these challenges, the Administration has taken several important steps, most notably through the Recovery Act, the Small Business Jobs Act, and the Startup America initiative, to increase the flow of credit and capital to small business.

The Administration has enacted 17 tax cuts for small businesses to support America's entrepreneurs. It has also enacted policies to make health insurance more affordable for small businesses and entrepreneurs and to facilitate small business exports to new markets overseas. Taken together, these efforts have improved the outlook for American small business and created a stronger environment for entrepreneurship.

Conclusion

The past year has seen crucial improvement in the American economy. Although the recession generated devastating job losses and an output decline of historic proportions, the economy is no longer on the brink of a depression. Growth has resumed, jobs are returning, and unemployment is falling. Now is the time to chart the course for an economy that will provide jobs, new and revitalized industries, and rising living standards for Americans. This *Report* lays out the central elements of the path forward.