

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
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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

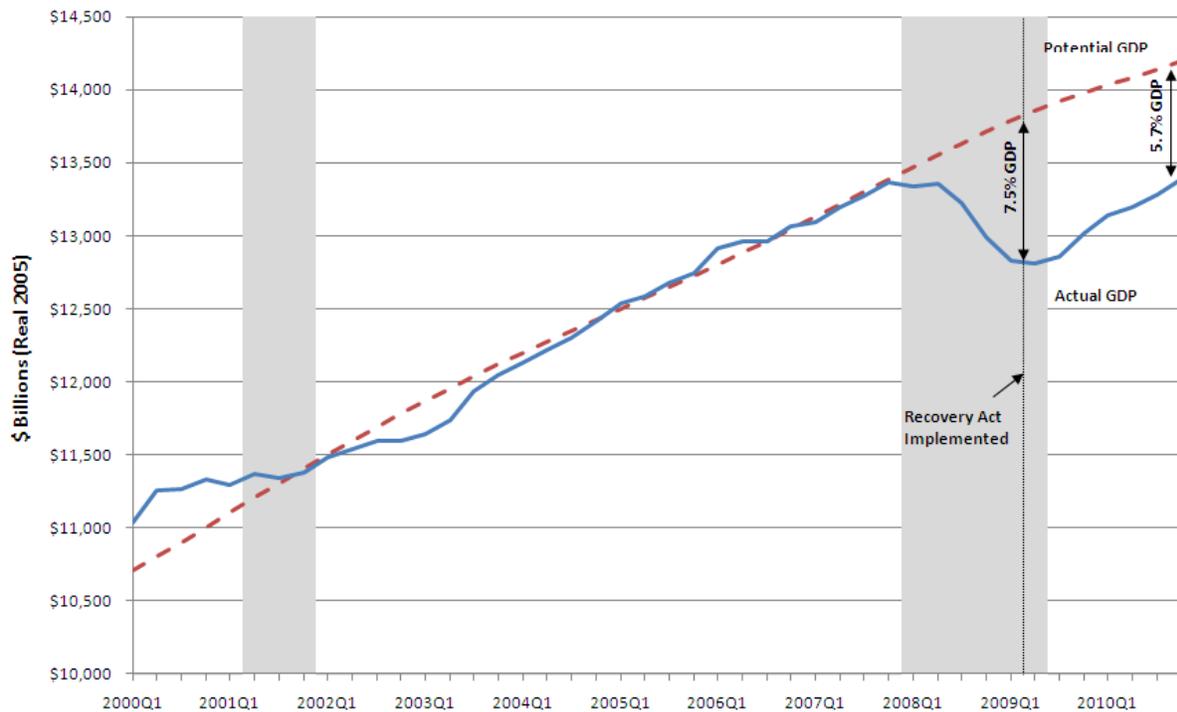
The unemployment problem continues to be caused by too little aggregate demand. **If we want to help the unemployed, we need to address the output gap—the gap between what our economy is producing and what it could be producing at full employment.**

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

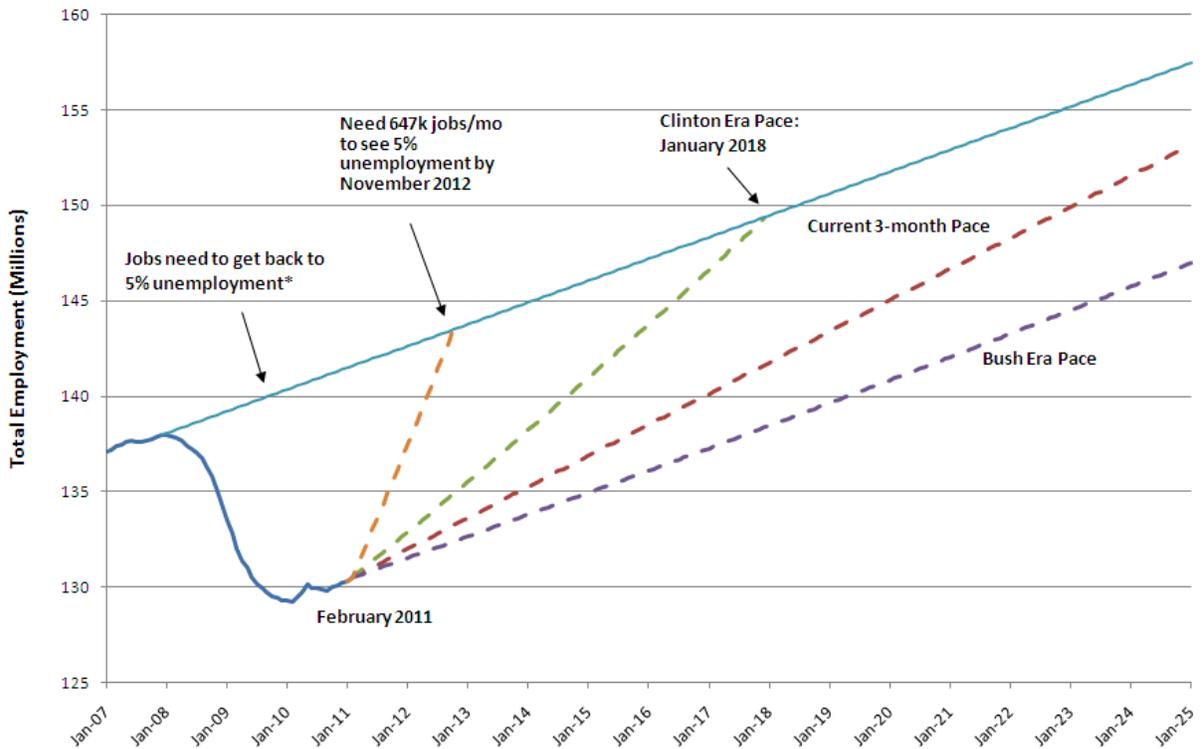
We can see the lack of urgency to hire across the private sector due to lack of demand in a wide array of data. The National Federation of Independent Businesses, for example, continues to report that its members—most of whom have fewer than 40 employees—see a lack of sales as the key factor that they 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.

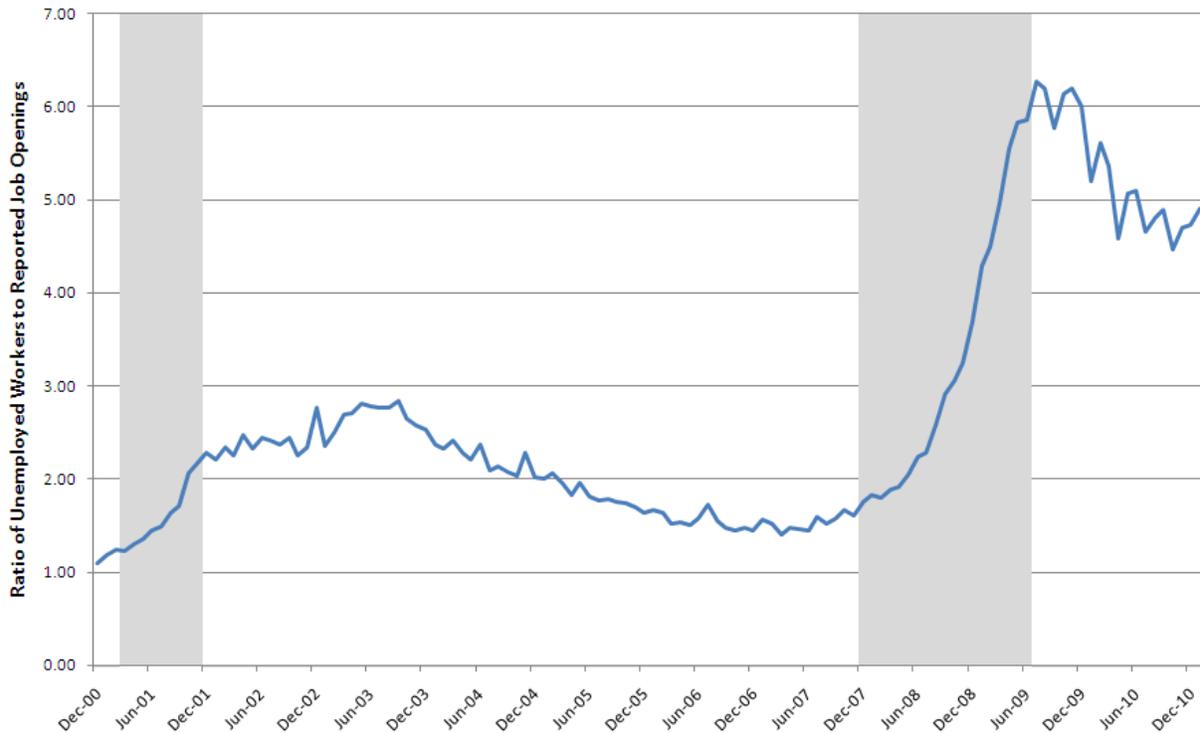
Figure 2. Employment Projections Under Four Growth Scenarios



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

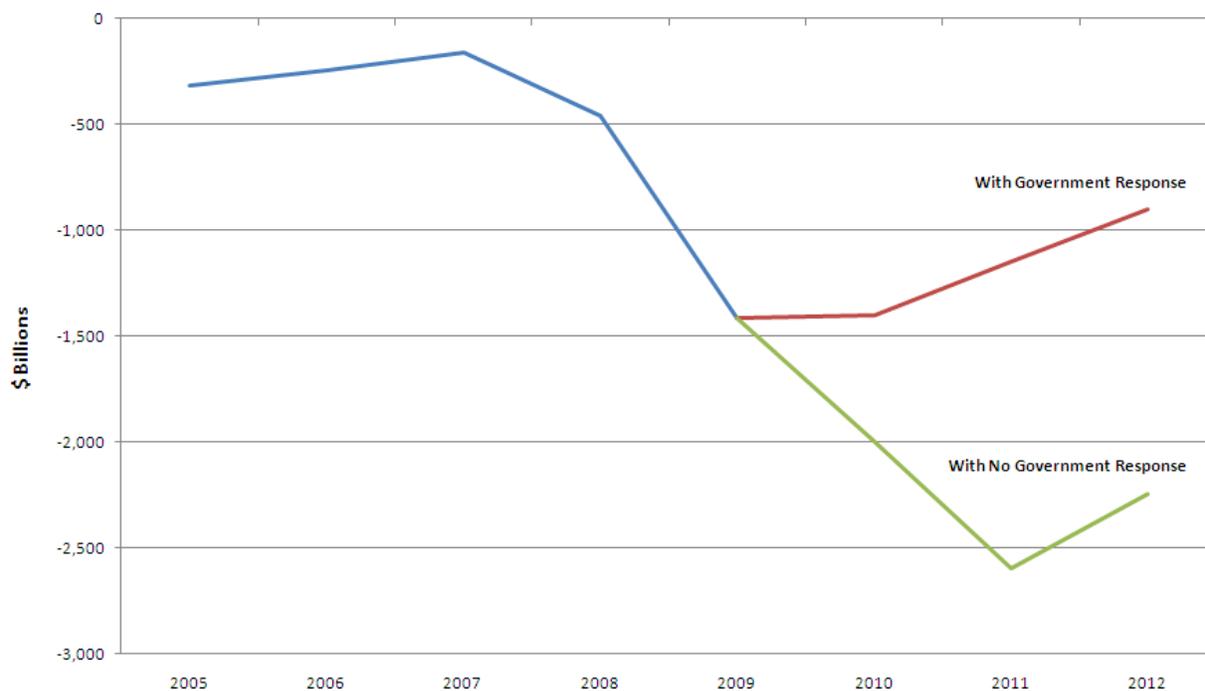
Today, to boost growth, the Federal Reserve has pursued quantitative easing, using the proceeds from the central bank's mortgage bond portfolio to buy long-term government debt. That is, they are using unorthodox methods of pumping money into an economy and working to lower interest rates that central 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 reciprocity across states on the economic stabilizing effect of unemployment benefits. He compares the effect on stability of the 10 states with the highest reciprocity 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 reciprocity rates were 50 percent more effective than low reciprocity 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.

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- 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.
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- 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.
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- 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>.