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THE ECONOMIC OUTLOOK

HEARING

BEFORE THE

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CONGRESS OF THE UNITED STATES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

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JOINT ECONOMIC COMMITTEE

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WEDNESDAY, NOVEMBER 13, 2013

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

The committee met, pursuant to call, at 2:36 p.m. in Room 216 of the Hart Senate Office Building, Hon. Kevin Brady, Chairman, presiding.

Representatives present: Brady of Texas, Paulsen, Hanna, Carolyn B. Maloney, and Delaney.

Senators present: Klobuchar, Murphy, Coats, and Lee.

Staff present: Corey Astill, Hank Butler, Conor Carroll, Gail Cohen, Barry Dexter, Al Feizenberg, Niles Godes, Colleen Healy, Christina King, J.D. Mateus, Patrick Miller, Robert O'Quinn, Jeff Schlagenhauf, Andrew Silvia, and Sue Sweet.

OPENING STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Chairman Brady. Chairman Furman, welcome. Both Vice Chair Klobuchar and I appreciate your willingness to reschedule this hearing, and I am hopeful that you will resume the long-standing practice of the Chairman of the Council of Economic Advisers testifying before the JEC about the Economic Report of the President immediately after its release. Welcome today.

We are all pulling for a strong recovery. Too many Americans of all ages and all races have simply given up hope of finding a full-time job.

Now four full years after the recession ended, while some parts of the Nation are making progress, the current recovery remains the weakest among all post-1960 recoveries in every major measure of economic performance, generating a troubling and we think dangerous "Growth Gap."

While real GDP has grown by 10 percent since the recession ended, that is just barely above one-half of the growth in average recoveries over the same period, producing a growth gap of $1.3 trillion in the economy.

For families the growth gap hits home. Real disposable income per capita has increased by a mere 3.7 percent. That is less than one-third of the 11.7 percent average. This means a family of 4 has $11,420 less in real after-tax income to spend that they would have had if this recovery had merely been average.

And the current recovery has produced 4.4 million fewer private payroll jobs since the cyclical low than an average recovery.

An important gauge of America's jobs picture is the employment-to-population ratio that measures the proportion of the country's population age 16 or over that is employed.

By now it would have risen by 1½ percentage points in an average recovery, more than double that in a Reagan recovery. But today the America's employment-to-population ratio has actually declined by 1.1 percentage points. And to put the stalled labor market into perspective, in October of 2013 the employment-to-population ratio was only 6/100ths of a percentage point higher than the lowest reading during the President's Administration.

In October, the labor force participation rate fell, as you know, to 62.8 percent, a low not seen since the Carter Administration.

And as many unemployed Americans are learning the hard way, the decline in the official unemployment rate to 7.3 percent is largely illusory because so many Americans have simply given up looking for work.

If the labor force participation rate had not declined since the President took office, the unemployment rate would be a whopping 11.3 percent today.

As President John Adams observed, "Facts are stubborn things." And facts prove that this is the weakest recovery since 1960—indeed, since World War II.

On July 24th, President Obama described "a growing middle class" as "the engine of our prosperity." And he was exactly right.

In this recovery, however, middle-class Americans continue to suffer while Wall Street has roared. Since the recession ended, the S&P 500 Total Return Index is up by more than 86 percent, while real disposable income per capita is up a mere 3.7 percent.

To make matters worse, as of this past July 15.7 million more Americans were receiving food stamps, while only 2.1 million more Americans were employed. Adding eight Americans to food stamps for every one finding work is not growing the middle class. In fact, the recovery might better be described as the real war on the middle class.

Today we want to discuss the Economic Report of the President, the roadblocks to job creation and economic growth, and search for bi-partisan solutions to restore prosperity to the suffering middle class.

Clearly Main Street is being harmed by the President's higher taxes, mountains of new red tape on local businesses, and the disastrous roll-out of the ill-named "Affordable Care Act" that is cutting workers' hours, raising their health care costs, preventing small businesses from hiring, and cancelling health insurance for millions of Americans.

Both parties agree that Americans deserve better.

Chairman Furman, we look forward to your testimony.

With that, I recognize Vice Chair Klobuchar.

[The prepared statement of Chairman Brady appears in the Submissions for the Record on page 22.]

OPENING STATEMENT OF HON. AMY KLOBUCHAR, VICE CHAIR, A U.S. SENATOR FROM MINNESOTA

Vice Chair Klobuchar. Well thank you very much, Mr. Chairman. Thank you, Dr. Furman, for being here.

The last time a Council for Economic Adviser Chairman testified before this Committee was in October of 2009. So we thank you for coming close in to the time that you were appointed.

I note that that month the economy shed more than 200,000 private-sector jobs as it struggled to regain its footing—the exact opposite of what we just saw with the job gains from the past month of October. And in fact we have now seen an average of 200,000 jobs for each month in the last three months.

I think we all know that we have come a long way, as this chart shows, since the beginning of the downturn. Four years later, we are still adding jobs. Not as many as we would like, as the Chairman pointed out, but we have still seen 44 straight months of private-sector job growth: 1.9 million private-sector jobs just this year.

In this time, 7.8 million private-sector jobs have been created overall, including more than 2.4 million in the past 12 months.

Last month, the unemployment rate was 7.3 percent. In my State, as I have noted here before, the unemployment rate is down to 5.1 percent. So let's look at another measure of the economic progress: the number of unemployed workers per job opening.

In 2009 there were nearly 7 unemployed workers for every job opening. There are now about 3 unemployed workers for each opening, almost back to the pre-Recession ratio of 2 unemployed workers for every job opening.

In addition, while economic growth has been slower than we would like, the overall economy has grown for 10 consecutive quarters, growing at an average annual rate of 2.4 percent.

We are also seeing promising signs of growth in critical sectors like the housing market. Single-family home prices are up more than 10 percent from a year ago. Housing starts are up across the country by 19 percent from August 2012 to August 2013.

These are positive signs, but it is clear there is much more to be done. We need to focus on policies—what we often have done in this Committee on a bipartisan basis—policies that spark job creation in the short term, while laying the groundwork for prosperity in the long term.

The first thing we need to do is to stop subjecting the economy to self-inflicted wounds like we experienced last month with the government shutdown and brinkmanship over paying our bills. That crisis was unnecessary.

A 16-day government shutdown negatively affected millions of people's daily lives, stunned countries around the globe, and caused significant harm to our economy. As Dr. Zandi testified, who had testified before our Committee twice this year, noted that it took about, out of the fourth quarter GDP, reduced GDP by .5 percentage points, taking it from 2.5 to 2 percent. He estimated the crisis cost the country $20 billion.

The agreement reached in mid-October reopened the government, allowed us to pay our bills on time, and set up a framework for reaching a long-term deal. I am hopeful that this will happen. As we know, we have until mid-January, and we also have an opportunity as you know, Mr. Chairman, to replace the upcoming sequestration cuts, and I hope some of the other existing sequestration cuts, with some additional revenue or finding other ways to reduce our debt besides that hammer of sequestration.

I have two good ideas right now—the Farm Bill. I felt good about our first Conference Committee meeting. It went well, between the House and the Senate, and that would bring the debt down, at least the Senate side bill, $24 billion.

And of course the Immigration Bill. We have had a hearing on that here. That would bring the debt down $158 billion in 10 years, $700 billion in 20 years.

So those are all positive ideas, as well as the many things we have discussed in this group.

The last thing I wanted to mention was exports. It's been one of the brightest spots in our economy. I truly see this as a way we get out of the downturn that we have experienced. The total value of American exports reached a record $2.2 trillion last year.

Exports are a key driver of job creation, with every billion in exports supporting nearly 5,000 jobs. I am proud to be on the President's Export Council. I think there's a lot of good work being done there, including the Export Control List, which I've advocated for changing so that we make it easier for some of our industries to export items. And we just have to look at seeing ourselves as the competitor in this global economy and looking at how we can compete in today's world.

Because if we have learned anything from the economic turmoil of the last few years, it is that America can no longer afford to be simply a country that churns money. We have to be a country that makes stuff, that thinks, that invents things, and exports to the world.

I look forward to hearing your testimony. Thank you.

Chairman Brady. Thank you, Vice Chair.

Dr. Jason Furman is a distinguished Chairman of the Council of Economic Advisers. Previously he served as Principal Deputy Director of the National Economic Council, and Director of the Hamilton Project at the Brookings Institute.

He is an expert in fiscal policy, tax policy, economics, Social Security, and monetary policy, all key issues for our country.

Dr. Furman earned his Doctorate in Economics and MA in Government from Harvard University, and a MSC in Economics from the London School of Economics.

Chairman, thanks for joining us today, and you are recognized.

STATEMENT OF THE HON. JASON FURMAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, WASHINGTON, DC

Dr. Furman. Well thank you so much, Chairman Brady, Vice Chair Klobuchar, and Members of the Committee.

As you know, the Council of Economic Advisers and the Joint Economic Committee were created by the same Act of Congress and have a common interest in using economic analysis to craft and promote policies to support economic growth.

I am pleased to be before you today and look forward to continuing the strong relationship between the CEA and JEC.

In my statement I would like to highlight some of the main opportunities and challenges the economy faces right now, and then briefly discuss several policies that could capitalize on the opportunities and address the challenges. All of these are discussed in more detail in my prepared remarks.

After going through the worst Recession since the Great Depression, the economy today is strengthening. The private sector has added 7.8 million jobs over 44 consecutive months. The unemployment rate has fallen by about 7/10ths of a percentage point per year. And while it remains unacceptably high at 7.3 percent, it is now back to where it was in December of 2008.

Mr. Chairman, in the question and answer we may be able to discuss some of the points you raised about the participation rate and the employment population ratio, and come back to those important issues.

The economy has expanded for 16 out of the last 17 quarters. America has a strong auto industry. Our banks are increasingly well capitalized. Our housing prices are rising, and construction is recovering.

With this context, there are five areas of opportunity that I would like to highlight, including two cyclical factors that could contribute to the recovery, and three structural factors that will help improve the economy's long-run growth potential as well.

First, the most immediate macro economic opportunity is the potential for continued increases in residential investment, consumer durables, and consumer spending more generally.

Residential investment has helped drive the recovery over the last two-and-a-half years, growing at a 12 percent annual rate. The over-building of new homes during the bubble has now been offset by several years of depressed construction. And if you look at housing construction, it remains below the steady-state level that we would expect from household formation, indicating further potential in that sector.

There is similar pent-up demand in the automobile sector, as well.

The second cyclical factor is that the economy is headed towards a less contractionary fiscal stance, although the precise magnitude will depend on policy choices.

The budget deficit has fallen rapidly from 9.8 percent of GDP in Fiscal Year 2009 to 4.1 percent of GDP in Fiscal Year 2013.

Remarkably, nearly half of that deficit reduction, 2.7 percent of GDP, was in this last fiscal year alone. Although deficit reduction is an important long-term policy goal, the rapid fiscal consolidation over the past year has created challenges for growth.

The good news is that the economy has already gone through the most severe fiscal headwinds, and further deficit reduction will be at a more gradual pace—although the exact pace does depend on policy.

Third, and shifting towards more structural items, the marked slowdown in the growth of health care costs presents a long-run opportunity for job and wage growth. According to the Center for Medicare and Medicaid Services, inflation-adjusted health spending grew at a 2 percent annual rate over the 3 years since 2010, the lowest rate recorded since we began tracking these data in the 1960s. Lower health spending helps with wages and jobs.

Fourth, the dramatic increase in domestic energy production is another opportunity for the U.S. economy. Crude oil production has growth each year the President has been in office, reaching its highest level in 17 years in 2012. We have seen stronger fuel efficiency, and as a result of all of these advances we learned just today that our domestic production of crude oil exceeded our net imports of oil in October.

More broadly, the President remains firmly committed to an all-of-the-above energy strategy, including progress on renewable energy as well.

Finally, the last favorable trend we have is that technology provides significant opportunities for long-term growth, especially in areas that benefit from the combination of mobile computing and increasingly fast wired and wireless internet connections.

Over the last four years, the United States' investment in these networks has growth 40 percent, markedly faster than in Europe and Asia, and these investments are key to a vibrant ecosystem throughout our economy.

We have several outstanding challenges that I wanted to briefly list, as well, Mr. Chairman and Madam Vice Chair.

The first is that we are still struggling with the legacy of a severe recession. And most notably, the significant elevation of the unemployment rate. That current elevation is primarily due to the large number of long-term unemployed workers.

The second, and less widely appreciated challenge, is that the Recession appears to have exacerbated a longer term trend of reduced job-to-job mobility for the labor force. While many focus primarily on net job growth, the flow of workers across firms matters a lot to the economy as well, providing workers with matches to the jobs in which they are most productive and can be paid the most. As a result, reduced mobility is an important challenge.

Third, and finally, a long-standing and deeply embedded trend is the rise in inequality. It began in the late 1970s, and one of the starkest data points in that regard is that last year 19.3 percent of the total income went to the top 1 percent, the largest share since 1928.

Finally, turning very briefly to the policy agenda, the most immediate priority is to do no harm by avoiding repeated fiscal wrangling, allowing our economy to capitalize on all of the opportunities that I sketched earlier.

There are also substantial opportunities to make more rapid progress in addressing the challenges identified through an affirmative agenda to create jobs, increase growth, and raise wages.

One area we can make progress in is on budget policy. The President's budget includes significantly more medium- and long-term deficit reduction than the sequester. As a result, the Congressional Budget Office estimates that the deficit falls to 2.1 percent of GDP in 2023. And that is consistent with debt falling as a share of the economy.

Moreover, the President's proposal shifts the composition of spending towards investments in jobs, infrastructure, education, and research, while taking steps to strengthen Medicare, continue to slow the growth of health care, and reduce inefficient tax expenditures and reform our business tax code to make it more competitive.

Getting beyond these immediate fiscal challenges would allow the U.S. economy to continue to mend and strengthen, but there are opportunities to do more, and the President has sketched many of these out in the context of his better bargain for the middle class, which addresses jobs, housing, retirement, health care, and ladders of opportunity.

Finally, the President has identified immigration reform and the farm bill, both of which were mentioned by the Vice Chair here today, as two economically important priorities that he would like to work with Congress to get done.

That concludes my comments, and I would be happy to take any questions you have.

[The prepared statement of Hon. Jason Furman appears in the Submissions for the Record on page 26.]

Chairman Brady. Mr. Chairman, thank you for being here. You cited some positive economic statistics in your testimony, which we appreciate very much.

I agree with your assessment of energy and technology and tax reform as potential upsides in growing this economy, but I think everyone has to agree this is four years after the Recession officially ended that this is a disappointing recovery. A lot of Americans have given up hope. A lot of college graduates have no jobs or are working behind cash registers. A number of people have just dropped out completely.

So my question is: Do you—with this economy disappointing this far into the recovery, do you anticipate the President making a change in the direction of his economic policies? Or will he continue to stay the course?

Dr. Furman. Well, Mr. Chairman, I am not sure that I fully accept the premise of your question. I went through some of the statistics in terms of the strength of the recovery.

I would, in benchmarking that success and strength, look at some comparisons. For example, we have growth more strongly than many countries around the world, including in Europe. Financial crises pose a very significant challenge and tend to have longer lasting effects on the economy.

And there has been a several-decades-long slowdown in things like the growth force of the labor force, as the Baby Boomers retire, and that also has an impact on the total growth. And when you take all of those factors together, I think we are making progress. We are making progress at a faster pace than you often have in the face of such a massive financial crisis. But I absolutely agree with you, Mr. Chairman, that we cannot be fully satisfied with where we are and we want to continue to make that progress.

To that end, the President would like to go to the next stage of what we do. So I don't know that I would describe it as the same or different, but a continuation. So we had temporary business tax cuts during the initial recovery phase. Now we are more focused on ongoing permanent business tax reform.

We had temporary investments in infrastructure in the beginning. Now we are more focused on the sustained six-year reauthorization of the Highway Bill. And so many of those are, as the economy recovers, the direction we would like to see our policy going.

Chairman Brady. Do you see—our businesses have cited repeatedly the uncertainty over higher taxes, the regulatory onslaught, the Affordable Care Act, as significant drags on the economy? Do you view the current rate of red tape on local businesses as a drag on the economy?

Dr. Furman. Mr. Chairman, the President has worked very hard and issued an Executive Order that you have to take cost/benefit into account in designing regulations. You have to do them flexibly. You have to do them in the lowest cost manner possible. And I think it has been very successful in regulations whose benefits exceed their costs. But we have to constantly look to see how we can do better.

Chairman Brady. In 2012 the Federal Government issued more than 2,300 federal regulations. Only 14 underwent a full cost/benefit analysis. To me, that doesn't seem to be a reasonable approach of laying what may be commendable goals with the impact on local businesses.

Let me ask you this: The Affordable Care Act is forcing businesses to cut hours. I visited a steel company in the Houston region last week that is doing everything to keep its workers at 49 workers, and manage to renew their health care plan to avoid a 47 percent increase.

Do you believe the Affordable Care Act is acting as a drag on our local economies?

Dr. Furman. No, Mr. Chairman, I do not. I think the Affordable Care Act includes several important things that actually help our economy. One of them I briefly mentioned in my prepared remarks, which is the large slowdown in the growth of health costs.

Premiums are rising at 8 percent a year—going up until 2010. After 2010, they have grown at 6 percent a year. There are many factors that have contributed to that slowdown, but I have no doubt that the Affordable Care Act is one of them, and that that is good for businesses.

Chairman Brady. As you know, there is a great deal of dispute about what has temporarily slowed medical price increases, but I know of almost no local business in my district that has only seen a 6 percent increase in their insurance premiums. Just the opposite.

They are stunned by the increased costs. Now they are seeing workers who, frankly, are having their hours cut. So I think there is a significant drag.

Let me ask you this. With Wall Street roaring as a result of the President's policies, middle-class America struggling in a significant way, what specifically is the President going to do differently in economic leadership to bridge the inequality between the middle class and Wall Street?

Dr. Furman. Mr. Chairman, there is a long agenda designed to get at that question.

I think first and foremost it has to be to continue to create jobs, and to create jobs at a faster rate, and that is everything from investments in infrastructure to reforming our business tax code.

We have to address many of the particular issues that face middle-class families, helping them to own a home. Some of the credit standards have gotten increasingly tight. We can do something about that.

Some of the challenges for retirement. Many families are having a hard time saving for retirement. Helping more of them have accounts.

Bringing down and slowing the growth rate of the cost of health care I think is an important part of that agenda for the middle class as well.

Chairman Brady. May I ask, before I turn to Vice Chair Klobuchar, will the White House, having stated its support for corporate tax reform, will the White House be bringing a proposal forward? And will it be encouraging Senate Democrats to pass a tax reform bill this next year?

Dr. Furman. Mr. Chairman, as you know, the President put forward a framework for business tax reform, and it described it at a certain level of specificity in terms of, for example, naming a rate of 28 percent; describing how it is you would pay for that rate. But chose not to put out a fully detailed proposal in order to both solicit more ideas, but also be able to more effectively work with Congress, which actually drafts the laws.

This is a big goal for the President. It is something he tasked his economic team with as early as 2010. We're always trying to figure out what's the best way to push it forward. And so we would welcome any advice and opinion on that. And we have certainly encouraged Democrats and Republicans to do that, but also to embed it in a broader grand bargain for jobs that includes not just business tax reform but the other things we need for our competitiveness like investments in infrastructure, training, and strengthening manufacturing.

Chairman Brady. Thank you, Mr. Chairman. Vice Chair Klobuchar.

Vice Chair Klobuchar. Thank you very much, Mr. Chairman. Thank you for your testimony, Dr. Furman.

We talked about some of the stability improvements in the economy and also the employment situation. I cited the figure about how in 2009 there were 7 unemployed workers for every job opening; now there are 3. And we are almost back to the pre-Recession ration of 2 unemployed workers for every opening.

For the record, our State—Representative Paulsen and my State of Minnesota—just hit a 12-year high for job openings. A few questions along those lines.

We had a hearing on long-term unemployment here, and one of the things we have seen—and I know you have seen with the statistics—is that there may be some signs of structural unemployment; that there is evidence that long-term unemployed workers may eventually become difficult to employ; that even though we have seen improvements, there are a number of them that still are not getting jobs, and that there are negative perceptions developed over time.

Could you talk about any specific policies that you think could help for the long-term unemployed?

Dr. Furman. Yes. So the entire—almost the entire increase in unemployment relative to where it was prior to the Recession, is because the long-term unemployment rate is elevated. The short-term has basically returned to about where it was prior to the Recession.

I think to date we have not seen that turning into a serious persistent structural unemployment, but I think we have to be very worried that could happen. We saw in Europe when that happened it led to persistently high unemployment and other adverse impacts for their economy.

The first most important thing about long-term unemployment is the same things you do about regular unemployment, which is increasing aggregate demand and investing in jobs like infrastructure, manufacturing training, business tax reform, all the issues I had been talking about already.

I think there are some issues specific to the long-term unemployed that you want to look at as well: ways of encouraging people to move more quickly into jobs; training, matching them to jobs. And the President has a Pathways To Work Fund that he has proposed, which is designed to help states experiment with different approaches to those goals.

Vice Chair Klobuchar. Right. And in fact Minnesota has a good pilot going with some of our businesses, a community college in the northern suburbs, and then our high schools. We have one high school where the kids can literally get an advanced degree right in high school. And looking at that model more, when we've got 60 percent of our manufacturers who say they literally can't find someone to fill a job.

And so we are doing a major report on manufacturing that is coming out soon—I don't know what's wrong with this microphone; I can use yours, just kidding. I think it's better. So we have a major report coming out on manufacturing, showing that for the first time in really the history of our Nation the number of people who are filling manufacturing jobs with advanced degrees, even if it's a one- or two-year post-secondary degree, has exceeded people that don't have those degrees.

So I think we are seeing a major change there, and I would agree with you on the work skills' training.

Could we talk about, you know we have these budget negotiations going on right now, and how damaging from your seat as Chair of the Economic Council, do you see another episode of brinkmanship, or if we get close to a shutdown, or experience a shutdown?

Dr. Furman. I think there is no doubt that the shutdown and the brinkmanship over the debt limit hurt the economy. When it comes to economic growth, there is a variety of estimates.

We had estimated 0.25 percentage points off the fourth quarter growth rate. That was more conservative than what Macro Advisers, Goldman Sachs, Standard & Poor's, others, estimated who thought the effect might be as large as 0.6 percentage points off the fourth quarter growth rate.

I think you also observe it in the data. If you look especially at daily and weekly data in the first half of October, you saw two different measures that showed slowing chain store sales. Two different measures showed plummeting consumer confidence. Two different measures, unemployment insurance and a survey, showed weakening job market prospects. And you also saw weaknesses in housing.

So you saw a concentrated worsening of the economy in the first half of October.

Vice Chair Klobuchar. I thought I saw your energy statistics that just came out today, that our oil produced domestically has now exceeded what we're bringing in from other countries? Is that——

Dr. Furman. Yes, for the first time in a long time.

Vice Chair Klobuchar. Very good. And that does not even include the natural gas and some of the other things?

Dr. Furman. Correct. That is just oil.

Vice Chair Klobuchar. Okay. Because that is what I have seen, too, as being a major—having a major role in our increase in manufacturing, is the fact that it is easier to transport things and cheaper to do it than it was before. So that is a good thing.

The last thing I was going to ask about is, just as we look at the potential for some kind of a long-term budget and tax reform that could actually fund some major areas that you identified with education, and infrastructure, and some of these other things, have you looked at this idea—Congressman Delaney has been working on this; we have a bill coming out of the Senate, a bi-partisan bill this week—about an Infrastructure Financing Authority? Or as it's known, an Infrastructure Bank?

Dr. Furman. I haven't looked at your particular bill, but I've looked at other——

Vice Chair Klobuchar. This is the one with Senator Warner.

Dr. Furman. Okay, so if it's the bill I'm thinking of, that is very similar to the approach that the President has suggested in the past. And I think it is important in the time of limited budget resources that we are able to leverage our budget dollars as far as we can, and also to direct them as effectively as we can.

It is not just more money; it is smarter money, and leveraging our money. And as I understand it, that would be the goal of your proposal, and certainly something I think is important.

Vice Chair Klobuchar. And you and I, in this context of corporate tax reform, discussed, a few months back, repatriation and how that could play a role, and whether it is tied in with an infrastructure financing authority or not. Do you want to talk about that?

Dr. Furman. Sure. I think as a one-time stand-alone matter, a repatriation holiday I don't think would be very effective in creating jobs, and I think would cost significant money.

I think it is different when you are talking about ongoing reform of the tax code. And if you are transitioning to a new tax system, then you might actually get some money as part of that transition process that you could then take back and put back into infrastructure.

But it is important in transitioning to a new system that it is both improving the competitiveness of our companies, but also taking base erosion very seriously and doing that on a permanent basis rather than on a one-time basis.

Vice Chair Klobuchar. Good. And one last question. Immigration reform? How do you see that? We had Grover Norquist here testifying about the deficit reduction it would bring. I'm sure that is a major factor. But do you see it as contributing to our economy if we get the reform done?

Dr. Furman. Yes. I think this is an issue where there is widespread agreement among economists, and the Congressional Budget Office embodied that agreement when it said that GDP would be $1.4 trillion higher in 2033 because of immigration reform.

What I thought was so exciting about that estimate is that's not just a larger population of workers—although that is important and good—it's that we would actually have more what economists call "total factor productivity growth," more innovation, more ideas. Because immigrants have always been a really important source of that in America.

We have even more of that with immigration reform. And so we would have more output as a result.

Vice Chair Klobuchar. Thank you.

Chairman Brady. Thank you. Chairman Paulsen is recognized.

Representative Paulsen. Thank you, Mr. Chairman. Dr. Furman, thanks for being here to testify.

This Committee has actually spent a lot of substantive time discussing and going over some ideas regarding the growth gap and how America has been lagging a little bit in terms of what an average recovery would be like.

As your testimony pointed out, the fundamentals are there, kind of on the right track in many respects, but there are a lot of folks that we talked to, a lot of Minnesota companies. Our unemployment situation is better than in the rest of the country, but for many of them it doesn't feel like a recovery.

You know, for the average folks they think it should be much better. There is a lot more potential, I guess is what I am trying to say.

Vice Chairman Klobuchar had mentioned earlier that we are doing better in Minnesota. I will tell you that I have met with small, medium, and large companies from LubeTech in Plymouth to Carlson Companies in Minnetonka, there is one theme that has arisen, and it is around the uncertainty of the tax code.

Typically Congress does six-month extensions, retroactive provisions, and there's no doubt that a lot of Minnesota employers would like a tax code that is stable, that is predictable, and that is conductive to growth. And I agree.

And in that light, let me just ask you a couple of questions around the impact of our current tax code on economic growth.

Yesterday there was a piece written in The Wall Street Journal entitled "The Biggest Fiscal Losers," and it did note that in the last year the deficit had decreased in large part due to higher revenues from higher tax rates.

However, it also noted that the revenue gains from higher tax rates were offset by the slower growth caused by the higher tax rates. Do you believe that revenues are affected by slower economic growth as a result of higher marginal tax rates?

Dr. Furman. I certainly agree that revenues are affected by growth. I don't agree that the tax changes that we made at the beginning of this year have had an adverse impact on growth. I think they were part of an overall economic plan that gave more certainty about taxes to the middle class, extended their tax cuts, and brought down the deficit over the medium and long run, and I think that is a sound economic strategy.

Representative Paulsen. Now recently the Federal Reserve Bank of San Francisco did a study, and it found that roughly 90 percent of the recent fiscal drag comes from higher taxes, not from the slowed spending due to the sequestration.

Do you believe that worry over the sequestration's effect on the economy was overblown?

Dr. Furman. The Congressional Budget Office estimated that the sequester would cost 750,000 jobs, and would take a 0.6 percentage point off the growth rate. That to me is a reasonable estimate. But I think the important issue is that it is not the magnitude of deficit reduction in the sequester, it is the composition and timing of it.

We would actually like to see more deficit reduction than you saw in the sequester over the medium and long run, and we would like to see it coming more in areas like entitlements and tax expenditure rather than in up-front investments in education and infrastructure.

Representative Paulsen. And let me follow up on that, because I would agree with you, for those who say that a blunt approach to dealing with the budget and sequestration is not the answer, but we have got to address the long term financial pressures that the country faces—namely, those of our entitlement programs, as you mentioned.

If we were to replace sequestration with reforms to some of those entitlement programs, what reforms would you support in order to put our economy and the United States back on a fiscally sustainable path?

Dr. Furman. The President submitted a budget, and the essence of that budget was a balanced set of changes both to entitlements and to revenue in terms of entitlements. It included things like means-testing Medicare, further reducing the cost of prescription drugs, and some other structural reforms to Medicare.

In terms of revenue it included reducing tax benefits for the highest income households, and that was something he saw going together as an effective and balanced package.

Representative Paulsen. In this latest round now of the budget discussions that will be ongoing, will the Administration, or do you feel the President will be pretty aggressive in terms of pushing some of those entitlement reforms that were first a part of his budget? Because there is an opportunity there on a bi-partisan basis.

Dr. Furman. The President will be aggressive in pushing those as part of the balanced approach that includes revenue, as well. And that was his basic principle: that you need a balanced approach that does include both entitlements and the revenue side.

Representative Paulsen. Thank you, Mr. Chairman. I yield back.

Chairman Brady. Thank you. Representative Delaney is recognized.

Representative Delaney. Thank you, Mr. Chairman, and thank you, Dr. Furman, for appearing here today and for your testimony. I think a lot of the data that you presented makes a very compelling case that our response, particularly in certain areas like the financial services industry which was very proactive and very strong and clearly resulted in this industry healing in the United States better than it has around the world; our response to the auto industry, the collapse of the auto industry; our response to the housing industry; has clearly paid good returns for the taxpayers.

But now I think we are confronted with a different set of challenges, which is how do we bring more Americans along into the recovery that we are seeing and will likely continue to see.

It seems to me one of the challenges that we face is that two of the dominant forces in the world the last 20 years—globalization and technology—have benefitted too few Americans. They have benefitted Americans that are highly skilled, have great educations, have access to capital, which is why we see good growth among high-skilled workers. And we are also seeing good growth among low-skilled workers because as we have more income inequality to some extent it creates more opportunity for low-skilled workers, because the service industries grow.

And so it is this middle-skilled worker issue that we have. And you have outlined some very good policies, in my judgment, to address this issue: investments in infrastructure, investments in basic research which has proven to be tremendously rewarding for the health of the economy, skills training, et cetera.

In which of these areas do you believe that there is actually an opportunity for good bi-partisan support? I know in infrastructure I've got a bill in the House that has got 23 Republicans and 23 Democrats on it, that funds infrastructure by tying it to repatriating overseas earnings as an example of good bi-partisan support for an initiative that is clearly very important for creating both short-term and long-term economic growth for the country.

What other areas, or in infrastructure in particular, or in investments in research, or in skills training, do you think we actually have opportunities for bi-partisan support? And what kind of proposals exist? Aside from just saying that we should be doing all these things, which I agree directionally we should be doing all these things, where do you have specific ideas that you think you have support in a bi-partisan basis?

Dr. Furman. Well, Congressman, of the nine people in this room that have microphones I am probably the least expert in that particular question, but let me try to answer it. And I will say a little bit where I think there ought to be.

There are some things like immigration, the farm bill, and the budget where you have seen progress in one or both chambers of legislation moving forward, and those would seem like very good areas to take and build on.

You have areas like infrastructure and the idea of leveraging and better targeting. The Chamber of Commerce and the AFL–CIO came out together to announce plans in that area years ago, Democratic and Republican Governors held hands as they announced plans in those areas.

There are other areas like pre-school. I cannot tell you what the bi-partisan prospects are for that right now, but I can tell you the President's pre-school ideas are motivated in part by the work of Nobel Prize Winner Economist James Heckman, who is a Republican, but has done the numbers and finds that that is among the highest rate of return you have in terms of investments in education.

And finally I would say business tax reform is something where I think there is an increasing amount of convergence and views on the topic.

Representative Delaney. But do you specifically, when you look at the agenda you're advancing, overlay kind of the reality of the political process in terms of thinking about what initiatives should get priorities?

In other words, I think one of the issues we have had in terms of trying to make a difference against this middle-skills job issue, if you will, is that we have not been doing the things we need to do. We have not been investing in infrastructure. We have been cutting back investments in basic research. We have not been doing the skills training we need to do.

So the cost of doing nothing has not been nothing. We have paid a big cost. So when we think about our initiatives, our policy initiatives, are we formulating ideas that we believe will actually have bi-partisan support? Or are we more kind of working on some of these things, you know, without thinking about the political context?

Dr. Furman. Right. I mean, in terms of me personally I tend to give more economic advice. But absolutely we are very focused. The President is very focused on getting things done, and getting things done either on his own administratively and also with Congress, in a lot of the areas I talked about: immigration, farm bill, budget, infrastructure, business tax reform. They are all areas where I think there is a lot of convergence, and it is just a question of going the last part of the way and really getting them done.

Representative Delaney. Great. Thank you.

Chairman Brady. Thank you. Representative Hanna.

Representative Hanna. Thank you, Chairman. Thank you, Doctor, for being here.

You mentioned in your earlier verbal testimony that the Affordable Care Act, which is only now being enacted, had produced cost savings, or cost cuts. Can you explain that, what they might be?

Dr. Furman. Sure. And I said it had contributed to it. I said it was one factor among many.

You have seen things like reduced hospital readmissions, fewer hospital-acquired infections. A large increase in accountable care organizations. All of those were reforms that were made in the Affordable Care Act. You will then have others that will matter in the future, things like delivery system reforms, bundled payments, and even some of the payment changes for providers have in the past we have seen gone through to the private side as well. So I think all of that is contributing.

Representative Hanna. In October the Labor Force Participation Rate was I think 62.8. It has not been that low since 1978. And if we accounted for the actual numbers of people unemployed it would be more like 11.3 percent, not the 7.3 that we see.

Do you think that that's—what could cause a trend like that? What do you see in the future? Do you think that trend is continuing? Maybe you can help me understand what you believe is causing that.

Dr. Furman. I think the number one thing causing it is the retirement of the Baby Boomers. And that wasn't just predictable; it was predicted. In the Economic Report of the President in 2004, written under the Bush Administration, they wrote in that Economic Report that starting after 2008 you would see an accelerating decline in the Participation Rate.

So we always knew——

Representative Hanna. That accounts for 4 million. How do you account for the other 2 million people?

Dr. Furman. You are certainly correct that that I think is the main factor, is that I think that there's also a cyclical reduction in the Participation Rate as well. And whenever the unemployment rate goes up, that tends to lead the Participation Rate to go down. And the Participation Rate tends to lag changes in the unemployment rate somewhat. So you have the structural compounded by the cyclical.

Representative Hanna. You spoke earlier, too, about inequality and the disparagement—the disparaging difference between what we—the poor, and the extremely wealthy that we see. But a lot of what we have lost is really the middle class, which skews that in a way. It's not necessarily relevant how rich people are, or how poor people are; it's the middle class I think that adds to that concern.

It would be my belief—it is my belief that educationally we have not kept up in the fashion that we should. Pre-K I think is a good example of that, and would probably go a long way towards helping that.

Dr. Furman. Yes.

Representative Hanna. But just give a moment to talk about it in any way you would like.

Dr. Furman. I appreciate that chance to expand on what I said. It was a point Congressman Delaney brought up, as well, and I very much agree. How the middle class is doing is the best test of how the economy is doing.

And to some degree what I was saying before was a shorthand for that trend we have seen of increased technology, increased demand for skills on the one hand; deceleration in educational attainment on the other hand; and those two trends combining to hollow out the middle class. So I certainly think an important part of the answer is in education, everything from pre-K as you just cited, through college.

Representative Hanna. Thank you. I'm set. Thank you, very much.

Chairman Brady. Thank you. Former Chair Maloney.

Representative Maloney. Thank you, Mr. Chairman, and Vice Chairwoman, and it is a particular pleasure for me to welcome Chairman Furman as he is from the City that I am privileged to represent. And I can say unequivocally that New Yorkers are very proud of you and the role that you have played not only in this position but in other positions in the Administration to assist President Obama in the economic recovery which has led to 44 straight months of private-sector job growth. The GDP has grown for 10 straight quarters. And housing is rebounding.

And the economic recovery is showing resilience and strength even though businesses and individuals have faced unnecessary uncertainty and harm because of the government shutdown.

And that fight that really hurt consumer confidence, the Reuters is saying that it is at one of the lowest points it has ever been. And I would like you to comment on this self-inflicted damage.

How much do you think it costs our economy?

And what other factors could slow and hold back our recovery? But it was interesting in your testimony that you pointed out that even with these manufactured crises and slowdowns, that our economic recovery was deeper and stronger than Europe. And could you comment on what factors and reasons this is happening?

Dr. Furman. Thank you so much for those questions.

In terms of consumer confidence, I think one of the troubling things is in the most recent consumer confidence data we got for the beginning of November it remained down, and actually fell a little bit further relative to where it was in October.

I personally would have liked to have seen the episode ended and that confidence starting to recover. And it is too soon to say how lasting the consequences of the shutdown and the brinkmanship would be, but clearly it will have some persistent effects. And I think the degree of that persistence will depend a lot on how we handle it the next time. And I think we have a great opportunity, with both parties coming together through regular order, to address it.

In terms of your second question, I think that is really the big-picture story in the economy. The unemployment rate, and I might be wrong in my memory, but I think it is north of 12 percent in the Euro Zone and rising. And here it is obviously 7.3 percent, and has generally been on a trend of declining.

And I think that is because, broadly speaking, we have gotten our economic policies right in this country. We have gotten, broadly speaking, our fiscal policies right, especially in the early days of the recovery.

We have focused on things like exports, that the Vice Chair was talking about. We have had a really vigorous program in terms of financial rescue. We have put effort into housing in terms of bringing foreclosures down, and providing refinancing for families.

So I think it is that broad-based all-fronts approach that has served the U.S. economy well.

Representative Maloney. I would like you to comment on what I am calling the Democratic Stimulus. This is the Credit Card Bill of Rights, the Credit Card Accountability Responsibility Disclosure Act that was the second bill that President Obama signed into law. It was a bill that I offered and worked on for over two years.

And there was a report in The New York Times, front page on the business section, that economists have come out with a report that this bill alone put $21 billion back into consumers' hands, back into the American economy, by cracking down on abuse, unfair, and anti-competitive practices.

So this is a stimulus that can help the overall economy. And my question is: Could you estimate the impact on the economy of the Card Act in terms of economic growth and employment?

Dr. Furman. Right. Well a study, as you just said, from some very good economists found that the Card Act was saving $20.8 billion per year, each and every year. It is important to understand that those savings disproportionately would accrue to middle, and in some cases lower income families who are more likely to spend the money. So there is no question that that would contribute to consumer spending and help the economy recover to its full potential.

I think it is also important to put it in the broader context of deleveraging we have seen for consumers, both credit cards but also as they have gotten mortgage debt and other debt more under control, you see interest payments have fallen from about 13 percent to about 10 percent and now stand around the lowest they have been on record.

So I think all of that puts consumers—the contributions of the Card Act and everything else—consumers in a better position to be investing in homes, to be spending, and to driving the recovery.

Representative Maloney. Well this was an important part of our recovery, and it did not cost any money——

Dr. Furman. That's correct.

Representative Maloney. It was just a reform. Can you think of any other areas that we could have a reform that would have this type of impact in helping the middle class, working men and women, putting more dollars, and rightfully so, back into their pockets? And thank the President for signing that bill into law.

Dr. Furman. I will certainly do that. I don't have anything off the top of my head, but it is certainly win/win when you can find a way to protect consumers, not cost taxpayers any money, and do it in a way that helps the economy. And we should certainly be looking to any opportunity that could accomplish that.

Representative Maloney. Thank you. My time has expired. Thank you.

Chairman Brady. Thank you. Senator Lee.

Senator Lee. Thank you, Mr. Chairman, and thank you, Chairman Furman, for being here with us today.

I know you have weighed in in the past—shifting gears for a moment—on changing the minimum wage, and on the bills addressing the so-called "Living Wage."

It has been suggested by some that we might at some point in the near future see movement of such a bill in the Senate, and so I wanted to talk to you about an article that you wrote in 2006, in June of 2006, in Slate, where you said you would "ignore efficiency and the impact on employment of the minimum wage for purposes of the article's argument."

While noting that at $10 or a $15 an hour minimum wage, ignoring those same factors would be, as you put it, "a terrible assumption."

Can you explain what efficiency and employment factors might exist there? And why it would be, quote/unquote, "a terrible assumption" to think that a $10 or $15 an hour minimum wage might not impact these?

Dr. Furman. Sure, Senator. I'm glad you've gone back and read that more recently than I have. But the issue with the minimum wage is that there have been a range of studies that have found that raising the minimum wage in the range of what we have seen before does not have an adverse effect on employment. And that is because the extra cost to a company is outweighed by the benefits, in terms of reduced turnover, better motivation, attracting workers, and the like.

The levels of the minimum wage one is most comfortable with are ranges that we have seen in the past, in terms of the level and an increase. I think it is important to understand that I was writing in 2006. There has been inflation since 2006.

So whatever numbers I have in that article there, if you are thinking about 2016, which is when many of these bills would be fully affected, you would want to take those numbers and take them up by 20 or 25 percent in order to have an apples-to-apples comparison.

So I certainly was not commenting on a $10 minimum wage in the year 2016. I was commenting on it in the year 2006.

Senator Lee. Sure. No, I understand that. And I also understand we have had relatively low inflation since then. So would it not be fair to say that the corresponding numbers might be, say, $12 to $18?

Dr. Furman. Well the effective date for a lot of the minimum wage proposals are around 2015 or 2016. So there would be a decade since when I wrote. And then I don't know the number off the top of my head. I would have thought it would be about 20 percent inflation over the course of that decade, but I could obviously look that up and get back to you.

Senator Lee. Okay. Thank you.

In your testimony, while writing about lower health care costs, you indicated that in the short run lower pressure on employee compensation would translate to job growth.

So all else being equal, would a higher minimum wage, say a $10 minimum wage, be a policy that would make it more likely to increase employment numbers, to put more Americans back to work?

Dr. Furman. Right. The difference is that there are two sides of the ledger when it comes to the minimum wage. On the one hand, it is an extra cost. But on the one hand it is also an extra benefit in terms of higher productivity, retention, motivation, all of those factors.

And the empirical work finds that those two factors roughly balance out, and as a result there is not a significant adverse effect on employment.

In contrast, paying extra for health insurance is really just a cost to a company and it is not, you know, everything else being equal, of any benefit to the worker so it does not have that corresponding other side.

Senator Lee. Okay. In that same piece that you wrote for Slate, you stated that: While supporting the minimum wage, absent other policy changes, you would prefer other policies because they tend to be more progressive, paid for disproportionately through taxes on the wealthy, on upper income individuals, rather than through higher prices that might be passed along to consumers.

In a piece on the minimum wage for The New York Times this March, former CEA Chair Christina Romer made a similar point, stating that it might be the case that, quote, "businesses pass along some of the cost of a higher minimum wage to consumers through higher prices. Often the customers paying those prices, including some of the diners at McDonald's or the shoppers at Wal-Mart, have very low family incomes. Thus, this price effect may harm the very people whom a minimum wage is supposed to help."

Is it in fact likely in your opinion that consumers would foot the cost of a higher minimum wage?

Dr. Furman. I think it is a relatively small portion of the cost for those businesses. I think the minimum wage adjusted for inflation is today the same value it was in 1950. It has not gone up in 63 years. And so I think there is certainly scope for an increase, and I think that would complement policies like an expanded Earned Income Tax Credit.

Senator Lee. Okay, I see my time has expired. But I understand you to be acknowledging that some of this would be passed on to consumers?

Dr. Furman. No, actually—I apologize, Senator, but I think it actually is part of a strengthening of the economy to put more purchasing power in the hands of families, and I think that would help the economy overall and help consumers more broadly.

Senator Lee. I wish we had more time to talk about that. Thank you, Mr. Chairman.

Chairman Brady. I can feel it coming on, Senator.

Mr. Chairman, than you for being here today. Obviously we are encouraged by certain parts of the economy, and still disappointed by many parts, but looking for bi-partisan solutions on how we improve the economy, grow jobs, and bridge the inequality between the middle class and Wall Street.

I very much appreciate you being here today and look forward to hopefully having you back after the next Economic Report is released, after the beginning of the year, February, March, whatever that timeframe is. And, Chairman, thanks for being here today.

With that, the hearing is adjourned.

(Whereupon, at 3:36 p.m., Wednesday, November 13, 2013, the hearing was adjourned.)

SUBMISSIONS FOR THE RECORD

Joint Economic Committee

Representative Kevin Brady • Chairman

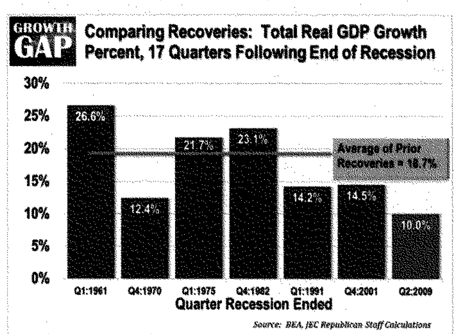
CHAIRMAN KEVIN BRADY
JOINT ECONOMIC COMMITTEE
NOVEMBER 13, 2013
Economic Outlook

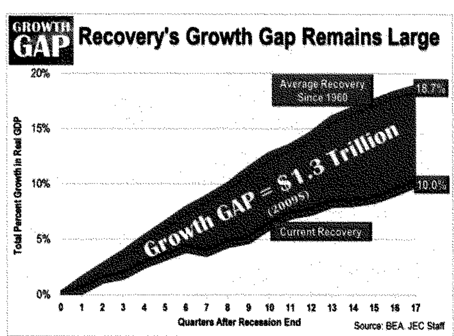
Chairman Furman, welcome. Both Vice Chair Klobuchar and I appreciate your willingness to reschedule this hearing, and I am hopeful that you will resume the long-standing practice of the Chairman of the Council of Economic Advisers testifying before the JEC about the *Economic Report of the President* immediately after its release.

We are all pulling for a strong recovery. Too many Americans of all ages and all races have simply given up hope of finding a full time job.

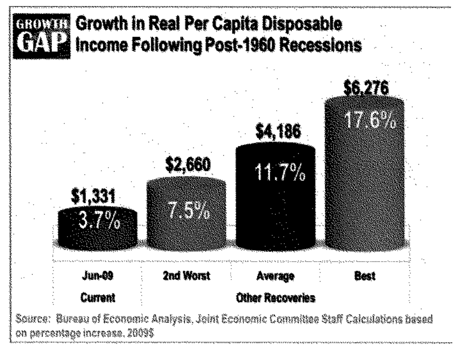
Now four full years after the recession ended, while some parts of the nation are making progress, the current recovery remains the weakest among all post-1960 recoveries in every major measure of economic performance, generating a troubling and dangerous "Growth Gap."

- While real GDP has grown by 10 percent since the recession ended, that's just barely above one-half of the growth in average recoveries over the same period, producing a growth gap of $1.3 trillion in the economy.

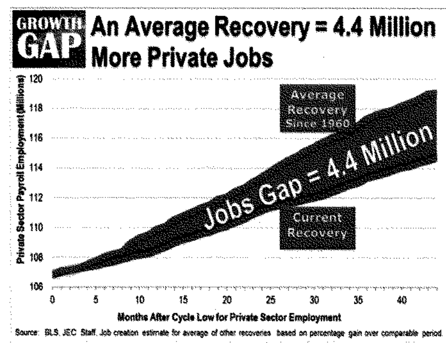




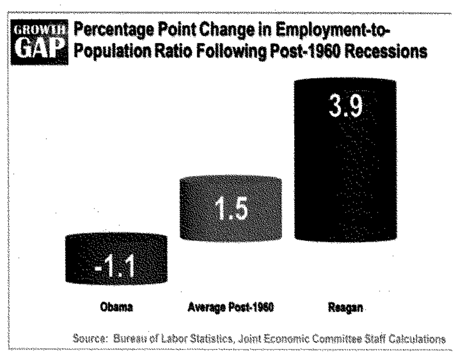
- For families the growth gap hits home. Real disposable income per capita has increased by a mere 3.7 percent, less than one-third of the 11.7 percent average. This means a family of four has $11,420 less in real after-tax income to spend that they would have had if this recovery had merely been average.



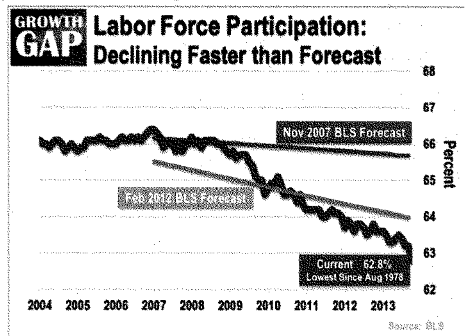
- And the current recovery has produced 4.4 million fewer private payroll jobs since the cyclical low than an average recovery.



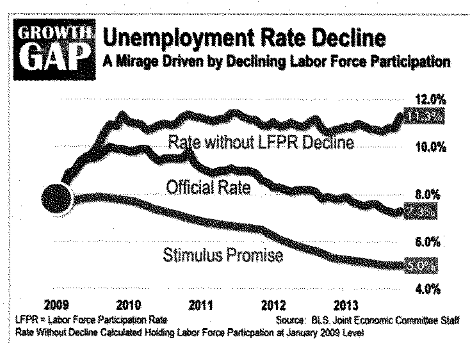
- An important gauge of America's job picture is the employment-to-population ratio that measures the proportion of the country's population age 16 or over that is employed. By now it would have risen by 1.5 percentage points in an average post-1960 recovery and more than double that (3.9%) in the Reagan recovery. But today the America's employment-to-population ratio has actually *declined* by 1.1 percentage points. To put the stalled labor market in perspective, in October 2013 the employment-to-population ratio was only six one-hundredth of a percentage point higher than the lowest reading during the Obama presidency.



- In October, the labor force participation rate fell to 62.8 percent, a low not seen since the Carter presidency.



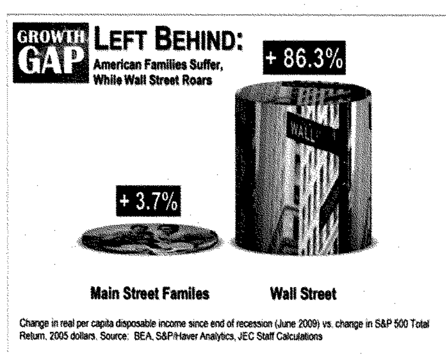
- And as many unemployed Americans are learning the hard way, the decline in the official unemployment rate to 7.3 percent is largely illusory because so many Americans have simply given up looking for work. If the labor force participation rate had not declined since President Obama took office, the unemployment rate would be a whopping 11.3 percent, not 7.3 percent.



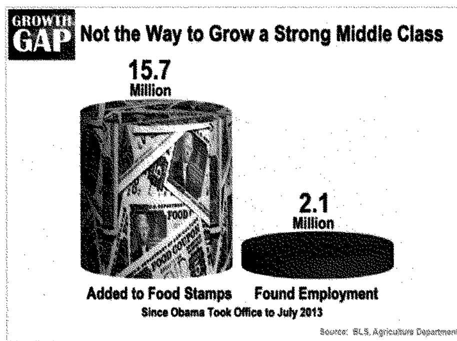
As President John Adams observed, "Facts are stubborn things." And facts prove that this is the weakest recovery since 1960, indeed since World War II.

On July 24th, President Obama described "a growing middle class" as "the engine of our prosperity." I agree.

In this recovery, however, middle-class Americans continue to suffer while Wall Street has roared. Since the recession ended, the S&P 500 Total Return Index is up by more than 86 percent while real disposable income per capita is up a mere 3.7 percent.



To make matters worse, as of this past July 15.7 million more Americans were receiving food stamps while only 2.1 million more Americans were employed. Adding eight Americans to food stamps for every one finding work is not growing the middle class. In fact, this recovery might better be described as the real war on the middle class.



Today, we want to discuss the *Economic Report of the President*, the roadblocks to job creation and economic growth, and search for bi-partisan solutions to restore prosperity to the suffering middle-class.

Clearly Main Street is being harmed by the President's higher taxes, mountains of new red tape on local businesses, and the disastrous roll-out of the ill-named *Affordable Care Act* that is cutting workers' hours, raising their health care costs, preventing small businesses from hiring, and cancelling health insurance for millions of Americans.

Americans deserve better. Chairman Furman, we look forward to your testimony.

Prepared Testimony before the Joint Economic Committee
Jason Furman, Chairman, Council of Economic Advisers
November 13, 2013

Chairman Brady, Vice Chair Klobuchar, and Members of the Committee—thank you for the chance to appear before you today. In my statement, I would like to highlight some of the main opportunities and challenges the economy faces right now and then briefly discuss several policies that could capitalize on the opportunities and address the challenges. Of course, the most immediate priority heading into next year is to "do no harm" by continuing to fund the government and pay the bills, but the important affirmative agenda to support growth, job creation, and higher wages remains critical as well.

The Current State of the Economy

I would like to first say a word about the major turnaround we have seen over the last five years. Recently we marked the fifth anniversary of the collapse of Lehman Brothers, an event that touched off one of the most acute periods of economic turmoil in our nation's history. The crisis manifested itself in a number of pernicious ways, including the loss of more than 700,000 jobs per month in late 2008 and early 2009, and the destruction of $16 trillion of household wealth.

Five years later, a resilient private sector has added 7.8 million jobs over 44 consecutive months. Job growth has been steady, with 2.4 million jobs added in the last twelve months, 2.2 million jobs in the twelve months before that, and 2.2 million jobs in the twelve months before that (Figure 1). Since early 2010, we have seen over half a million jobs added in manufacturing, and more than 400,000 added in the high-tech industries (outside of manufacturing) which employ the largest share of scientists, engineers and technicians. The unemployment rate has fallen by about seven-tenths of a percentage point per year, and while it remains unacceptably high at 7.3 percent, it is now back to where it was in December 2008. The economy has expanded for sixteen out of the last seventeen quarters, America has a strong auto industry, our banks are increasingly well-capitalized, our housing prices are rising and construction is recovering.

The most recent data indicate that the economy was strengthening through the third quarter, with GDP growing at a 2.8 percent annual rate and job growth revised up for August and September to an average of 200,000 jobs per month. The data for October are consistent with an economy with a private sector that continues to drive the recovery, with strong payroll job growth continuing into October, although this growth likely would have been even stronger were it not for the shutdown and the brinksmanship over the debt limit. The negative consequences of these episodes on the economy can be seen in a range of data, especially for the first weeks of October, when unemployment insurance claims spiked, chain store sales slowed, worker-reported instances of hiring decreased, and consumer confidence plummeted. Although there were significant shutdown-related measurement issues in the household survey for October, it also showed signs that the shutdown negatively impacted the economy.

Areas of opportunity

With this context, there are five areas of opportunity that I would like to highlight, including two cyclical factors that could contribute to the recovery, and three structural factors that have significant potential for longer-run growth, job creation, and wage increases.

Cyclical Factors that Could Contribute to the Recovery

First, the most immediate macroeconomic opportunity is the remaining potential for continued strong increases in residential investment, consumer durables (including autos), and consumer spending more generally. Residential investment has helped drive the recovery over the last two and a half years, growing at a 12 percent annual rate, and significant potential remains for growth in this area. As discussed in the 2013 *Economic Report of the President*, the over-building of new homes during the bubble years was fully offset by several years of depressed construction activity. Consequently, new residential construction is now poised to rise to a level more consistent with historical rates of new household formation and property depreciation (Figure 2). These fundamentals imply that we will eventually return to a level of residential construction activity substantially above the roughly 900,000-units-per-year pace we have seen in recent months.

In addition, we have seen strong motor vehicle sales, with the third quarter selling rate the highest in over five years (Figure 3). Here too is potential for further growth given that the average age of cars on the road recently reached a record high of 11.4 years. While some of the increased longevity of cars can be attributed to improved vehicle quality, it is also likely it partially reflects deferred car purchases that will be recovered over the next few years.

Moreover, consumer spending in general has the potential to grow as employment gains boost incomes, access to credit improves, and household balance sheets continue to strenghen. We also saw the two main measures of consumer sentiment reach multi-year highs over the summer, although they both fell back sharply in October in response to the shutdown and debt limit brinksmanship.

Second, the economy is headed towards a less contractionary fiscal stance, which should create less of a headwind for private-sector growth going forward—although the magnitude will depend on policy choices like the resolution of the sequester. The budget deficit has fallen rapidly, from 9.8 percent of GDP in fiscal year 2009 to 4.1 percent of GDP in the fiscal year that just concluded. That is the fastest sustained pace of deficit reduction we have seen in this country other than the demobilization from World War II, and remarkably, nearly half of that total deficit reduction—2.7 percent of GDP—took place in just one year: fiscal year 2013.

Although deficit reduction is an important long-term policy goal, the rapid fiscal consolidation we have seen over the past year can also create challenges for growth and job creation. Fortunately, we have had a private sector that was leading the economic recovery and keeping our overall growth rate roughly steady, while declining federal spending subtracted from GDP growth in 10 of the last 12 quarters. More broadly, in the last three years we have seen private components of GDP increase at a 3.1 percent annual rate, while the government component has contracted at a 2.2 percent annual rate (reflecting contributions from both Federal and State and local spending reductions), with a weighted average netting out to a 2.1 percent annual increase in GDP overall.

The good news is that the economy has already gone through the most severe fiscal headwinds at both the federal and State and local levels and that further immediate deficit reduction will be at a more gradual pace. The degree of that pace depends on policy choices, a topic I will return to at the end of my testimony.

Structural Factors that Could Help Longer-Run Growth

In addition to the potential for the immediate recovery, there are three important structural factors that are helping growth today and have the potential to help on a sustained basis in the future as well.

First, the marked slowdown in the growth of health care costs presents both a short-run and long-run opportunity for job and wage growth. Just last month, new data and official projections from the Centers for Medicare and Medicaid Services (CMS) indicated that inflation-adjusted health spending has grown at a 2 percent annual rate over the three years since 2010, the lowest rate recorded since we began keeping track of these data in the 1960s (Figure 4).

The CMS figures show that the slowdown in costs affects all portions of the health sector. Over the three record-setting years from 2010 to 2013, inflation-adjusted per-beneficiary spending by private insurers is projected to have grown by just 1.6 percent per year. The comparable figures for major public health insurance programs are even lower: 0 percent for Medicare and -0.5 percent for Medicaid. All of these rates are well below the average annual growth rate of inflation-adjusted per capita health spending over the decade ending in 2010 (3.2 percent). Moreover, the slowdown has affected virtually all categories of spending. Over this period, there have been particularly large reductions for prescription drugs, with spending actually falling in real terms.

The CMS announcement followed an August release from the Kaiser Family Foundation, which reported estimates of average health insurance premiums from its annual survey of employers. Kaiser found that premiums for employer-provided family coverage grew just 2.3 percent from 2012 to 2013, after adjusting for inflation, less than one-third the rate observed in the early 2000s.

The Congressional Budget Office (CBO) and a wide range of analysts have concluded that only a small fraction of the current slowdown can be attributed to the recession as evidenced by the facts that you see the slowdown in areas like Medicare, and the health care component of the personal consumption expenditures price index, both of which are less subject to cyclically-driven fluctuations. Much of the slowdown appears to reflect deeper changes affecting the health sector and has the potential to be persistent. It is also likely that some of the features of the Affordable Care Act that have already been implemented, such as payment reforms that incentivize better patient outcomes, are contributing to the slowdown in cost growth.

In the long run, savings from slower health care cost growth will be passed on to families in the form of higher wages. But in the short and medium run some of these savings are reflected in lower pressure on employee compensation, which in turn means more job growth.

Second, the dramatic increase in domestic energy production is another opportunity for the U.S. economy—and also for our security and climate. Government-funded research supplemented private industry's work to develop the technology that sparked the boom in oil and gas production. Crude oil production has grown each year the President has been in office to its highest level in 17 years in 2012. In fact, over the past four years, American domestic oil supply growth has accounted for over one-third of global oil supply growth. Natural gas production increased by 5 percent in 2012 and currently is at an all-time high. Stronger fuel efficiency standards and investments in cutting edge technologies have led to the most fuel efficient light-duty vehicle fleet ever, and we are working to increase the efficiency of the medium- and heavy-duty fleet as well. At the same time, we have almost doubled the production of biofuels since 2007 to a near all-time high, which further reduces our need for oil in the transportation sector. The result of these advances is that United States is now nearing the point where our domestic production of crude oil exceeds our net imports of oil on a sustained basis (Figure 5).

Even as we continue to see positive signs in the area of domestic oil and gas production, the President remains firmly committed to an "all of the above" energy strategy, and there have also been great strides made in expanding the use of renewable sources, which in total have grown by over 20 percent since the beginning of the Administration. Wind and solar production have each more than doubled since the President took office, and Congress made sure this progress would not be derailed when it included an extension of the Production Tax Credit in the American Taxpayer Relief Act signed earlier this year. The creation of an Energy Security Trust Fund – which the President proposed in his last State of the Union – would represent an additional commitment to the investments in renewables that will be needed to broaden adoption of these important sources.

Ultimately, the broad-based energy boom we have seen has a number of advantages for America, including contributing directly to jobs in the energy sector, and indirectly to jobs in other sectors by making energy-intensive industries, like manufacturing, more likely to locate and succeed in the United States. Increasing productivity through new techniques and technologies raises national income and increases growth. Reducing America's dependence on foreign oil and increasing our net exports leads to greater energy security, higher economic growth and higher standards of living. Finally, our shift towards renewables and natural gas has improved the climate outlook.

Third, technology provides significant opportunities for long-term growth, especially in areas that benefit from the combination of mobile computing and increasingly fast wired and wireless Internet connections. Total factor productivity, which measures our ability to produce more output from a given set of inputs, has grown at a 0.8 percent annual rate in the last forty years since 1973, which is well below the 2.2 percent annual growth rate enjoyed in the golden age from 1948 to 1973. Even small improvements in Total Factor Productivity growth going forward would make a profound difference over time.

One of the promising areas for Total Factor Productivity growth is the innovations in hardware and software for mobile devices and the wired and wireless infrastructure investments to support these technologies. In the last four years annual investment in U.S. wireless networks grew more than 40 percent, from $21 billion to $30 billion. At the same time, investment in European wireless networks remained flat and wireless investment in Asia (including China) rose only 4 percent. This infrastructure is at the center of a vibrant ecosystem that includes smartphone design, mobile app development, and the spillovers from the widespread adoption of these technologies in our communities.

Outstanding Challenges

While we have made substantial progress and have significant potential for further progress, more work remains to be done in helping our economy recover from the 2007-09 recession and address much longer-term trends and challenges. I want to highlight three important challenges:

First, we are still struggling with the major legacy of the severe recession—significant elevation in the unemployment rate and a reduction in the participation rate, which are creating hardship for millions of families. The current elevation in the unemployment rate is primarily due to the large number of long-term unemployed workers (Figure 6). If one looks at the unemployment rate based only on persons out of work for less than 27 weeks, this measure is largely back to its pre-recession average. The bulk of the remaining elevation in the unemployment rate is due to the fraction of the labor force that has been out of work for 27 weeks or more, which remains 1.6 percentage points above its pre-recession average. This aspect of the current labor market situation is an important reminder that despite the progress we have seen, more work must be done to boost aggregate demand, support job creation, and provide a path back to employment through our employment services. These steps are especially urgent because the longer the situation persists, the harder it becomes to address the erosion of skills that can result from a period of extended unemployment.

At the same time, the participation rate has continued to fall. One important reason for this fall is demographic shifts arising from the retirement of the baby boom generation, a trend that has been long anticipated. In 2004, for example, the *Economic Report of the President* noted "the long-term trend of rising participation appears to have come to an end. … The decline [in the labor force participation rate] may be greater, however, after 2008, which is the year the first baby boomers (those born in 1946) reach the early-retirement age of 62." The economic downturn further contributed to a cyclical reduction in the participation rate, possibly exacerbated by the increase in the long-term unemployment rate. The demographic trend towards lower participation rates will continue but the cyclical contribution to lower participation rates should diminish as the economy continues to heal.

The second and less widely appreciated challenge is that the recession appears to have exacerbated a longer-term trend of reduced job-to-job mobility for the labor force. We have all had our eye primarily on improving net job growth—the additional jobs added each month. However, the flow of workers across firms—hiring in excess of job creation and separations in excess of job destruction—plays an important role in the U.S. labor market. This job switching improves the allocation of workers to jobs and supports wage growth as workers switch to new, higher-paying jobs. Job switching also helps workers find the jobs for which their skills are best suited, which can increase their productivity and fuel more robust economic growth. Academic economists and those in the Federal Reserve System have documented a large decline in worker mobility over the past several decades, with declines concentrated in the recessions of 2001 and 2007-2009. Job openings, voluntary separations, and total hires declined substantially during the recession and have only partially recovered. The quit rate also remains below pre-recession levels, as workers are likely still reluctant to voluntarily leave jobs. While the sources of this declining mobility are at least partly cyclical, other structural sources are not fully understood, and it is an important indicator for us to watch.

Third and finally, the longest standing and most deeply embedded challenge we face is the rise in inequality. We have seen a large increase in inequality since the late 1970s, arising from a combination of technological change, globalization and institutional changes, like the erosion of the inflation-adjusted minimum wage and the decline in union membership. The first two of these changes have tended to raise the relative demand for capital and skilled labor and therefore the returns to these inputs. At the same time deceleration in educational attainment, suggests a possible growing scarcity in skills and therefore the number of workers poised to take advantage of the increased demand and wages available to skilled workers. And the weakening of long-accepted labor market institutions further lowers the status and power of the workers left behind and therefore their earnings.

These deeply rooted trends have continued over the course of this recovery and manifest themselves in both earnings data and income data. The income data through administrative tax records provides a particularly clear window into the very top of the income distribution. These data, as compiled by Emanuel Saez of the University of California at Berkeley, show that the top 1 percent of tax units received 19.3 percent of total income (excluding income from capital gains, which can be highly volatile year-to-year) in 2012 (Figure 7).This was the largest share since 1928 and up from 17.5 percent in 2011. About half of the increase in the top 1 percent income share went to the top 1 percent of the top 1 percent—the 0.01 percent. This is all symptomatic of a broader trend of the disconnect between productivity growth and compensation for the typical middle-class family. Addressing inequality and reconnecting productivity growth and wage growth for typical families are both part of the same challenge.

The Policy Agenda

The most immediate priority is to do no harm by avoiding repeated fiscal wrangling and another government shutdown, allowing our economy to capitalize on all of the opportunities I sketched earlier, notably housing construction, reduced fiscal headwinds, health cost containment, the energy boom, and technological advances. Beyond that, however, there are substantial opportunities to build on the favorable trends I identified while making more rapid progress in addressing the challenges through an affirmative agenda to create jobs, increase growth and raise wages. I will focus on two specific areas—budget policy and the broader agenda to create what the President has called "a better bargain for the middle class." In addition to these areas, the

President has also identified immigration reform and the farm bill as two economically important proposals that have been passed by the Senate and should be enacted by Congress.

Budget Policy

The President's Budget proposes investments in jobs and growth, a replacement of the sequester, entitlement reform particularly continued efforts to slow the growth of healthcare, and tax reform particularly in the area of business taxation. The proposal includes significantly more medium- and long-run deficit reduction than the sequester: in 2021, the President's framework has $224 billion in non-interest deficit reduction as compared with $109 billion from the sequester in that year, and by 2023 the deficit reduction under the President's plan grows to $296 billion while the deficit reduction under the sequester falls to $15 billion. As a result, the Congressional Budget Office estimated that the deficit falls to 2.1 percent of GDP in 2023 under the President's approach, consistent with falling debt as a share of GDP (Figure 8). Moreover the President's proposal shifts the composition of spending towards investments in infrastructure and research, while continuing to take steps to strengthen Medicare by reducing overall health spending and reforming the tax code to reduce inefficient tax expenditures. The President is encouraged that the conference committee is working on reconciling the House and Senate budgets through a regular order process and is encouraging the committee to follow this type of balanced, growth-oriented approach to investing in priorities and reducing the medium- and long-run deficit.

The Better Bargain for the Middle Class

Getting beyond these immediate fiscal challenges would help allow the U.S. economy to continue to mend and strengthen. But there are opportunities to do substantially more to support job growth and to continue to push back against the deeper trends of inequality. For instance, CBO and other economists estimate that we can increase GDP growth, raise long-run productivity growth, raise long-run wages, and reduce the budget deficit by simply passing commonsense immigration reform. Other opportunities to do more include the elements of a "Better Bargain for the Middle Class" that the President has been laying out such as:

- **Jobs.** The President has called for a Grand Bargain on Jobs that would include business tax reform to broaden the base, reform the structure, and cut the rate, combined with investments in infrastructure, manufacturing and training. At the same time, to help turn the slowdown in foreign economic growth from a challenge to an opportunity, the Administration continues to work towards new free trade agreements like the T-TIP and TPP that will facilitate mutual gains from trade, create new market access for American products abroad, and set high standards for intellectual property, labor and environmental issues, helping to create more good, higher paying jobs in the United States.

- **Housing.** Over the summer, the President laid out his vision for housing finance reform, which would replace Fannie Mae and Freddie Mac with a system based around private capital, safe and responsible mortgage products, and an explicit and very narrowly defined role for government. The Administration is supportive of bipartisan efforts in the Senate to make this vision a reality and create a more stable foundation for affordable homeownership.

- **Retirement.** A number of studies have found that the current architecture and tax incentives for retirement savings could be greatly improved, especially as they relate to low- and middle-income households. The President's Budget proposals have repeatedly set out ideas for creating a better retirement saving system, including automatic IRA enrollment and an expanded tax credit for small employers starting new 401(k)s. We have known for years that too many households are unable to accumulate sufficient savings for a secure retirement, and the financial crisis no doubt exacerbated the problem. This area is critically important for middle class security and is ripe for improvement.

- **Health Care.** Earlier I mentioned the substantial slowdown in health care costs that we have witnessed recently, but the next step is making sure that all families have the chance to take advantage of it. Unfortunately, too many Americans have had difficulties with the online insurance marketplaces. The Administration continues to work around the clock to address technical issues and create a better shopping experience for consumers, which will ultimately allow the Affordable Care Act live up to its promise.

- **Ladders of Opportunity.** Central to the President's agenda are policies that can foster greater economic mobility across generations and give all citizens a path to the middle class. In particular, the President is focused on expanding access to early childhood education and making college tuition more affordable, two priorities that are essential to making sure that children have the chance to realize their full potential. To make sure that work pays, the President is also calling for an increase in the minimum wage that would ensure that a parent working full time would not have to raise his or her children in poverty.

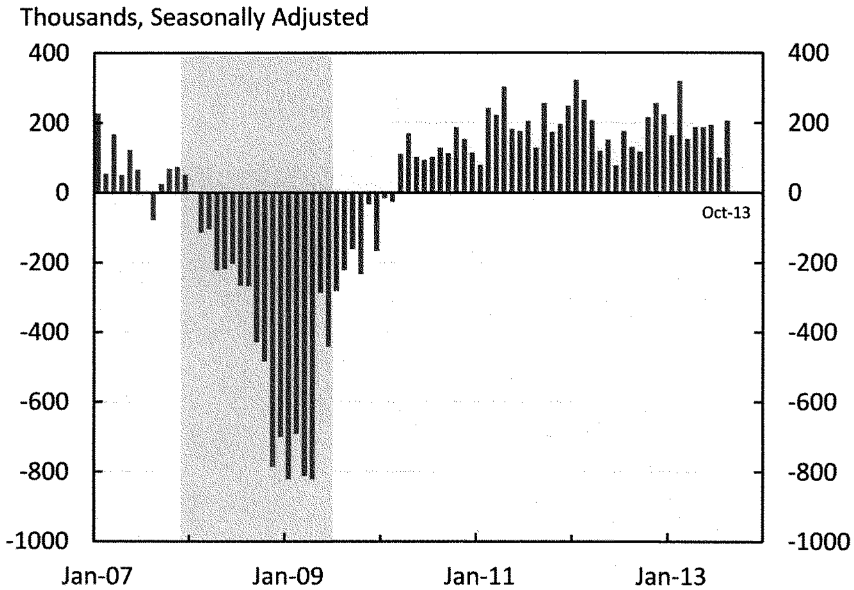
I look forward to answering your questions.

Testimony Before the Joint Economic Committee

Jason Furman
Chairman, Council of Economic Advisers

November 13, 2013

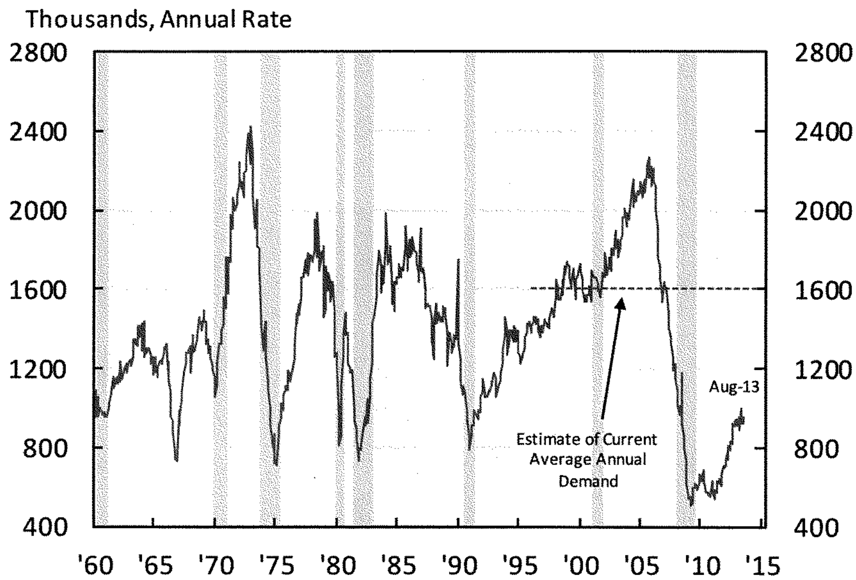
Figure 1
Monthly Change in Private Payroll Employment



Source: Bureau of Labor Statistics.

1

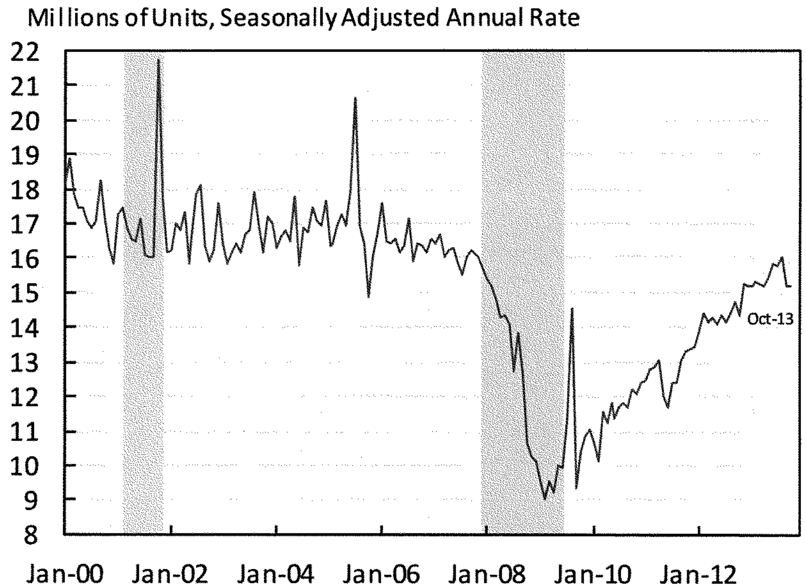
Figure 2
New Residential Construction: Building Permits



Source: Census Bureau.

2

Figure 3
Car and Light Truck Sales



Source: Federal Reserve Board.

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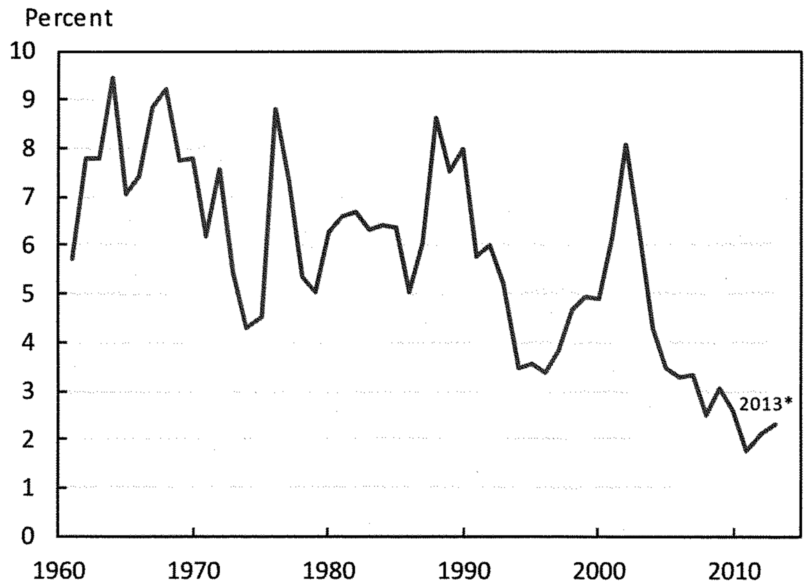
Figure 4
Growth in Inflation-Adjusted National Health Spending



*2012 and 2013 are projections.
Source: Centers for Medicare and Medicaid Services.

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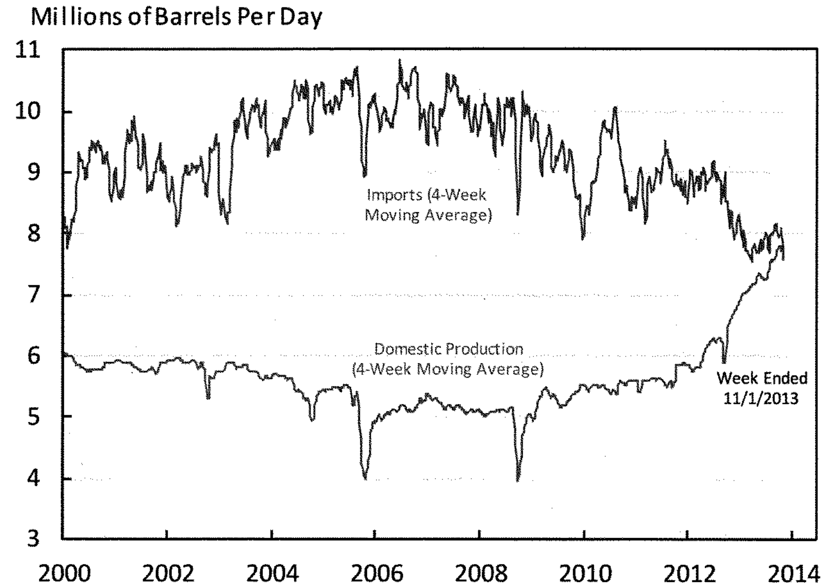
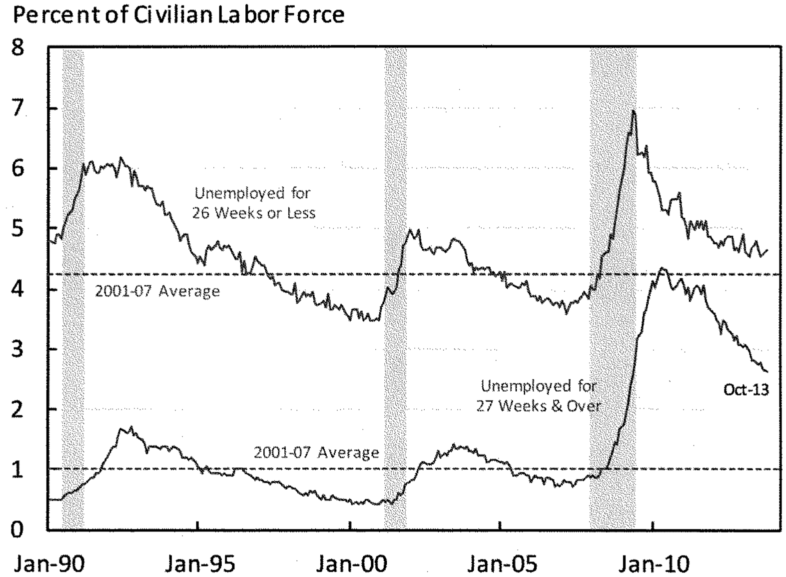
Figure 5
Crude Oil Production & Imports



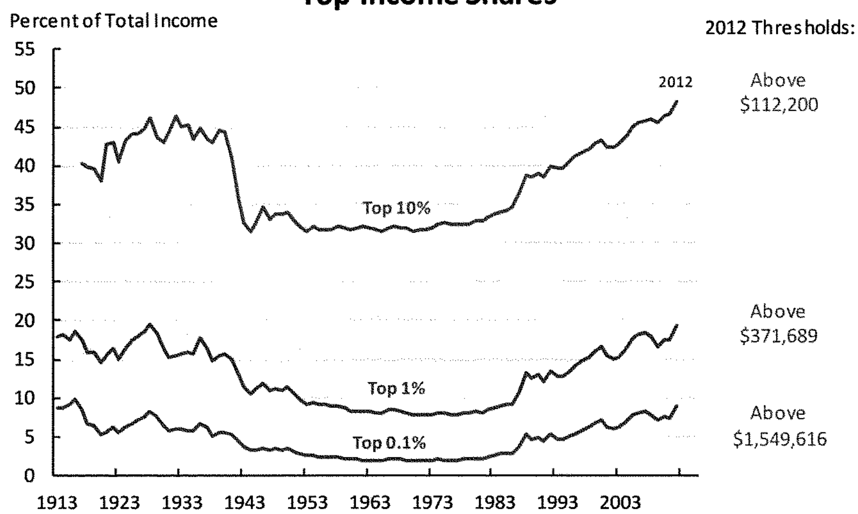
Source: Energy Information Administration.

Figure 6
Unemployment Rate by Duration



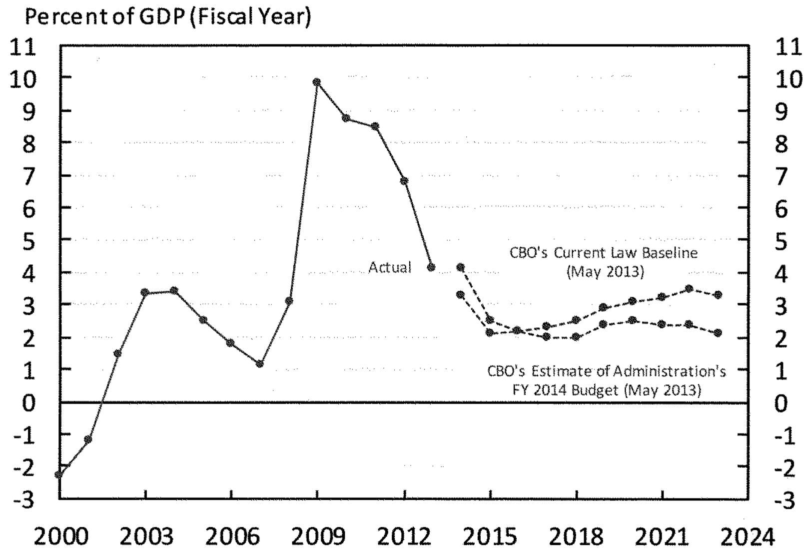
Source: Bureau of Labor Statistics.

Figure 7
Top Income Shares



Source: Saez (2013) update to Piketty and Saez (2003).

Figure 8
Federal Budget Deficit



Source: Office of Management and Budget; Congressional Budget Office.

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