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Reuters/ Jason Reed – U.S. President Obama delivers remarks on job creation in Lanham.

Priority No. 1: Creating an Agenda to Spur Job-Creating Economic Growth

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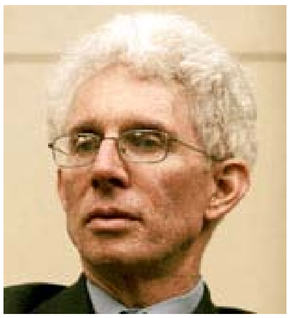
Events in the United States are confirming what scholars have concluded: economic downturns driven by financial crises differ fundamentally from classic cyclical recessions. Because a massive amount of wealth is destroyed and the normal flow of credit is disrupted, production shrinks sharply, demand recovers slowly as consumers and businesses shed debt, and job losses are large, pervasive, and long-lasting.



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Whether measured by duration, overall GDP, consumption, or investment, the recession that began in December 2007 was the worst in the post-WWII era. Annualized GDP fell by nearly 4 percent, consumption by nearly 2 percent, and investment by a staggering 21 percent. Median single-family home prices fell by 25 percent, the stock market by nearly 55 percent. Unemployment surged from 4.8 percent to a peak of 10.1 percent, representing more than 8 million jobs—again, the steepest rise since the Great Depression. And many of the lost jobs have disappeared forever.

As is typical for financial crises, recovery in the labor market is expected to be painfully slow. After unemployment peaked in November of 1982 at the end of the Reagan recession, it took only 18 months for the jobless rate to decline to its pre-recession level. This time, by contrast, both the CBO and the administration project that with current policies it will take at least five years. If so, millions of Americans would be condemned to prolonged unemployment, and many of them would never work again.

Is this the best we can do? Some may argue that it is: the economy has suffered the equivalent of a life-threatening injury; now that public intervention has stopped the bleeding, the process of repair and recovery will move at a pace that we cannot force without doing further damage to the patient.

To test this proposition, I propose a thought-experiment; suppose we decided to place job-creating economic growth at the top of our nation's priority list and developed the agenda best calculated to achieve it. What would it be, would our political system be able to enact it, and would the American people be willing to endorse it?

To begin, the growth model on which we have relied since the 1980s has hit a wall. In recent decades, household debt soared to unsustainable levels, household savings plunged to near zero, and personal consumption rose to unprecedented levels as a share of GDP. The push to expand rates of homeownership overreached, with catastrophic consequences. Meanwhile, we failed to invest in, or adequately maintain, our stock of public goods—roads, bridges, and ports, among others—which predictably deteriorated. After a welcome respite in the 1990s, we steadily added to our public debt, which then surged explosively as revenues collapsed. Total debt, public and private, soared from the 1950-1980 average of 150 percent of GDP to more than 350 percent. And we tolerated a trade deficit that both reflected and contributed to dangerous fiscal imbalances at home and around the world.

The economic consequences are clear, and the policy implications are unmistakable. We need a new growth model, defined by a number of structural shifts—from household debt accumulation to savings, from rising public debt to stabilization at a sustainable ratio of GDP, from consumption to investment, from private housing to public infrastructure, from domestic to foreign demand.

And we need something else as well—a change in tone and climate that increases confidence in the future on the part of both households and businesses. As George Akerlof and Robert Shiller have argued, Keynes was onto something when he insisted on the importance of "animal spirits" for economic growth. Today, this vital force is conspicuous by its absence. Gallup data out last week demonstrate a sharp plunge in household confidence, to levels not seen since the beginning of the Obama administration. For their part, businesses are sitting on record amounts of cash--$1.8 trillion according to the latest Federal Reserve Board report—even though investors and boards are pushing managers for higher rates of return.

Let's begin with steps to rebuild confidence. Many private sector pleas for "stable expectations" represent thinly disguised special pleading. (Exhibit A: the 50-page list of complaints the Business Roundtable sent to the administration last month.) Change is often necessary—seldom more than in the circumstances that President Obama inherited. Nonetheless, too much change, too fast, for too long, fosters uncertainty that can become paralyzing. So we need to stabilize the policy environment by instituting a moratorium on major new policy initiatives not directly related to economic growth and by accelerating the rule-making process to clarify legislation already passed.

We also need to stabilize long-term fiscal expectations, starting with discretionary spending, unproductive tax expenditures, and the modest adjustments needed to restore Social Security to sustainable balance. (As economist John Makin has suggested, we may need to balance fiscal restraint with aggressive anti-deflation monetary policy for quite some time.)

And the administration should take steps to improve the atmospherics of its relations with the private sector, by toning down the rhetoric that business (rightly or wrongly) experiences as threatening, by institutionalizing serious and sustained consultation with private sector leaders, and by appointing more senior officials with substantial private sector experience.

But business confidence will avail us little if it is not matched with public confidence. And we cannot rebuild public confidence if we leave working and middle-class families to fend for themselves. Terminating extended unemployment insurance makes no sense, economically, psychologically, or morally. Nor should these families be allowed to fall through the cracks in our health insurance system while they wait years for the reforms to come fully into force. And working with private lenders, the government should take another run at mitigating home foreclosures, now running at a rate of more than 1 million a year, that are intensifying pressure on the already beleaguered residential housing market.

Along with these importance confidence-building steps, we should reexamine our basic policies with an eye to accelerating growth and job-creation. For example:

- Starting next year, Congress and the administration should take up pro-growth tax reform. Cross-national research respected by conservative as well as liberal economists has shown that, independent of levels of taxation, the *kind* of tax system a country chooses has an important effect on economic growth. Reducing our dependence on income and payroll taxes while expanding the role of energy and broad-based consumption taxes would yield dividends measured in growth and jobs.
- Reflecting the fact that infrastructure produces public as well as private goods, we should create public incentives for much larger private capital investments in public infrastructure. This would require shifting away from direct tax-based funding of projects toward a user-fee model that would produce a reliable return on investment. This approach would work more effectively if decisions about major projects were made by bank-like boards on economic grounds rather than through political logrolling. Done right, infrastructure investment not only boosts growth but also generates decent jobs that cannot be done offshore.
- Forced retrenchment at the state level will weaken federal government efforts to stimulate growth and job creation. On the other hand, many states exacerbated their problems by making unsustainable promises during flush times, and it is understandable that many citizens and elected officials are reluctant to subsidize what they regard as short-sighted profligacy. To square this circle, the federal government should initiate conditional revenue-sharing, extending bridge loans to states with the expectation that these borrowers would enact binding plans for structural fiscal reform that met targets specified in law. States that do so would have their loans converted into grants; those that don't would have to repay them, with interest.
- The administration should put some policy flesh on the bones of the president's pledge to double exports over five years . . . and put some political muscle behind it as well. This would require an across-the-board push to jump-start the stalled trade treaty agenda, as well as serious discussions with the Chinese about steps the United States may have to take if currency imbalances persist.

- The administration should adopt an explicitly pro-growth regulatory policy. To implement it, OMB's Office of Information and Regulatory Affairs would be required to give greater weight to the growth and employment consequences of proposed regulations.
- The debate about comprehensive immigration reform won't reach a conclusion anytime soon. In the interim, we can at least make it easier for people with advanced education, critical skills, or entrepreneurial capacity to enter and remain in our country. (The research on the contribution of such immigrants to innovation, growth, and jobs in recent decades is truly compelling.)
- And finally, while we continue the argument about K-12 educational standards and testing, we can agree on the need to focus on reducing high dropout rates, which swell the prison population while weakening the workforce. And we can agree, as well, on aggressively using community colleges to narrow the gap between the skills jobs coming onstream over the next decade will require and the profile of today's unemployed workers.

Even if the agenda I've sketched makes sense, it would not be easy to adopt. Recent surveys suggest that Americans are increasingly deficit-sensitive . . . and increasingly skeptical that public investment of any kind can boost growth and job creation. Moving my agenda forward would require more bipartisan engagement, cooperation, and compromise than our polarized politics has witnessed for quite some time. It would force both parties to stare down key base constituencies. Above all, it would demand both elected officials and their constituents to subordinate other objectives, however worthy, to the overriding objective of restarting the engine of economic growth and sustaining robust job creation.

No doubt seasoned observers of the American political scene will be dubious, not without cause. My point is not that a way forward would be *easy*, but rather that it *exists*. In the years to come, persistent slow growth and high unemployment will reflect, not economic necessity, but rather political failure. The choice is ours to make.

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