



**Keynote Address by Alice M. Rivlin
Director, Greater Washington Research at Brookings**

“Non-Profit Survival of the Fittest: Crisis Management and the New Normal”

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Survival of the fittest doesn't have a real cheerful ring to it. I think everyone in this room knows that times are tough and are likely to stay that way for quite a while. My job is to try to give you some educated guesses about how economic developments might unfold, both at the national level and here in the Washington region, and how those developments might affect the non-profits that you are trying so hard to lead effectively.

Gathered in this room are some of the people I admire most—people dedicated to making this corner of the world a better place to live and work; people who work extremely hard and don't get nearly as much credit as they should for it, people have seen their less empathetic former classmates making gazillions of dollars trading derivatives and wondered why the world is organized this way—but not wished they had chosen a different career path.

I wish I could bring you major good news on the economic front—something to stand up and cheer about--but at the moment the best I can say is that I expect the national economy to improve over the next couple of years (and Washington's with it), but quite slowly, especially with respect to jobs and unemployment. So your jobs are going to continue to be very hard.

Outlook for the National Economy

Collectively, we dug ourselves a huge hole and it will take a long time and a big effort to climb out. This is no ordinary recession. It is not a dip in business cycle that will right itself after a few months and let everyone get back to their normal activities. This recession was precipitated by a gigantic financial crash that brought credit to a screeching halt around the world in the fall of 2008, toppled venerable financial institutions, and is still far from over, despite out-sized efforts on the part of governments and central banks to prop up the system and control the damage. We know from centuries of experience

that recessions that result from financial crises are deeper than others and take much longer to recover from. And this crisis was a doozy! It not only started with a staggering financial meltdown—that could have been much worse if national authorities had not intervened so aggressively—but the nature of the bubble that burst was particularly damaging. Bubbles happen periodically when people lose sight of reality and bid up prices of any asset—stocks, land, art works—usually borrowing heavily to do so. They are sure they can pay back easily because the price will keep going up, so they ignore the risks. So prices do go up in a self-perpetuating cycle—until they stop and the loans have to be paid back.

But this burst bubble was particularly damaging because it did not involve stock prices or works of art this time. It was a housing price bubble with an enormous pyramid of bad mortgage debt, and derivatives of that debt, piled on top. Housing is a huge part of Americans' household wealth. This burst bubble left us with more houses than we need, diminished household wealth, millions of foreclosures and mountains of underwater mortgages. It a really bad hole to be in.

And we did it to ourselves. We didn't have to have this financial crisis. There were a lot of culprits: lax and cruelly predatory lenders, weak regulators, titans of finance that took out-sized risks with other people's money and revealed not just their greed but their astonishing stupidity, and leaders whose ideological blindness kept them from noticing the perverse incentives that had crept into the financial system. It is important to remember how unnecessary this all was, so we make every effort not to let it happen again.

We had not experienced a recession of this depth and pervasiveness since the 1930's, so it took a while for economists and others to recognize how bad it was. The catastrophe was occurring in the summer and fall of 2008, right at the climax of the national election. The economy was still deteriorating when the new team took over in January 2009 amid unrealistic expectations that a change of leadership could put things right in short order. Perhaps if there had been more time to absorb the depth of the economic fall—as there was before Roosevelt came to power in 1933—there would be less disappointment over the state of the economy now. If the polls are right, much of the public seems to have concluded that if the president and the congressional leadership haven't fixed the economy after 18 months, they must be doing something wrong. It just couldn't be that hard!

Unfortunately, I think it is that hard. Most of the policies, both fiscal and monetary, have been the right ones. They have kept the recession from getting worse and gotten us on the track to recovery. The stimulus put money in people's pockets, sustained consumption, kept state and local governments from making even deeper cuts in services and laying off even more workers, and created and preserved millions of private sector jobs. There is plenty of evidence that without the stimulus unemployment would have been worse. The same could be said for the Federal Reserve's policies of keeping interest rates low and supporting the mortgage and consumer credit markets.

But “it could have been worse” is not a winning slogan when unemployment is nearly 10 percent and people still live in fear of losing their jobs and homes. The free fall of spending has indeed turned around and GDP has been growing for over a year. But that spending growth itself has been moderate compared with past recessions when growth often spurted in recovery. Restrained spending is not hard to understand coming out of a recession that followed a frenzy of over-spending and over-borrowing, based partly on housing values that proved an illusion.

The real mystery to economists is why more jobs have not been created by the sustained moderate growth in aggregate spending. By the rules of past recessions, we should have more jobs by now. But employers appear to have been producing more of whatever they sell with fewer workers (keeping productivity growth high), perhaps partly out of fear that the recovery won't last. This combination of slow spending growth and unusually low job creation relative to that spending is keeping unemployment distressingly high.

Recent job numbers have been particularly disappointing and have led some to wonder if we are headed into another recession—the proverbial double dip—especially now that the stimulus spending is coming to an end. It is hard to be sure, but I doubt it. My guess is that we will see continued slow growth and very gradual improvement in the unemployment rate, but no return to anything we could call full employment for several years.

The situation is complicated by the government debt crisis in Greece and some other parts of Europe and fears of a debt tsunami in our own country. It is not news that the federal budget is on an unsustainable track for the next several decades. Social Security, Medicare, and Medicaid spending will rise faster than the economy can grow and faster than revenues. The combination of an aging population and rising health care spending produces a widening wedge between federal spending and revenues. People like me who worry about the federal budget have seen this coming for a long time. The projected debt trajectory is simply unsustainable. We can't borrow that much more every year without paying much higher interest rates and becoming increasingly vulnerable to a loss of confidence in our credit-worthiness.

Before the financial crisis and the recession hit us, we had the illusion that there was time to fix the problem. Our economy was growing pretty strongly; our debt to GDP ratio was not very high. Sure, we faced a long run problem, but no imminent crisis. But the financial crisis and the recession forced us to borrow unprecedented sums very quickly--partly as a result of revenues falling off as they always do in recession and partly to respond to the recession and the financial meltdown. Hence, we find ourselves in very different situation from even two years ago. Debt to GDP has gone from under 40% to more than 60% and is headed rapidly up. The short-run deficits, which will recede as the economy recovers, will be overtaken by the longer run deficits caused by spending related to aging and health care out-running revenue. Quite suddenly we have a debt and deficit problem whose solution cannot be postponed much longer.

In 2010 we face a serious dilemma. We must not derail this fragile recovery. With unemployment still so high we need to extend unemployment benefits, help the states avoid drastic spending reductions, especially in Medicaid, and avoid pervasive tax increases. At this same time we must take real steps to bring down future deficits and reassure our creditors, here and abroad, that we have serious plans to rein in continuing future deficits. This is not a choice between stimulus and restraint. We have to do both at the same time: keep some stimulus going until recovery is assured and simultaneously take action that will reduce the rate of growth of future spending and add more revenues. We can't wait until economy recovers to design the deficit reduction; we have to start now.

I am right in the middle of the deficit/debt dilemma because I am a member of the President's Commission on Fiscal Responsibility and Reform. We are a bipartisan group, co-chaired by Erskine Bowles and Alan Simpson, with eighteen members, twelve of whom are members of the Senate or the House. I am also co-chairing with my long-time friend, Pete Domenici, a Debt Reduction Task Force, sponsored by the Bipartisan Policy Center. Both are charged with presenting blue-prints for reining in future deficits and stabilizing the rising debt. Will we succeed? I am hopeful, mostly because I believe that more and more people (including many elected officials) realize that the status quo is unsustainable and inaction spells eventual disaster. But over-reacting and cutting deficits too soon could also derail the recovery and be very damaging. I was glad to hear this morning the Senate has acted to extend unemployment compensation. They should also do more to aid the states. Adding to the short-term deficit is not inconsistent with action to reduce deficits in the future. We have to be smart enough to keep two ideas in our heads at once.

I have gone into the deficit issue because it is relevant to the economy non-profits will be dealing with in the future—after the recession is over. We should not imagine that we can get through the recession and then go back to business as usual. Avoiding a future debt crisis will take heavy-duty budget action both on the spending and revenue sides. Federal spending cannot go on rising substantially faster than GDP forever. We have to slow down the growth of spending even if we increase revenues, because continuously raising revenues will eventually undermine economic growth. So we will see measures to reduce growth of Social Security and health care for seniors. We will also probably see restraints and probably freezes on discretionary spending programs. Federal grants will be squeezed and in turn the states will squeeze localities and service providers. This not a temporary situation, because the upward pressure on federal spending from the interaction of aging and health care inflation will not go away. We are facing a permanent squeeze on public spending. This means more responsibility will fall on the private and non-profit sectors.

The Washington Area

If we turn to the Washington area, the news is a little better, but only in the sense that this area has suffered far less than most other large metropolitan areas (metros). As we have seen, our Washington metro is not immune to recession and its consequences. In the last

two years unemployment is up, poverty has increased, and more people are turning to public and private agencies for relief from hunger and homelessness. Housing prices are down and foreclosures up. The drop in tax revenues has hit all local and state governments. All of this puts increased pressure on non-profits.

To be sure, the recession has hit many other metros harder. The nature of our economy helps protect us. We have hardly any manufacturing and are not a leading financial center. We specialize in knowledge-based activity and services of all kinds, especially high-end business services. We have an unusually well-educated work force. The federal government is the engine that drives this economy, directly or indirectly, accounting for at least a third of economic activity. In response to economic crisis, not to mention two wars, federal activity is actually expanding.

A national analysis of the 100 largest metros produced periodically by my colleagues at Brookings shows that all metros have been hurt by the recession, but some have suffered less than others and some are recovering quite strongly. We are one of the lucky ones. About a fifth of all large metros have made a full recovery in output (gross metropolitan product) and have had continuous output growth since the end of 2009. Washington is high on that list. The other favored metros are all state capitals or other centers of government or military activity. Employment, however, has not come back as fast anywhere, and Washington is no exception. Employment in the Washington area is still down about 2.2% from its peak, a relatively small drop in comparison to others. The drop in employment was 17% in Detroit, and Detroit was in bad shape even before the recession. Employment has begun to recover quite strongly in the Washington area, but is not back to its previous peak.

However, one of the downsides of being a relatively well-off economy with strong future growth prospects is that we had a bigger housing bubble than most places and, when the bubble burst, a steeper decline and more foreclosures. We built a lot of new houses, especially high end houses, in the outer suburbs, many of which did not sell. We are beginning to work off this inventory of unsold houses, many of them bank-owned, but it will take time. Housing prices are still falling, although not as fast as they were. This is good news for buyers, many of whom took advantage of the temporary federal tax credit, but it is bad news for governments, which depend heavily on real estate taxes to finance services.

Averages are misleading, especially in a region with such evident economic and racial/ethnic contrasts. Despite the obvious mixing of cultures and incomes in some parts of the region, the divide between east and west remains sharp. Poverty has risen in the less prosperous parts of the area, especially in the District, and child poverty is remarkably high.

All of you can point to signs of hope and progress in schools, health care, housing, crime, and the environment. There is a new consciousness of the importance of green building, containing sprawl, and investing in healthy, walkable urban environments. But this good stuff that you are all engaged in will have to be done in a context of permanently

constrained resources. The combination of the likely slow recovery from the recession and the continuing pressure on public budgets resulting from demographics and rising cost of health care means that tough times are not going to end anytime soon.

I believe this difficult economic prognosis has two major implications. First, we must learn to act regionally in deploying both public and private resources. Pollution and traffic congestion, for example, undermine the health and productivity of the region, but they cannot be solved by individual jurisdictions on their own. They are inherently cross-border problems that must be addressed with collective regional action. Second, non-profits must work together to use their resources more effectively. In the words of a previous speaker, they must conserve, cooperate and consolidate to carry out their missions efficiently. If they do not, they will not be among the fit who survive.