Putting Americans Back to Work: Competing Visions for Job Creation

Testimony to the Senate Democratic Policy Committee

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Wednesday, December 16, 2009
10:00 a.m. to 11:30 a.m.
628 Dirksen Senate Office Building

[1] I am grateful to Ezra Greenberg and Matthew Platkin for assistance in preparing this testimony. The views expressed here are the author's own and do not necessarily reflect those of the Brookings Institution staff or trustees.

Chairman Dorgan and members of the Committee, I thank you for inviting me to testify to this hearing on the pressing problem of job creation. My oral testimony will be based on the summary bullet points shown below. My written testimony expands on these points.

Summary

- The steps that have been taken to turn the economy around are succeeding. Unemployment is still too high and the recovery is fragile, but the economy is now moving in the right direction. The rise in unemployment and drop in employment this year have resulted in criticisms of the economic policies used. However, these policies are working and have brought the economy back from the danger of depression.

- If the economy creates 200,000 jobs a month going forward, it will still take seven years to reduce the unemployment rate to 5 percent.

- As we assess the different visions for job creation it is worth looking at what has worked in the past. Job growth from January 1993 to January 2001 averaged 237,000 jobs a month, much higher than in any other recent administration.

- There are a number of policies that are currently being discussed for a new jobs bill and I support such a bill provided the overall budget cost is kept small. I strongly support the extension of emergency assistance to individuals and states and localities. I support efforts to expand SBA-backed lending that is made on a sound and responsible basis. I have been skeptical of proposals to use tax incentives for job creation but, among the possibilities, a refundable tax credit to small businesses to expand hiring looks attractive.

- Budget deficits are constraining choices. Consistent with keeping deficit reduction on track in the longer run, I support increased investments in science and technology, investing in skills as well as education, involving labor in efforts to increase efficiency and productivity, relaxing the constraints on H1B visas, and increasing national saving to keep U.S. manufacturing competitive.

- Whatever mistakes have been made in the past, it is now time for the government to work with business and labor to restore the American economy.

Introduction

With unemployment at 10 percent and payroll employment still falling, I know everyone is aware of the difficult challenge ahead to restore full employment to the U.S. economy.

Over seven million payroll jobs have been lost in this recession through November of this year.

There are many factors that caused the financial crisis that precipitated this deep recession, but high on the list are the over-borrowing that pervaded the economy and lax regulatory supervision of financial institutions and mortgage lending standards. The previous Administration inherited budget surpluses but quickly turned these into chronic deficits that triggered massive borrowing from overseas. The large federal budget deficits contributed to the climate of over-borrowing. And at the same time, the belief that regulation is always detrimental, encouraged financial regulators to take a hands-off view of financial institutions even when they were taking excessive risks.

The challenge we now face is that job growth in the recovery, once it begins, must substantially exceed the normal rate of labor force growth in order to bring down the rate of unemployment. In fact, using standard forecasts of future labor force growth, suggests that *if payroll employment increases were to average 200,000 a month, a pretty good pace of growth based on past history, it would still take seven years to get the unemployment rate down to 5 percent.*[2]

The good news to balance this stark picture is that it does seem that the economy is turning around. There was 2.8 percent growth of GDP in the third quarter of this year and it looks as if there will be around 4 percent growth in the fourth quarter, based on data already reported. The pace of job loss is abating quite rapidly and, if the expected GDP growth materializes, that should result in net job creation, possibly by December and likely by the New Year.

A key reason for the recovery is that Treasury and the Federal Reserve were able to stabilize the financial sector, working together with Congress, which allocated the TARP funds that were essential to this process. Unpopular as they were, the steps taken to restore financial stability have worked, and the Wall Street banks are recovering and in some cases prospering. Another important reason for the recovery is that the President proposed and Congress approved a substantial stimulus package to bolster aggregate demand. While this package was not perfect, it was effective, and has contributed to the recovery.

Unfortunately, however, we are not yet out of the woods. There are likely to be several hundred more failures of small and regional banks in the next year or so. Commercial real estate loan defaults are contributing to the banks' problems, as is the fact that Fannie and Freddie are asking them to take back many of the residential mortgages that have become delinquent. Even if these smaller banks are taken over by other, stronger banks there is a danger that lending to small and local businesses will be undermined by these failures. In addition, consumers are still cautious, and with good reason. Their wealth has been diminished by the decline in home prices and equity prices. Their ability to borrow is more limited than before. And as long as the labor market remains weak and

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[2] Thanks to Ezra Greenberg for this estimate which assumes the trend growth in the labor force will be about 120,000 a month for the next five to ten years.

unemployment remains high, there is concern about the stability of family incomes. Most economic forecasters have learned humility in the past few years and I am reluctant to take a strong position on where the economy is headed. The chances are good that the economy is on the path to a solid recovery, but there is a significant danger that once the bounce-back period ends, growth will be sluggish in 2010 and perhaps 2011. If growth is too sluggish, a second-dip recession is possible.

Alternative Approaches to Job Creation

Over the recent past, there are very different rates of job creation that have occurred under different administrations. From January 1989 through January 1993, payroll employment in the nonfarm sector increased by 2.6 million or by about 54,000 a month. By contrast, payroll employment increased by 22.7 million from January 1993 through January 2001, or roughly 237,000 jobs a month. In the following eight years from January 2001 through January 2009, the net increase in jobs was only 1.9 million at a rate of only 19,000 a month. The record of job creation was better in the period January 1981 to January 1989 with a total payroll increase of 16.1 million or 168,000 a month, but this was still well below the growth 1993-2001.

I realize that many factors contribute to job growth, but when we evaluate alternative policy approaches to the economy we should at least look at the record and understand which approaches have worked in the past and which have failed.

The Obama Administration, the current leadership in Congress, and the Federal Reserve have taken a lot of criticism lately over the economy. The reason is not hard to find. Since January of this year, the unemployment rate rose from 7.6 percent to 10.2 percent in October, before dropping back to 10.0 percent in November, and payroll employment has fallen by over 3 million. To me, the criticisms seem totally wrong. The economy was in freefall in the last quarter of 2008 and the amazing fact is that things have turned around so quickly. Last March the dangers of a depression were real and urgent and so was the danger of a collapse of the financial system. Now the questions are around the speed of the recovery and how soon employment and incomes will start to grow again. I have been willing to express views that differ from those of the Administration and the Federal Reserve on financial reform and in other areas, but on the big issues of the recovery the policies have been the right ones and the results have been astoundingly positive. It is not surprising that with double digit unemployment, Americans are unhappy, but that will change as recovery takes hold.

Proposals to Improve Job Creation Quickly

There are four policies that are currently being discussed that could result in additional job creation quickly. These are, first, the extension of emergency assistance to seniors, the unemployed, COBRA and relief to states and localities. Second, tax incentives to help small businesses and measures to make small business lending easier. Third, additional funds for infrastructure and, fourth, incentives for energy efficiency improvements.

Is there a case for additional job creation efforts now? The case for such measures is that they would provide an insurance policy against a return to slow growth or a return to economic decline. The concern is that they would add to the deficit in the short run. I am very concerned about the budget deficit, but a jobs bill that kept the overall budget impact small would not pose a significant danger to the stability of the markets in Treasuries or the dollar. I would not support a bigger package unless there are clear signs that we are headed into a second dip recession. In the short run, faster growth in employment will itself reduce the budget deficit, partially offsetting the direct budget cost of job creation measures. In the longer run, as the economy move towards full employment, Congress and the Administration will have to make some very tough choices on spending and revenue to make sure the deficit is controlled. Job growth and a balanced budget are quite compatible, as I saw as a member of the Clinton economic team.

On the specifics of the proposals, I support extending emergency assistance, including the support for states and localities. The social safety net in the United States is not strong and seniors and the unemployed are being hard hit in this recession. Assistance to states and localities will mitigate layoffs of teachers and police and other workers. Improving credit availability for small and medium sized businesses is an important priority and should not be expensive as long as SBA-backed loans are made carefully. I am confident that Karen Mills, the Administrator, will do an excellent job on this, but she should not be pressured into making unsound loans. In terms of funds for infrastructure and tax incentives, the devil is in the details. I am a little skeptical of the benefits of such programs as job creators. Among the possibilities, a refundable tax credit for small businesses that add to employment looks attractive.

Policies Options for the Longer Run that may Help in the Short Run.

The deficits that have been inherited from the previous administration, and worsened by the recession and the need to restore financial stability, have put constraints on policymakers. There are lots of things that it would be great to do that would help the economy in the short run and the long run, but if done on a scale that could really move the needle on job growth over the next five years, they are too costly to carry out. I discuss below some policies that are worth considering as an improving economy makes funds available.

- **Invest in Science and Technology.** Government investments in science and technology have paid big dividends historically. Just looking at information technology alone, the government supported many of the early-stage innovations that drove the industry. It is important to note that high-tech industries do not usually create a lot of jobs directly, but they can transform the economy by the products and services they create, adding to overall employment and productivity. Government investment in technology goes wrong when the direction of investment is pre-specified. Instead, the funds should be directed by the opportunities inherent in the science and technology with guidance as to the broad social and economic goals. It is appropriate to look for ways to enhance carbon efficiency or ways to reduce the cost of treating diseases effectively. But it is a mistake to specify ahead of time how those goals are reached.

- **Invest in Skills and Not Just Education.** In the course of economic recoveries some of the same jobs that were lost are regained, but that is not the rule. Recessions are times when plants close and are never re-opened. Most of the new jobs created in the recovery will be in establishments that are new or that resume growing. Workers, young and old, will need to develop new skills. Losing a job is extremely painful, but the time when a typical worker will spend their entire career in one company is passed, if it ever existed. There is nothing wrong with education and the payoff to improving our schools would be tremendous. But classroom education divorced from practical experience is of limited value to many students, especially older workers. Not just older workers, because many young males have become impatient with formal education and are leaving high schools and colleges without graduating. This is an area where the federal government must partner with business to find ways to enhance the skills of the workforce, perhaps with some help from training subsidies or tax breaks (see also below). If American companies cannot find the skills they need in the U.S. workforce, we know what they will do. Produce overseas.
- **Involve Labor in the Skill and Improvement Effort.** Plants close when they are no longer economically viable. Sometimes this is the inevitable consequence of technological change or the impact of globalization. But many times the failure is not inevitable and the right policies at the company level would actually sustain jobs and improve productivity. What prevents this from happening? In some cases it is managers that resist efforts to change. In some cases it is the workers or the union they belong to. It is vital to a strong recovery that workers feel empowered to contribute to the success of their company and that their union is behind this effort. This may well mean that instead of giving training subsidies to companies (as I suggested above) that actually the subsidy should go directly to the workers. Administratively that is hard, but it is worth exploring. In addition it suggests the Administration should partner with unions to explore how to create jobs by increasing efficiency. It is hard to understand why it took 15 or 20 years for the American auto industry to adopt lean production. One reason was management, but another was resistance from the workers and the union. How many jobs have been lost because of that? If job growth in the recovery means creating good jobs, well paid, then there has to be the efficiency and productivity to justify those higher wages.
- **Relax the Constraints on H1B Visas.** Limits on H1B visas are seen as a way of protecting American jobs, especially at a time of high unemployment. This is a misconception. The skilled and educated workers that come to the United States are complementary with the skills of Americans. Immigrants have been the source of many of the innovative ideas that generate economic growth, both in Silicon Valley and throughout the country. They often start new companies. It is a mistake to deny our economy access to the human capital from this source.
- **Keep U.S. Manufacturing Competitive.** The manufacturing sector is in the front line of global competition. This sector lost 3.4 million jobs during the period 2000-2007 and has lost another 2 million since the recession started. The

reasons for the job losses are not solely due to trade by any means. Even countries like Germany and China that are large net exporters have faced job losses in manufacturing. But being globally competitive is a pre-requisite for a revival of the sector in the United States and the most important single factor that determines competitiveness is the exchange rate. I said earlier that no one wants to risk a collapse of the dollar, but it is also damaging to the economy to have an overvalued dollar. The dollar was overvalued in 2002 and its decline since then has been a benefit to manufacturing companies and workers. U.S. exports were growing rapidly in the years immediately prior to the global recession and they are poised to grow again, now that the world economy is recovering. Exports are expected to grow at close to 10 percent a year in 2010 and 2011, after adjusting for inflation. In order for the sector to remain competitive, however, the dollar has to stay at a reasonable level and that will not happen if we go back to overdependence on foreign capital inflows and that means, in turn, that the country must save enough.[3] Consumers are ready to do their part by saving more. Government must do its part by bringing down the budget deficit as the economy recovers. It is unlikely that the 5 million jobs lost in the past 9 years in manufacturing will be recovered fully, but there is an opportunity to save the jobs we have now and maybe get back some of those that were lost. Keeping health care costs under control is the key to a lot of things, including reducing the deficit and making manufacturing more competitive.

Conclusions

The U.S. economy has been a job-creating machine in the past and it can become one again in the future. One secret to the success of the U.S. economy is that government lets the private sector succeed. A vital part of the job creation strategy is to ensure appropriate reasonable regulation, avoid over-regulation and unnecessary barriers to private sector growth. I said earlier that recent criticisms of economic policy have been misplaced. At the same time, some of the criticisms of the business community are misplaced. Economic growth and job creation must come from the business sector, both big businesses and small, and it is vital that business, labor and government find ways to work together positively. Many leaders in the financial sector made horrendous mistakes that contributed to the crisis, but the time is past for name-calling. In November, Brookings held a CEO conference to discuss growth policies on a bipartisan basis. And an important goal of that meeting was to suggest a re-boot of the dialog on the economy. Economic growth is not a zero-sum game, but one where all our interests coincide.

Government can play an active role in job creation. The policies that have been followed by this Administration and Congress during the crisis have been extremely successful. Of course unemployment is still much too high and the recovery is not yet assured, but

[3] The relation between the budget deficit and the dollar is a complex one where economists may disagree amongst themselves. Provided global capital markets have confidence in the ability of the government to repay its obligations, a budget deficit will likely result in higher capital inflows from overseas and this will increase the value of the dollar. If confidence were lost in the credit worthiness of the Treasury, the dollar would crash and the consequences for the global economy could be quite severe.

the economy is vastly better than it was in January or at its low point in March, and it is now moving in the right direction. It is worthwhile to stop and celebrate this success.

The budget deficits inherited from the past constrain what can be done, but small steps can be taken that would help the job creation effort while minimizing the budget outlays. Extending emergency assistance is a cost-effective approach and so is assistance for small businesses. This testimony also looked at other policies to be considered in the longer run.