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THE 2013 JOINT ECONOMIC REPORT

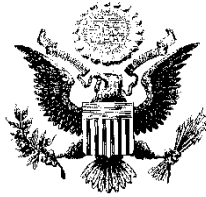
R E P O R T

OF THE

**JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES**

ON THE

**2013 ECONOMIC REPORT
OF THE PRESIDENT**



DECEMBER 11, 2013.— Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

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LETTER OF TRANSMITTAL

December 11, 2013

HON. JOHN BOEHNER
Speaker, U.S. House of Representatives
Washington, DC

DEAR MR. SPEAKER:

Pursuant to the requirements of the Employment Act of 1946, as amended, I hereby transmit the 2013 Joint Economic Report. The analyses and conclusions of this Report are to assist the several Committees of the Congress and its Members as they deal with economic issues and legislation pertaining thereto.

Sincerely,

Kevin Brady
Chairman

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THE 2013 JOINT ECONOMIC REPORT

DECEMBER 11, 2013. – Committed to the Committee of the Whole House on the
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**MR. BRADY, from the Joint Economic Committee,
submitted the following**

R E P O R T

**Report of the Joint Economic Committee on the 2013 Economic Report of the
President**

CHAIRMAN’S VIEW

The National Bureau of Economic Research’s (NBER’s) business cycle dating committee pegs June 2009 as the end of the “Great Recession.” In his letter transmitting the *2013 Economic Report of the President* (ERP)¹, President Obama stated “Our top priority must be to do everything we can to grow our economy and create good, middle-class jobs.” It is true that the economy has expanded in each of the last 17 quarters and added slightly less than 8.1 million private sector jobs over 45 consecutive

months. More than four years after the end of the recession, much of the nation has yet to experience anything resembling a normal economic recovery. Unfortunately, compared to other post-1960 recoveries, this recovery continues to scrape bottom on virtually every economic metric. The jobs have not fully returned, growth has been anemic, and incomes on Main Street have languished.

In the next section of our report, we examine the depth and breadth of the current recovery based upon data available as of December 6, 2013. After this general discussion, we review four chapters from the ERP: (1) “Jobs, Workers, and Skills;” (2) “Reducing Costs and Improving the Quality of Health Care;” (3) “Climate Change and the Path Toward Sustainable Energy Sources;” and (4) “International Trade and Competitiveness.”

We also include a discussion of the still unfolding implosion of the Affordable Care Act (ACA). Among the many issues Republicans on the Joint Economic Committee raised during debate over the ACA were the unsustainable funding scheme, its likely damaging effects on existing private insurance coverage and the quality of health care, its attempt to abolish the law of supply and demand, and its future negative economic consequences.

TRACKING THE RECOVERY

In this section of our report, we examine the strength and breadth of the economic recovery based on several economic metrics. Among the factors we examine are employment, unemployment, job creation, personal income, private business investment, and the effect of limited fiscal consolidation.

In general, we discuss the performance of the economy since the end of the “Great Recession” in June 2009. However, in many instances we examine the performance as measured by particular metrics from the low point for that metric during the current business cycle. For example, when discussing private sector job

creation, we compare recoveries from the cycle low point. We do this in part because this is the metric most frequently cited by the Obama Administration when touting the success of its economic policies.

Economic Growth

Since the recession ended in the 2nd-quarter 2009, real GDP has grown by a total of 10.2% over the four-year period, equivalent to an annualized growth rate of 2.3%. This compares with total growth of 18.7%, equivalent to an annualized rate of 4.1%, in the average post-1960 recovery. And the comparison with the Reagan Recovery is even more startling when real GDP increased by 23.1%, equivalent to an annualized rate of 5.0%, over the comparable period. This places the growth gap for this recovery at \$1.2 trillion (2009\$) compared to the average post-1960 recovery and \$1.9 trillion (2009\$) when compared to the Reagan Recovery (see Figure 1).

FIG. 1 - GAP IN REAL GDP GROWTH IS LARGE

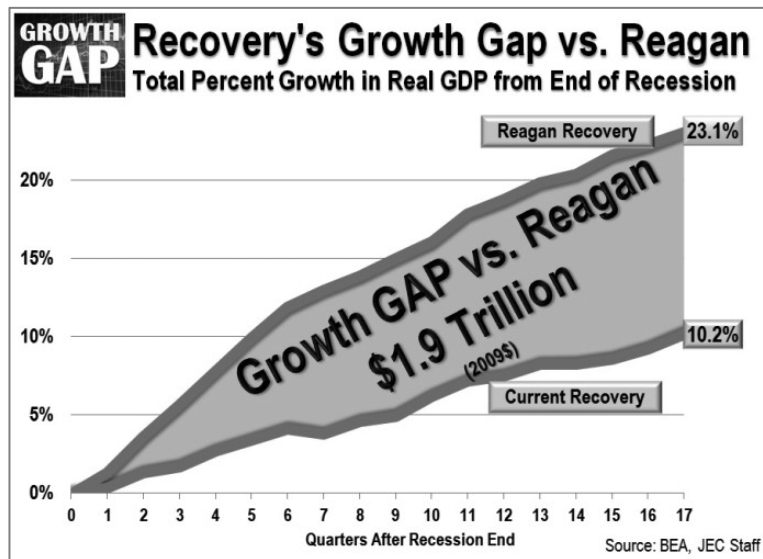
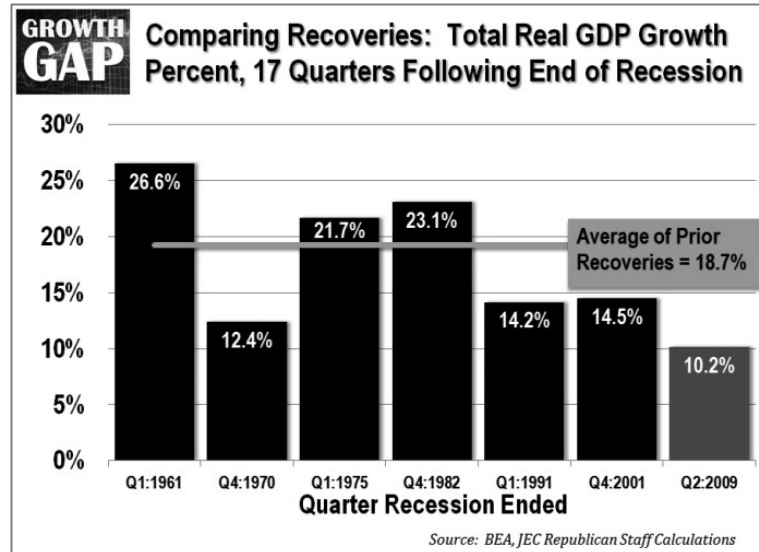


Figure 2 shows the total post-recession growth in real GDP for all post-1960 recoveries.

FIG. 2 - TOTAL REAL GDP GROWTH IN RECOVERIES



Private Sector Payroll Job Gains

The Obama Administration likes to tout its private sector job creation record, noting that there have been 45 consecutive months of private sector payroll job gains with slightly less than 8.1 million private sector payroll jobs added over that period, representing a gain of 7.5%. What the Obama Administration doesn't advertise is that the economy still has nearly one million fewer private sector payroll jobs than in January 2008 when private sector payroll employment peaked. The White House chooses February 2010 as its starting point for calculating its private sector "job creation" record which represents the recent low point for private sector employment.

Compared to other post-1960 recoveries, the Obama recovery continues to scrape bottom when it comes to private sector job creation even when using the Obama Administration's starting point. Private sector payroll employment grew an average 11.7% over the comparable period in other post-1960 recoveries. That

difference puts the private sector jobs gap for the Obama recovery at 4.4 million compared to other post-1960 recoveries.

The gap is even more pronounced compared to the Reagan recovery when private sector payroll employment grew by 14.0% over the comparable period. A Reagan-type private sector payroll jobs gain would have produced an additional 7.0 million private sector jobs (see Figure 3).

FIG. 3 - MASSIVE JOBS GAP VS. REAGAN

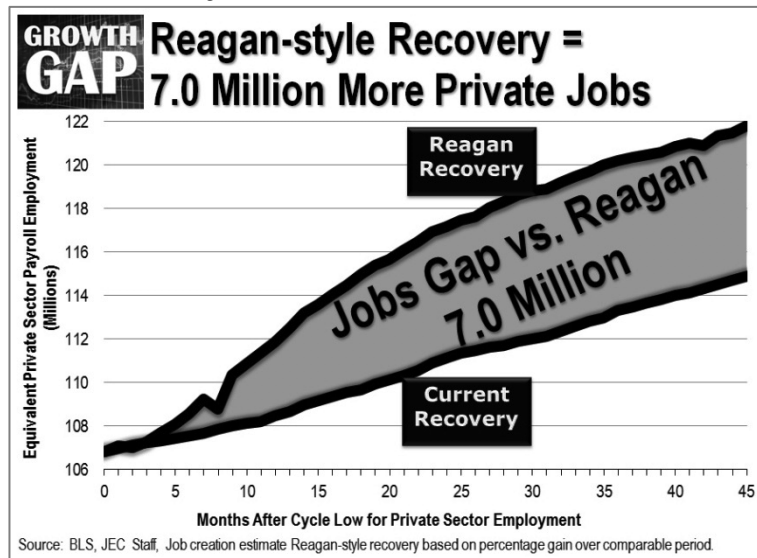
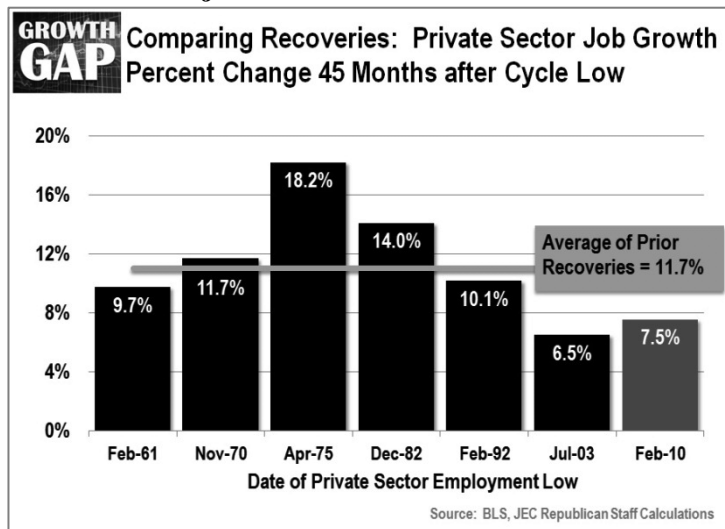


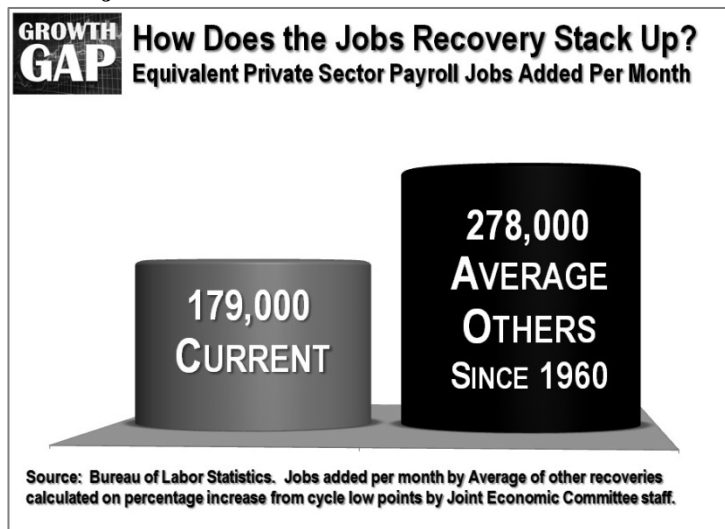
Figure 4 shows the percentage gain in private sector payroll employment for each recovery measured using the Obama Administration's metric that uses the cycle low point as a base.

FIG. 4 - PRIVATE JOBS GROWTH FROM CYCLE LOW



The reality is that the current recovery would have needed to produce roughly 100,000 additional private sector jobs each month in order to have simply been average (see Figure 5).

FIG. 5 – CURRENT RECOVERY MISSING 100K PRIVATE SECTOR JOBS EACH MONTH COMPARED TO OTHERS



The private sector job creation record of this recovery fares poorly not only when measuring from the cycle low point, but when comparing to end of recession or prior peak levels as well. Figure 6 illustrates the comparison for all three base points.

FIG. 6 – COMPARING PRIVATE SECTOR PAYROLL GAINS FROM VARIOUS POINTS IN POST-1960 RECOVERIES

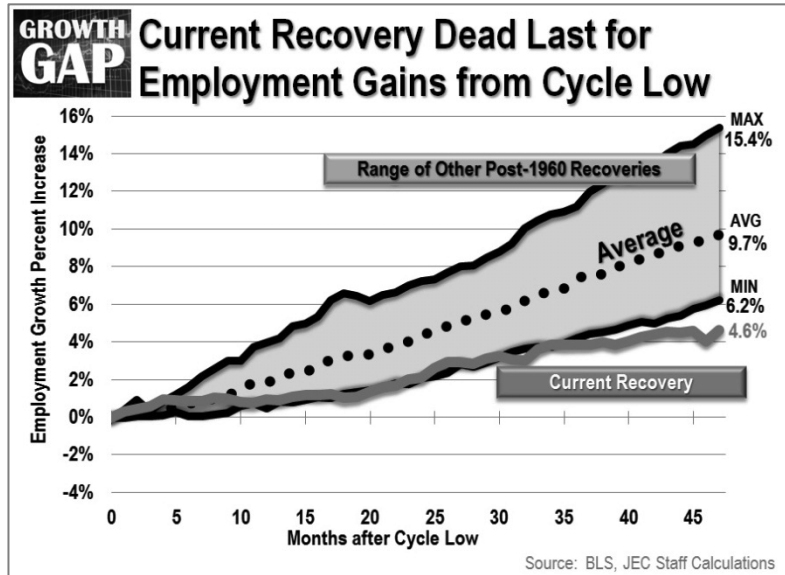
Private Sector Payroll Gains				
Recession		Percent Change Compared to:		
Start	End	Peak	End	Low
Apr-60	Feb-61	12.8%	12.9%	9.7%
Dec-69	Nov-70	8.0%	7.1%	11.7%
Nov-73	Mar-75	15.4%	19.7%	18.2%
Jul-81	Nov-82	12.3%	15.9%	14.0%
Jul-90	Mar-91	8.2%	9.0%	10.1%
Mar-01	Nov-01	2.4%	3.9%	6.5%
Dec-07	Jun-09	-0.7%	6.4%	7.5%

The fact that the economy has added roughly 8.1 million private sector payroll jobs is positive news. The fact that it has taken more than 4 ½ years to add those jobs is discouraging. The simple reality is that the Obama Recovery continues to add too few jobs at too slow a pace.

Employment as Measured by the Household Survey

While the Current Establishment Survey (CES) that measures payroll employment tends to get more attention, the household survey that also measures employment provides some insight into the dismal nature of the current recovery. If one adopts the same convention of measuring off the cycle low that the Obama Administration uses when discussing private sector job creation in the CES, this leaves the Obama recovery dead last for employment gains among post-1960 recoveries (see Figure 7).

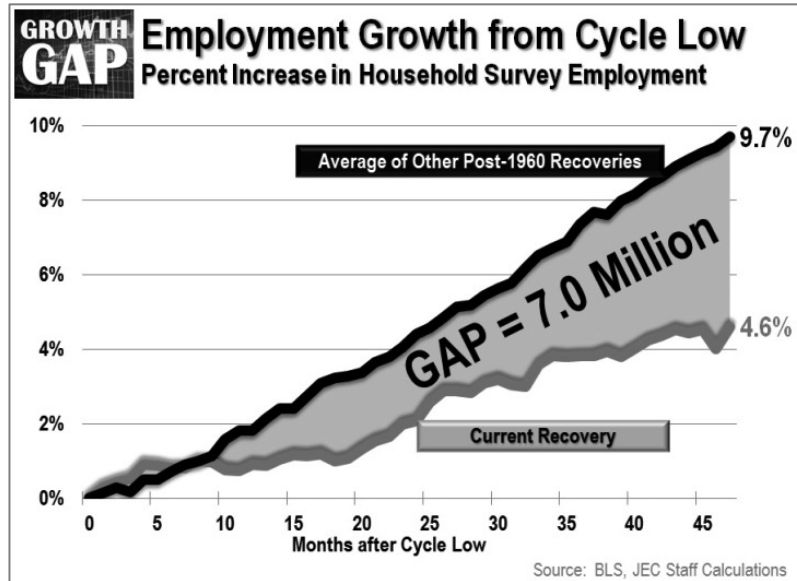
FIG. 7 – CURRENT RECOVERY’S EMPLOYMENT GAINS VERY WEAK COMPARED TO OTHER POST-1960 RECOVERIES



Employment as measured by the household survey hit bottom in December 2009. In the 47 months since, employment has risen by 6.4 million or 4.6%.

Over the comparable 47 months, the average of other post-1960 recoveries saw employment rise at a more brisk pace than the current recovery. On average, employment rose 9.7%, equivalent to an employment gain of 13.4 million. That puts the employment gap of the current recovery compared to the average of other post-1960 recoveries at 7.0 million (see Figure 8).

FIG. 8 – HOUSEHOLD SURVEY EMPLOYMENT GROWTH IS SIGNIFICANTLY SLOWER THAN OTHER RECOVERIES



This recovery's employment gap is especially pronounced when compared to the strong Reagan recovery of the 1980s. Measured off the cycle low over a comparable 47 months, employment in that recovery grew by 11.6% or the equivalent of 15.9 million. In other words, a Reagan-style recovery would have produced an employment gain 9.6 million greater than the current recovery.

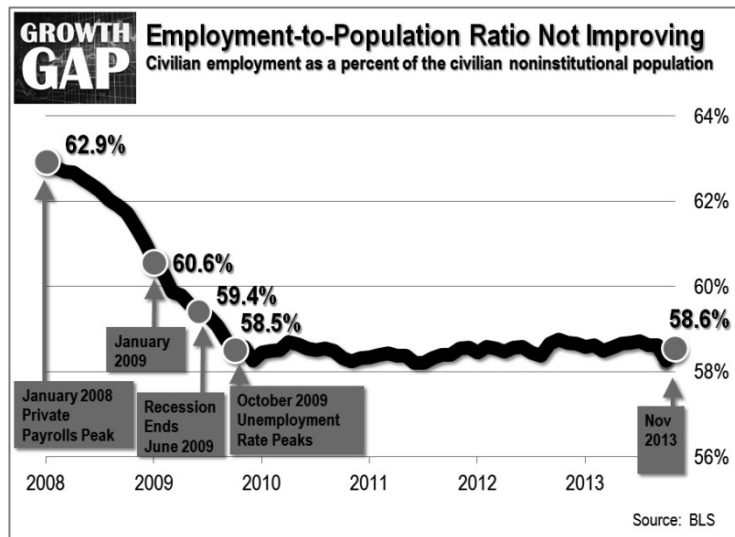
To be fair, population growth has slowed significantly in recent years. Yet even if one adjusts for different population growth rates, the current recovery lags the average employment growth of other post-1960 recoveries by more than 5.7 million.

The Unemployment Rate and Related Measures

The unemployment rate peaked at 10.0% in October 2009. Since that time, the rate has declined to its present level of 7.0%. This gives the impression of significant improvement. While the unemployment rate has declined, the percentage of adult Americans that are employed has not increased. Figure 12 shows

that the percentage of adult Americans who are employed, as measured by the employment-to-population ratio, has actually declined since the recession ended in June 2009.

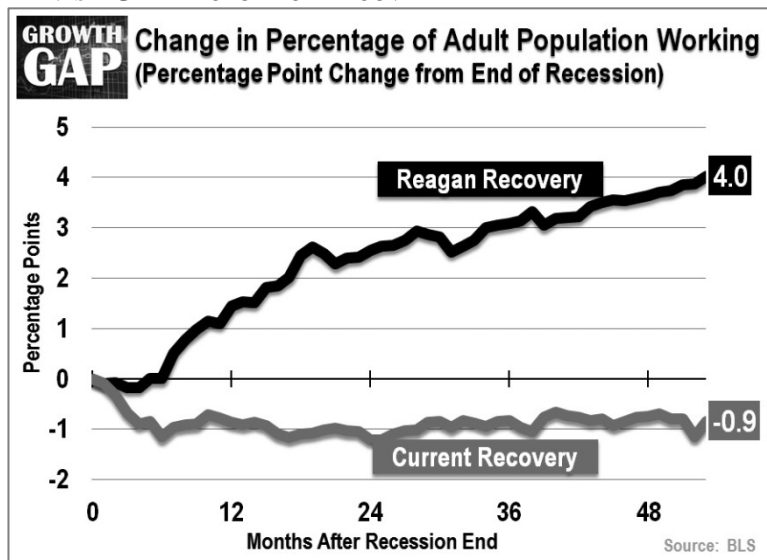
FIG. 12 – PERCENTAGE OF ADULT AMERICANS WHO ARE EMPLOYED HAS DECLINED SINCE END OF RECESSION



The employment-to-population ratio is more than four percentage points lower than in January 2008 when private sector payrolls peaked. It stands two full percentage points below the January 2009 level when President Obama took office. While the official unemployment rate has declined by three full percentage points since unemployment peaked at 10.0% in October 2009, the employment-to-population ratio has increased by a meager four one-hundredths of a percentage point over the same time period.

Figure 13 shows the very different progress on the employment-to-population ratio during this recovery and during the Reagan recovery. Since the end of the recession, the employment-to-population ratio has actually declined by 0.9 percentage point.² In other words, a smaller percentage of adult Americans are employed today than when the recession ended.

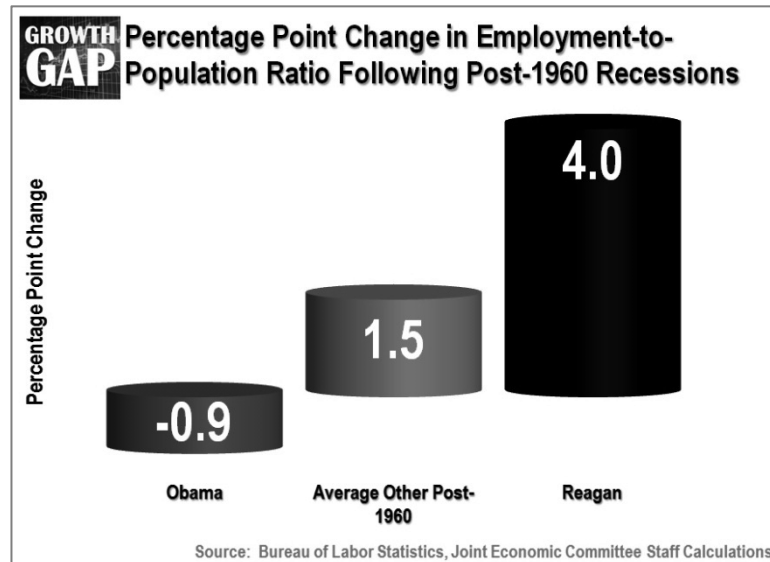
**FIG. 13- CHANGE IN EMPLOYMENT-TO-POPULATION RATIO
PAINTS A GRIM PICTURE OF RECOVERY**



Over the comparable number of months during the Reagan recovery, the employment-to-population ratio rose by 4.0 percentage points. This 4.9 percentage point gap³ is just another indication of how poorly this recovery stacks up against a strong recovery.

The current recovery also fares poorly against the average of other post-1960 recoveries. The average change in the employment-to-population ratio over a comparable period was a positive 1.5 percentage points (Figure 14). The lack of positive movement of the employment-to-population ratio suggests a population-adjusted employment gap of 5.7 million compared to the average recovery and more than 12 million compared to the Reagan Recovery.

FIG. 14 – UNLIKE OTHER RECOVERIES, THE EMPLOYMENT-TO-POPULATION RATIO HAS ACTUALLY DECLINED



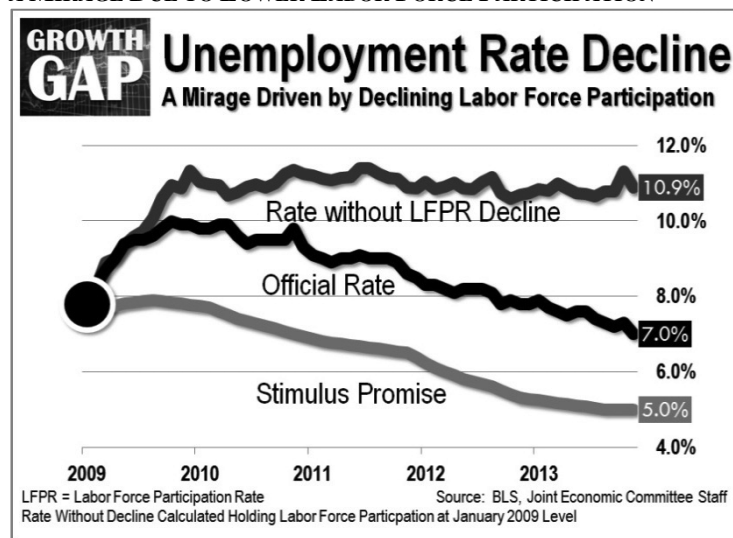
The failure of the employment-to-population ratio to rise coincidentally with a decline in the unemployment rate is the result of declining labor force participation. The decline in the labor force participation rate has been well documented. In November 2013, the labor force participation rate rebounded to 63.0% after hitting 62.8% in October – the lowest level since March 1978. While labor force participation has been projected to decline very gradually due to the aging of the population, the recent declines are troublesome and much greater than previously projected.

As mentioned earlier, the widely followed unemployment rate has declined to 7.0% from its October 2009 peak of 10.0%. This decline is largely a mirage that has been driven by the decline in labor force participation. While you can perform this analysis from any reference point, this analysis looks at the labor force participation rate today compared to when President Obama took office in January 2009. In contrast to the current labor force participation rate of 63.0% in January 2009 the labor force participation rate was 3.0 percentage points higher at 65.7%. At

the beginning of the recession, the rate was even higher, standing at 66.0%.

Absent the decline in labor force participation since January 2009, the unemployment rate would stand at 10.9% rather than the reported 7.0%, a 3.9 percentage point difference (see Figure 15).

FIG. 15 – DECLINE IN UNEMPLOYMENT RATE LARGELY A MIRAGE DUE TO LOWER LABOR FORCE PARTICIPATION



Both rates are significantly higher than the 5.0% rate that the Obama administration said the massive stimulus legislation passed in February 2009 would deliver.

While the headline unemployment rate is psychologically important and still widely followed, the dynamics of labor force participation make it increasingly less reliable as a meaningful measure of labor market health.

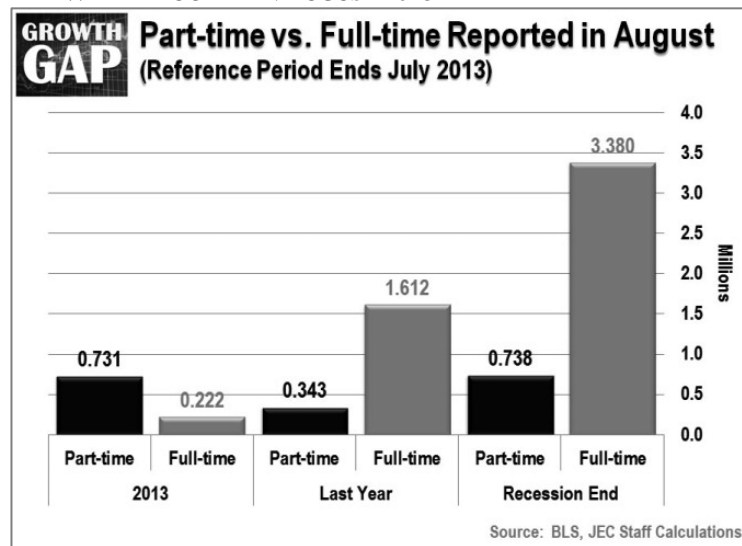
Full-time vs. Part-time Employment

Recently, there has been a great deal of discussion regarding the gains in full-time vs. part-time employment. It is important to

remember that data in the household survey tends to be very volatile and needs to be evaluated with care. Comparisons with past recoveries can be difficult because of changes in the wording of the survey questions that are asked about full-time vs. part-time employment status. Because of the volatility and seasonal trends in the data, the time period selected for comparison can create a misleading picture of the situation.

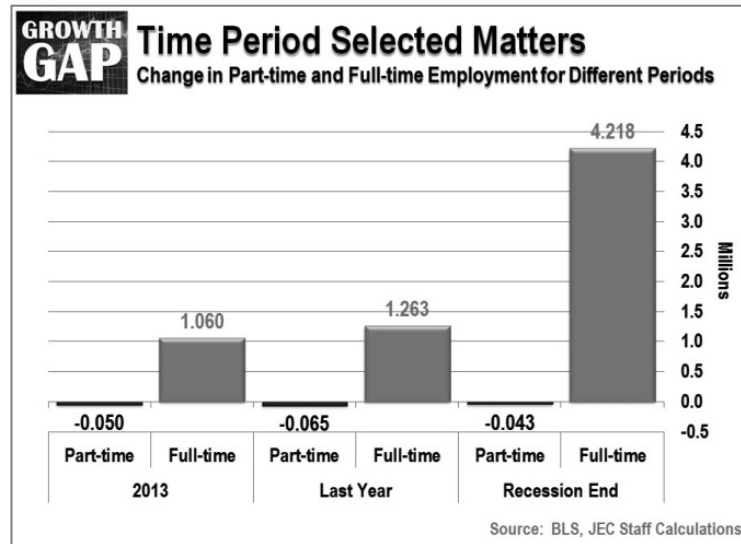
Figures 9 and 10 illustrate how the timeframe selected can change the full-time vs. part-time story. The ratio of part-time vs. full-time employment gains for 2013 looks significantly different today than it did when the report for July was issued in August.

**FIG. 9 – PART-TIME VS. FULL-TIME EMPLOYMENT:
THE WAY IT LOOKED IN AUGUST 2013**



The July report showed part-time employment gains outstripping full-time gains by a ratio of more than 3-to-1 in 2013 (See Figure 9). At present, the number of part-time employed has actually declined during 2013.

FIG. 10 – CURRENT DATA TELLS A DIFFERENT STORY

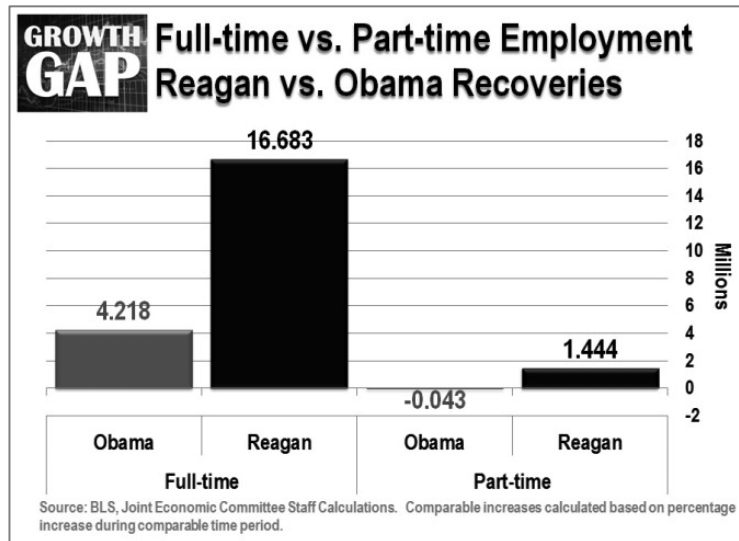


The reality is that the current recovery has failed to create both enough full-time and part-time employment opportunities.

As Figure 11 shows part-time employment gained in the Reagan recovery, but has declined in the current recovery. Full-time employment expanded at nearly four times the pace of the current recovery.

It is also important to remember that a large majority of part-time workers work part-time by choice. At present, there are 7.7 million part-time workers that are described as working part-time for economic reasons. That includes those working part-time because of slack work or business conditions as well as those who say they could only find part-time work. By contrast, there are some 18.9 million who say they are working part-time for noneconomic reasons.

FIG. 11 – BOTH FULL AND PART-TIME EMPLOYMENT GROWTH IS INSUFFICIENT IN THIS RECOVERY



To summarize, it is probably unfair to criticize the Obama Administration for an economy that has produced too many part-time jobs and not enough full-time jobs. A fairer criticism would be to note the failure to produce sufficient gains in both full-time and part-time employment.

Personal Income Growth

There are a number of different ways to look at how well American families and households have fared economically. This analysis looks at the change in real per capita disposable income during the current recovery compared with other post-1960 recoveries. While not perfect, this measure is useful because it accounts for inflation and is not distorted by changes in household or family structure over time.

In the 52 months since the recession ended through October 2013, real per capita disposable income has increased by only 3.7%. This is half the rate of increase in the second worst post-1960 recovery (See Figures 16 and 17).

Real per capita disposable income increased an average of 11.9% over a comparable period in the other post-1960 recoveries. If real per capita disposable income had increased at that rate in this recovery, it would have grown by \$4,245 (2009\$) instead of only \$1,332 (2009\$) (see Figure 17).

FIG. 16 – REAL AFTER-TAX INCOME LAGGING

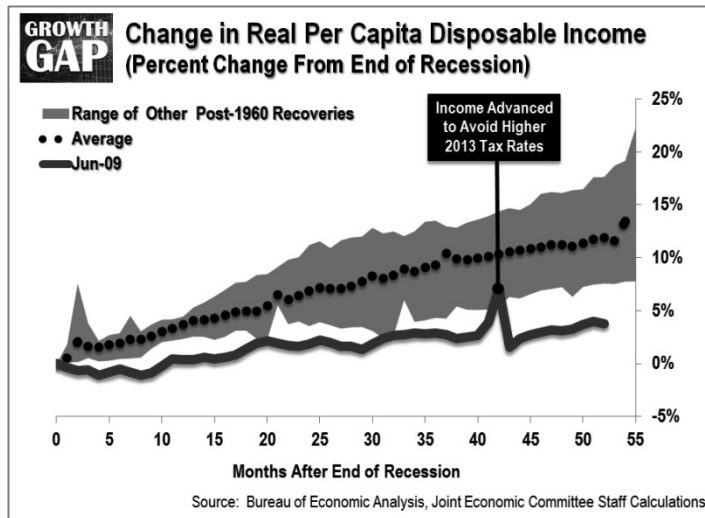
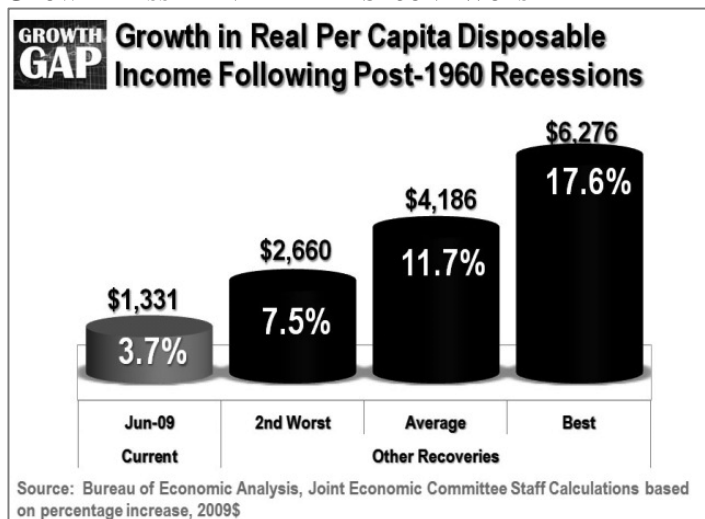


FIG. 17 – REAL PER CAPITA AFTER-TAX INCOME GROWTH LESS THAN HALF THE SECOND WORST



Perhaps one of the most disturbing aspects of the “personal income story” is the wide divergence between how the public at large has fared compared to Wall Street. While real per capita disposable personal income advanced a paltry 3.7% since the recession ended through October 2013, adjusted for inflation the S&P Total Return Index soared by nearly 95% over the same period (see Figure 18).

FIG. 18 – MAIN STREET FAMILIES CONTINUE TO SUFFER



While the Federal Reserve’s expansionist monetary policies may have helped to boost profits on Wall Street, it is increasingly clear that they have failed to deliver meaningful relief to families on Main Street. Economic policies that discourage investment and entrepreneurial risk taking on Main Street continue to deprive the American people of the economic recovery they need and deserve.

The Recovery Really is that Bad, but it isn’t because of the Sequester

Over the past year, there has been considerable discussion about the effects of automatic spending reductions contained in the

Budget Control Act of 2011. Advocates for more spending predicted economic and social calamity if the sequester was not stopped. Some economic forecasters predicted that both real economic growth and employment would suffer if spending reductions were allowed to take place.

While sequestration has received the vast majority of “ink” in this discussion, the tax increase component of fiscal tightening should have received the bulk of the attention. In its June 2013 Economic Letter, the Federal Reserve Bank of San Francisco noted: “Surprisingly, despite all the attention federal spending cuts and sequestration have received, our calculations suggest they are not the main contributors to this projected drag. The excess fiscal drag on the horizon comes almost entirely from rising taxes.” (Emphasis added.)⁴

In reality, the total reduction in federal government spending did not decline in fiscal year 2013. The Congressional Budget Office (CBO) recently estimated that during the fiscal year, total outlays declined by \$84 billion or 2.4%.⁵

However, that decline was more than accounted for by how payments to and from government-sponsored enterprises (GSEs) and the Troubled Asset Relief Program (TARP) are recorded. During fiscal year 2012, payments to GSEs were on net negligible. During fiscal year 2013, GSEs made net payments to the federal government in the amount of \$97 billion. Similarly, outlays related to TARP were estimated at \$24 billion during fiscal year 2012, while the government received \$9 billion in TARP repayments during fiscal year 2013. These payments are recorded as negative spending, not as revenues. Excluding outlays for GSEs and TARP yields a spending increase of \$46 billion, an increase of 1.3% of total outlays and 0.3% of 3rd-quarter GDP.

An analysis of spending trends should be made in an appropriate context. Nondefense spending was ramped up significantly

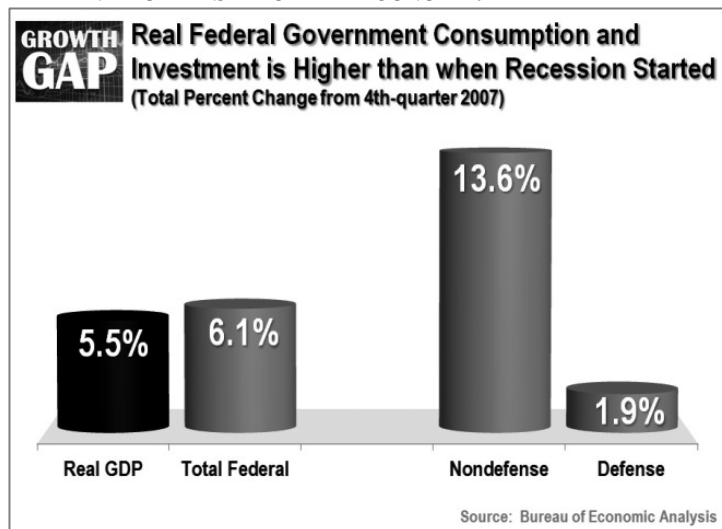
during the recession and defense spending was boosted by the troop surge.

While all federal spending does not show up in the federal government consumption and investment (FGC&I) component of GDP, comparing current levels with pre-recession 4th-quarter GDP levels helps put some perspective on the question. Real GDP was 5.5% higher in the 3rd-quarter 2013 than its pre-recession level. Real FGC&I was an even greater increase, 6.1% higher than the 4th-quarter 2007.

Most telling, as Figure 19 illustrates, is the comparative levels of federal nondefense consumption and investment and defense consumption and investment.

In real terms, defense consumption and investment is 1.9% higher than pre-recession levels, while real nondefense consumption and investment is 13.6% higher.

FIG. 19 – HAS THE GOVERNMENT PORTION OF GDP DECLINED RELATIVE TO THE SIZE OF THE ECONOMY?

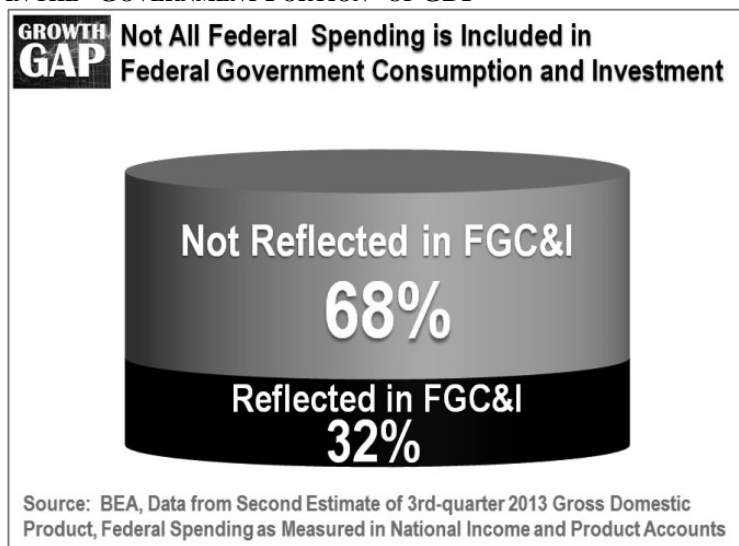


Federal government spending remains elevated despite the protestations that “austerity” is hurting the economy. In reality,

the only meaningful “austerity” that has been imposed is on American families via tax increases, not by reductions in federal spending. In reality, exceptionally low interest rates are masking the size of government spending on programs and entitlements.

Only about one-third of federal government spending is included in the federal government consumption and investment components of GDP. Other spending affects other GDP components. For example, Medicare reimbursements and food stamp purchases are included in personal consumption expenditures (Figure 20).

FIG. 20 – NOT ALL GOVERNMENT SPENDING IS INCLUDED IN THE “GOVERNMENT PORTION” OF GDP



Conclusion

The Obama recovery ranks last or close to last on virtually every indicator of economic health. And despite protests to the contrary, the anemic nature of the recovery has little to do with the modest amount of spending restraint imposed by the Budget Control Act of 2011. Constant intervention and interference in

the marketplace by the federal government and Federal Reserve are likely contributing to the slow recovery. The free market engine of American growth and prosperity has been restricted to first gear. The bottom line is that if we want to put America back to work, we have to let America work.

JOBS, WORKERS AND SKILLS

Summary

In the release of the 2013 ERP, the Council of Economic Advisers (CEA) highlighted: (1) the current demographic and labor force trends; (2) government as a partner in human capital and skill; and (3) immigration. The CEA notes that the aging population and slowing population growth will present challenges to America's workforce in the coming decades. Paired with the rising tuition costs and increasing levels of student debt, this complicates the drive to create a highly-skilled and educated workforce that meets the needs of America's future. The CEA believes that increasing the minimum wage incrementally to \$9.00 per hour by 2015 followed by indexing for inflation thereafter will ensure decent pay from work to support a family. The report also notes that commonsense immigration reform will "boost the economy by adding workers and making our labor force younger and more dynamic. (ERP, p. 159)"

The CEA notes the prime working-age population (ages 25-54) is projected to decline to 37.9 percent by 2040 from 40.5 percent in 2012. The report provides a brief examination of the trends in the labor force participation rate over the last several decades, noting that the labor force participation rate growth has slowed in the 1990s and began to decline in the 2000s after peaking at 67.1 percent in 2000. Interestingly, women's participation rate has also slowed in recent years, a much newer trend in the 2000s relative to the steady decline in the participation rate of men, which began in the 1970s. Though the report admits that there are plausible but not fully investigated explanations regarding the decline in the labor force participation rate for 16-24 year olds

and an increase in the rate for those ages 55 and older, it remains unclear why the labor force participation rate decline in the prime working-age population has occurred, currently at levels not seen since the early 1980s.

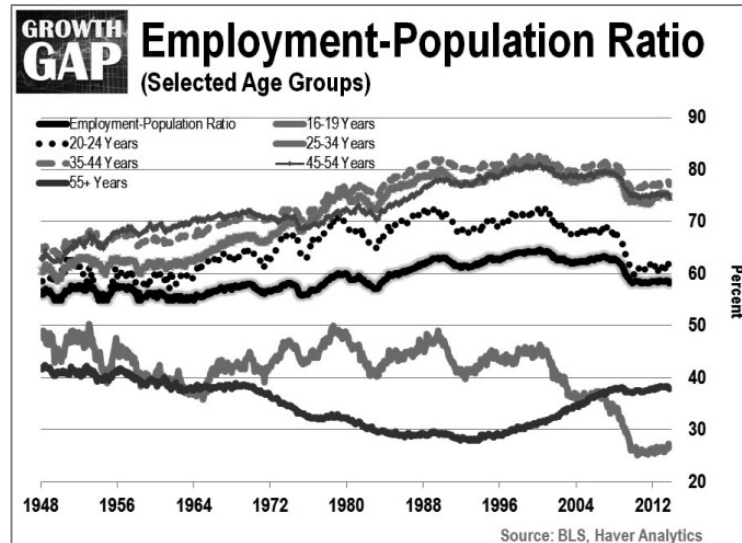
The depiction of a steep increase in returns to postgraduate education was accurate. The CEA suggests that Federal policies intended to reduce the price of education have helped to offset the increase in the net cost of attending college, but this assertion is unclear. The report details the current state of student loan debt, highlighting the likely causes and the potential threat to financial stability that such high debt could impose.

In the report, the CEA described the benefits of legal immigration, such as increasing the size of the labor force and customer base, yet the suggestions put forth to reform immigration policy, while going in the right direction, fall short on achieving the desired outcomes of boosting the economy and reducing illegal immigration. The report notes that numerical limits and backlogs have created long waiting times. Additionally, caps remain on H1-B visas, which permit temporary employment for skilled professionals sponsored by U.S. employers, except for higher education institutions and government research organizations that are exempt from such caps.

Response

While the population is indeed aging and the birth rate is in decline, these trends do not wholly account for the decline in the labor force participation rate and the employment-to population-ratio. The labor force participation rate measures the share of working-age population (age 16 and older) that is employed and unemployed but looking for a job. The employment-to population-ratio, which measures the share of the working-age population that is employed, declined during and after the 2001 recession, but was on a path to recovery of pre-2001 recession levels before the most recent recession occurred.

FIG. 21 – PARTICIPATION RATE ON THE RISE FOR OLDER AMERICANS



As noted in a report from the Bureau of Labor Statistics (BLS), because the population is continually growing, a rise in employment may not appear in the ratio, but a decrease in the ratio will reflect as a decline of employment in the ratio. Additionally, the overall participation rate is “difficult to interpret during recessionary periods, because it demonstrates no established cyclical pattern; the labor force can either expand or contract in response to worsening economic conditions, as the unemployment of one family member may spur another to look for a job or may influence others to refrain from entering an unpromising labor market.”⁶ However, if the participation rate among the prime working-age population continues to decline or stagnate, it could have negative consequences on economic expansion and quality of life going forward.

While the CEA accurately states that a family with two children and one minimum wage income still lives below the poverty line, it is unclear how they conclude that raising the minimum wage to \$9.00 per hour would raise the wages of roughly 15 million

workers. What the CEA fails to mention regarding the poverty line is that in addition to tax credits, there has been a proliferation of welfare programs and increase in benefits per recipient, especially in response to the recession, that are not counted in poverty statistics.

Most curious in this section of the report was the CEA's conviction that there has been a shift in the consensus view among economists about the effects of increasing the minimum wage on employment. This claim is unfounded and unsupported given the large swath of studies over the span of the last five decades and beyond that claim the opposite to be true, or that minimum wage workers are significantly hurt in other ways if not by reduced employment.⁷ At best, it could be claimed that the consensus view remains inconclusive as to the magnitude of the negative effect of a minimum wage increase. Contrary to the CEA's assertion, there is still an overwhelming consensus that increasing the minimum wage can have a notable negative impact on employment for low-skilled labor. In response to the increase to the mandated minimum in wages, businesses that cannot afford to pay the higher wage for the same unskilled labor react in a number of ways, as a Cato analysis notes, including but not exclusively by: reducing hours, cutting benefits, decreasing the number of persons employed, increasing the chance and duration of being unemployed in economic downturns, encouraging cuts to worker trainer programs, and increasing job turnover, all of which reduce productivity and hamper economic growth.⁸ More importantly, the evidence that the CEA cites in support of a minimum wage increase measured small increases in the minimum wage, and the report fails to acknowledge that the 25 percent increase from \$7.25 to \$9.00 is by no means a small increase.

Furthermore, as reported by BLS, while workers under age 25 represent only one-fifth of workers, they make up half of those paid the Federal minimum wage or less. Furthermore, the coming employer insurance mandates associated with the Patient Protection and Affordable Care Act compound the problem

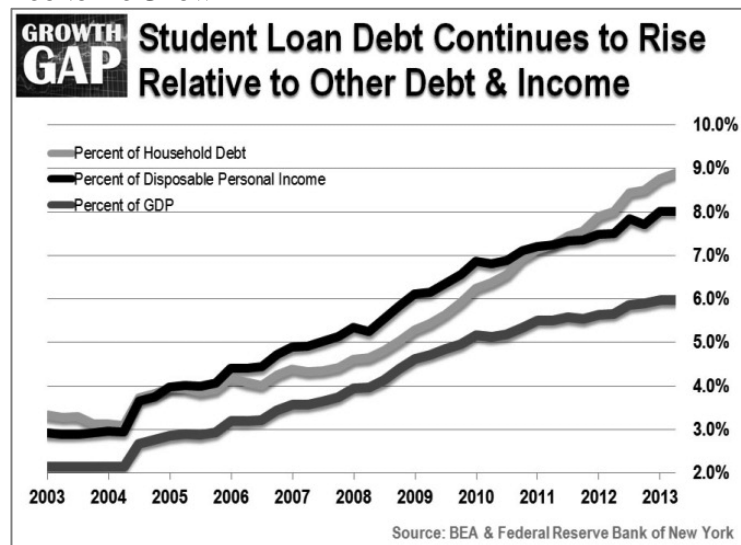
businesses face in the increasing cost of employing low-skill workers. According to the Wall Street Journal, the cost of both mandates together is expected to be at least \$5,700, a 37 percent increase to employers provided employers pay the penalty instead of providing coverage. If an employer opts to pay for coverage, then that combined cost could amount to as much as \$7,900 or more, a more than 50 percent increase.⁹

The CEA notes that the President has taken significant steps towards ensuring that post-secondary education remains affordable to students, but fails to acknowledge that some of those steps can have unintended consequences that can fuel the problem of rising tuition costs. As noted in a recent Wells Fargo Economic Group analysis, federal lending has dominated the marketplace for loans, which presents a problem as in health care, as prices and terms are set differently than in a private market. The analysis notes that the Consumer Financial Protection Bureau identifies only 15% of outstanding student debt originating from the private market. While favoring the social welfare benefits over the concern of students' ability to repay loans, the analysis states: "This presents a challenge to price discovery and alters the risk-return tradeoff, with more risk being shifted to taxpayers, the ultimate backers of federal debt and who are, moreover, not involved in making the credit decision to extend the loan."¹⁰

By all accounts, as a percent of household debt, disposable personal income, and GDP, student loan debt is rapidly on the rise, as shown in the figure above. Compounding the problems associated with this trend, household income growth has lagged behind tuition growth over the past decade. The cost of tuition and fees for post-secondary education has notably increased as a proportion of median household income, rising from 9.6 percent in 1976-77 to 25.0 percent in 2009-10. Many recent studies have pointed to federal aid as effectively increasing the price of tuition proportionally to the amount of aid offered. According to data from 1996 to 2008, Pell Grant recipients on average saw an increase in tuition price of \$17 to every \$100 of Pell Grant aid

offered. For selective nonprofit colleges, this ratio was observed to be as high as \$66 in average tuition price increases for every \$100 of Pell Grant aid offered to students.¹¹ This issue points to very dire circumstances for generations X and Y, who according to a recent report from the Urban Institute, have accumulated less wealth than their parents did at that age over 25 years ago.¹²

FIG. 22 – STUDENT LOAN DEBT MAY THREATEN FUTURE ECONOMIC GROWTH



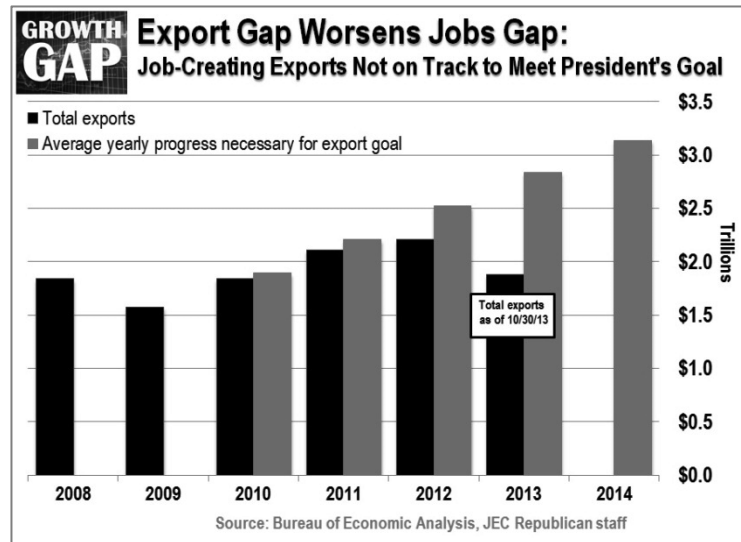
Finally, though the ERP does not go into great detail over the immigration policy changes that the Administration supports and therefore makes it difficult to evaluate, the removal of numerical limits and reduction in backlogs on legal immigration and visas, especially for skilled labor, would significantly reduce the incentive for illegal immigration and encourage skilled workers and entrepreneurs to choose the United States as a place of business and livelihood.

INTERNATIONAL TRADE AND COMPETITIVENESS

The ERP highlighted the President's National Export Initiative (NEI), which aims to double U.S. exports over five years in order to support up to two million new American jobs (ERP, p. 220). As a starting measure for this goal, the Administration chose a low point of 2009, when exports sank to an estimated \$1.57 trillion due to the recession. In order to meet the NEI objective, exports would have to reach \$3.14 trillion by the end of 2014.¹³

Thus far, the Administration is falling far short of this goal, which prompted private-sector economists to conclude that doubling exports before 2015 is firmly out of reach.¹⁴

FIG. 23 – ADMINISTRATION FAILING TO AGGRESSIVELY PURSUE POLICIES TO PROMOTE EXPORTS



The ERP blames weakness in the global economy for not making greater progress on exports (ERP, p. 221). However, other action and inaction by the Administration have contributed to the export gap.

For example, the Government Accountability Office (GAO) released a study critical of the Administration's Trade Policy

Coordinating Committee, on which the Council of Economic Advisers participated. GAO concluded the following:

In announcing the National Export Initiative, the President not only reemphasized the importance of exports to the U.S. economy, but specifically highlighted the need to understand and coordinate federal resources for export promotion. However, the TPCC does not provide decision makers—including Congress and the Export Promotion Cabinet—with information that provides a clear understanding of how resources are currently allocated across the country and around the world among its member agencies or across federal export promotion priorities.¹⁵

More fundamentally, the President has not armed himself with the tools necessary to pursue an aggressive, job-creating trade agenda.

The ERP correctly states that market-opening trade agreements are “critical to the growth of trade-supported jobs (ERP, p. 221).” During the previous administration, the number of countries with which the United States had a reciprocal free trade agreement expanded from three to 17.¹⁶ In contrast, the current administration has not concluded any free trade agreement that it initiated. Further, the Administration delayed submitting for congressional approval trade agreements with Korea, Colombia, and Panama that were negotiated during the previous administration. By the Administration’s own estimates, these agreements translated into the creation of 250,000 jobs.¹⁷ The delay has cost American farmers and other exporters crucial market share as competing trade agreements, such as the one between Canada and Colombia, entered into force.¹⁸

The ERP mentions that the Administration is currently negotiating with several countries in the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) (ERP, p. 221). Trade Promotion Authority

(TPA) is a critical tool for negotiating trade agreements because it assures our trading partners that the commitments made by the Administration will not be undone by Congress. The Administration now admits that it needs TPA in order to conclude important agreements like the TPP and TTIP.¹⁹ However, the Administration has not actively engaged with Congress on the contours of TPA. In addition, the President could have been granted TPA as early as 2011, when an amendment was offered that would have given him this authority. Instead, the President chose not to seek TPA, and members of his own party overwhelmingly rejected it.²⁰

CLIMATE CHANGE AND THE PATH TOWARD SUSTAINABLE ENERGY SOURCES

Failure to Analyze Effectiveness and Costs of Climate Policies

Chapter 6 of the 2013 ERP adds little to the understanding of climate change and what to do about it from an economic perspective. Most of the chapter invokes the threat of extreme climate developments that it represents would occur in the absence of Administration climate policies. The CEA repeatedly refers to a scientific consensus that anthropogenic greenhouse gas emissions are causing global warming²¹ and devotes a large part of the chapter to describing its harmful effects, conceding uncertainty only in the degree to which they are harmful. It thereby seeks to establish the necessity of the particular policies the Administration has chosen without discussing their relative effectiveness to date,²² their expected progress toward a concrete emissions objective, or their costs.

The CEA associates a “negative externality” with energy related greenhouse gas emissions because they “impose costs on others who are not involved in the transaction resulting in the emissions (ERP, p. 186),” stating further: “This diagnosis of the market failure underlying climate change clarifies the need for government to protect future generations that will be affected by today’s emissions (ERP, p. 196).” The CEA cites four estimated

present values for the future cost per ton of CO₂ emitted, the “social cost of carbon (SCC)” in 2011.²³ But the CEA does not relate these values to emission reductions; one does not know from the report what imposing them does to CO₂ emissions.²⁴ (There are other greenhouse gases; CO₂ is the major one and the ERP focuses on it.)

Further, the Council does not explain how much SCC the various Administration policy approaches already impose on emitters or how much more it thinks should be imposed. The report lists four methods to impose the SCC: (1) market-based solutions (cap-and-trade), (2) technology-based emissions regulation, (3) transitioning to more efficient energy technologies and use of renewable sources, and (4) preparing for future impacts that are by now unavoidable (ERP, pp. 196, 197).²⁵ But the report does not say how much or the SCC that the industry faces from each of them, especially from the predominant method the government uses to impose it, namely regulations and mandates with respect to (2) and (3).

Estimates of the Total SCC

The report also does not show total costs to the economy of applying the SCCs, it only mentions costs per ton. The following table shows total social cost of carbon estimates for the U.S. CO₂ emission volumes depicted in the ERP’s Figure 6-2, which are obtained from the Energy Information Administration (EIA). The total costs are derived by applying the Interagency Working Group’s latest SCC estimates (in 2013 dollars rather than 2007 dollars).²⁶ Though providing only 2011 figures, the Council explains that the SCCs will rise over time because marginal damages increase as atmospheric CO₂ concentrations rise (ERP, p. 191).

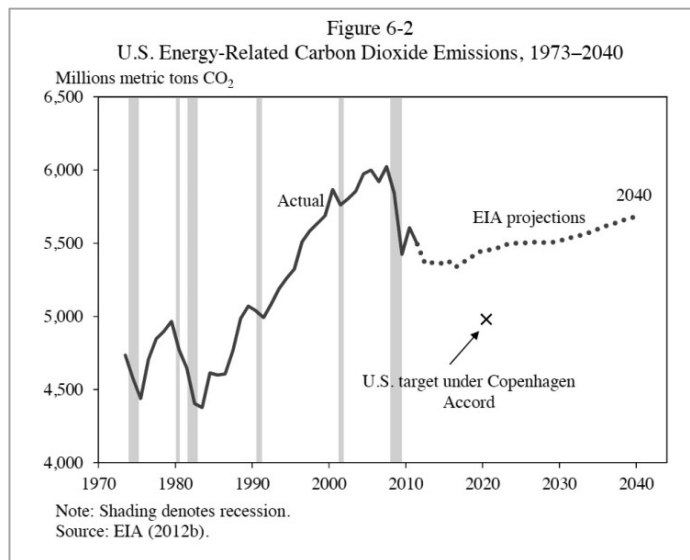
YEAR	CO ₂ Emissions Billion Metric Tons	SOCIAL COST OF CO ₂ Billions* of Current Dollars			
		Discount Rate			95 th Percentile
		5.0	3.0	2.5	3.0
2010	5.63	\$ 68	\$ 203	\$ 320	\$ 554
2015	5.38	\$ 71	\$ 223	\$ 341	\$ 641
2020	5.45	\$ 72	\$ 256	\$ 387	\$ 769
2025	5.50	\$ 84	\$ 289	\$ 421	\$ 866
2030	5.52	\$ 97	\$ 314	\$ 459	\$ 960
2035	5.61	\$ 116	\$ 349	\$ 496	\$ 1,078
2040	5.69	\$ 131	\$ 386	\$ 541	\$ 1,194
2045	N/A	\$ 26/Ton	\$ 72/Ton	\$ 101/Ton	\$ 225/Ton
2050	N/A	\$ 30/Ton	\$ 77/Ton	\$ 107/Ton	\$ 242/Ton
Notes: SCCs are based on averages from different models and scenarios.					
* Through 2040.					

The costs shown represent substantial economic burdens. It is important to know how large a burden the economy already bears and how much more the Administration wants to add with the regulations the EPA has in the pipeline. The Council suggests that a “robust” response to climate change should anticipate the worst outcomes that models have projected (ERP, p. 193), which indicates a preference for the costs in the column entitled “95th Percentile,” referring to the present costs for the worst 5 percent of modelled future climate outcomes. Yet, for all the certitude it expresses in the incontrovertible need to arrest global warming, the Council does not show any of these costs much less which ones the Administration believes ought to be imposed.²⁷

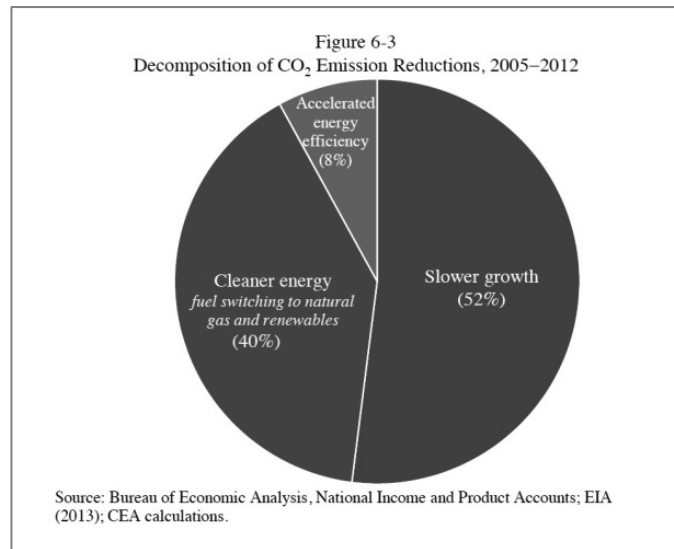
The ERP Does Not Map a Path to the Administration’s Objective

The Administration had pledged at the United Nations Climate Change Conferences in Copenhagen and Cancun to achieve specific levels of greenhouse gas emissions for 2020 and 2050. The ERP’s Figure 6-2, reproduced below, shows the 17% reduction the Administration agreed to from the level of U.S. emissions in 2005. But the report does not say what calculations led the Administration to make this pledge. It is also remarkable that the CEA shows a target without a path to meet it, especially given the chapter’s title referring to “the path toward sustainable

energy sources.” The Council should have laid out what it would take to achieve the 2020 target shown in the graph—now just seven years away—and the longer term 2050 target of reducing greenhouse gas emissions by 83% from their 2005 level, which is not shown in the graph and far below the range selected for ERP’s Figure 6-2.



There is a striking drop in emissions after 2008 that coincides in large part with the Great Recession. The Council estimates the contributions to the emission reductions that occurred since 2005 from various sources and, indeed, finds that more than half of the emission reductions were due to slower economic growth, as shown in ERP’s Figure 6-3.



It appears that it would take another “Great Recession” to approach the U.S. target under the Copenhagen Accord. It would have been appropriate for the Council to address the sacrifice of economic growth required to reach the target, but instead, the Council says it expects the economy to improve and that “the weakness of the economy in 2007-2009 will no longer restrain energy consumption (ERP, p. 195).” For recent reductions in emissions to continue, it advises that “a greater share will need to be borne by fuel switching into natural gas and into zero-emissions renewables, and by accelerating improvement in economy-wide energy efficiency (ERP, p. 195)” but offers no estimate of the extent or cost.

Current “Clean” Energy Technology is not Up to the Task

Germany, a country cited by the report as leading the United States in energy efficiency due in part to more energy efficient automobile and building codes (ERP, p. 199), has made a determined effort to increase efficiency in energy use and to adopt alternative energy sources; it now receives over 20% of its electricity from renewables. But a leading German weekly news magazine recently summarized the results this way: “Germany’s

aggressive and reckless expansion of wind and solar power has come with a hefty pricetag (sic) for consumers, and the costs often fall disproportionately on the poor. Government advisors are calling for a completely new start.”²⁸ A recent Wall Street Journal editorial put it another way: “A love affair with renewables brings high prices, potential blackouts and worries about ‘deindustrialization.’”²⁹ Japan, another country similarly cited in the ERP, just abandoned its emissions pledge for 2020 and set a new, much less ambitious target.³⁰

There is a debate going on in the United States among climate policy advocates over whether existing low carbon technology is good enough to continue pushing its general adoption with mandates and subsidies. Some claim that we have all the “clean” energy technologies we need and that they should be deployed through regulatory mandates and subsidies and taxes on “dirty” energy. But as practical problems of implementation have mounted, such as the “blend wall” for ethanol in the gasoline supply and insufficient supply of cellulosic ethanol to meet mandated levels of usage, objections to this approach are increasing. The Information Technology and Innovation Foundation (ITIF), for example, argues that technological breakthroughs are needed, not the dissemination of fundamentally flawed “clean” energy technologies that are uncompetitive with fossil fuels outside of niche markets and must be imposed through mandates, subsidies and taxes that have no chance of being adopted globally.³¹

Government subsidies and mandates can force an expansion of renewables that is initially affordable because it starts from a low base. Advocates of widespread deployment had hoped that economies of scale would bring down unit costs as volume increases, but it is ever more evident that with current technologies scale economies are not sufficiently pronounced and some long-run supply curves may even slope upward. Increasing volume does not make renewables competitive with fossil fuels but increases the burden on the economy. The Administration wants to lead the world to clean energy, but

emerging economies, whose CO2 emissions are increasing, will not follow a path that leads to an impasse. The Council lauds the government's investments in technology and R&D "aimed at driving costs down to the point where renewable energy is competitive with traditional fossil-fuel energy (ERP, p. 204)" but is silent on the technology deployment debate and the implications for its prescription of fuel switching and efficiency.

Positive Externalities

By inducing economic development and technological progress, current energy production can bring benefits that also are not part of decisions made in market transactions. These could be considered a positive externality of energy use. For example, increased production, investment and hiring in the oil and gas industry drive business expansion beyond the industry itself through a well-established U.S. supply chain, and, as incomes rise for wage earners, landowners, and governments spend more, inducing further economic expansion. A large number of studies have estimated the indirect and induced effects on GDP and employment of the oil and gas shale revolution with substantial positive value-added and employment multipliers.³²

The federal government invokes such multipliers for its own spending, which it claims generates benefits in excess of costs by stimulating production and hiring. Indeed, the ERP proclaims its commitments to "economic and job growth" and "energy security" in the energy chapter's first sentence ahead of "clean energy" and "climate change." It points to the "economic benefits of low-cost energy (ERP, p. 185)" specifically and points out the resulting "competitive advantage to the U.S. industrial sector (ERP, p. 202)" as well as induced growth in "agriculture, petrochemical manufacturing, and other industries (ERP, p. 204)."

The U.S. economy is operating below capacity and while it has been growing, the rate of growth lags far behind that of previous recoveries from recession, leaving a large share of the population

unemployed. Among the reasons are federal mandates and regulations that force the cost of efforts to manage the climate onto current production. Hence, there is a tension between advocating stimulus measures to raise production while at the same time adding cost that puts downward pressure on production. The ERP does not mention them, but negative multipliers attached to the social carbon costs are estimated in the hundreds of billions of dollars, as much as \$769 billion in 2020 alone, the year of the Administration's initial emissions target (see prior table).

The tension shows in various Administration policy stances, such as in its ambivalence toward hydraulic fracturing, for which it professes support indirectly by claiming an "all of the above" (ERP, p. 202) energy strategy, while at the same time seeking to take on a traditional state function and regulate it. Tensions abound also in the Administration's proud citing of increased domestic oil and gas production (ERP, p. 202) while refusing to allow more offshore drilling and indefinitely delaying construction of the Keystone pipeline, a project that would reduce U.S. oil imports from unreliable sources and create jobs in the United States. Beyond citing the general challenge of finding a responsible, balanced path, the ERP offers nothing concrete.

Economic Resiliency

Among the long-term positive externalities of economic growth are higher incomes, increasing productivity, technological progress, and introduction of new capabilities. A larger, more advanced economy can deal more readily with adversity whatever its nature. The tradeoff of negative for positive growth effects is on vivid display in many countries, such as China, that cope with immediate and tangible pollution problems in order to industrialize because it lifts their people from poverty and introduces advanced technologies. The more advanced their economies, the more able they are to overcome natural disasters and other hardships. Indeed, the concept of "negative externality" hardly applies in many countries because the state

has direct control over industrial activity and has to deal with the associated effects of pollution. When the externality is internalized it does not mean, as the report suggests (ERP, p. 186), that emissions necessarily will be reduced or eliminated. A government may choose not to cut emissions and accept the trade-off of negative for positive effects from energy use in what it views as its nation's long-term interest. This explains why some governments, rather than raise fossil fuel prices with taxes, push down their domestic gasoline and diesel prices below their import cost with subsidies and price controls.

Policies to Protect Us from the Elements

A good case could be made for policies that confer benefits regardless of whether particular predictions of the rate and direction of climate change come true. Beyond technological advancement and economic growth, protection from the natural elements that can wreak havoc whether or not the globe warms has value. In the section entitled "Preparing for Climate Change," the report advocates measures such as improving building codes, making structures more storm- and flood-resistant, investing in community planning and response, revisiting federal crop and flood insurance subsidies with a view toward encouraging drought-resistant varieties, and building away from flood plains. It also lists investments in maintaining existing infrastructure such as levees and enhancing the electrical power grid. These are sound suggestions in principle. It would have been instructive for the report to discuss their costs and benefits and compare them with other policies.

Conclusion

The Council treats Administration policies as self-justified by their professed intent to counteract global warming and says as much in the conclusion of chapter 6. It provides no basis for determining what policies are more or less effective among those adopted or for deciding what other policies may be better.

The chapter promoting the massive undertaking of managing the global climate does not address the impact on the economy of doing so. The Council cites different values for the social cost of carbon without quantifying the effect on emissions and economic output of imposing them. Its general appeal to fuel switching and efficiency improvements gives no measure of scale or cost and ignores the debate over forcing dissemination of alternative technologies as they exist versus developing superior ones. In particular, the Council's report does not show the path to the Administration's 2020 emission target—the point marked 'x' in the ERP's Figure 6-2.

Much of the report dwells on aspects of the climate that are outside the Council's purview. Having done so, the Council seems remiss in not mentioning that while greenhouse gas emissions have been increasing globally, the average global temperature has not risen in the last decade and a half. The crux of the anthropogenic global warming theory is that increasing greenhouse gas emissions cause the global temperature to rise. The Council delves into some detail on the subject of warming and states that "The Arctic has warmed ... in part because warming melts snow and ice, leading to less reflected sunlight, which causes yet more warming (ERP, p. 186)." But in September it was reported that the area of Arctic sea ice was almost 30% greater in August than a year ago, the main significance of which is that "the narrative of the 'spiral of death' for the sea ice has been broken."³³ This finding was reported after the ERP's release but suggests that the subject of climate change is better left to experts in that field. The CEA should have focused instead on the economic aspects of the Administration's emission objectives and what it would take to achieve them; that could have been very instructive.

REDUCING COSTS AND IMPROVING THE QUALITY OF HEALTH CARE

Health Care Spending

Chapter 5 of the ERP, which is entitled “Reducing Costs and Improving the Quality of Health Care,” discusses the rising cost of health care which it attributes to a combination of changing demographics, high labor-intensity of health care services, new technology, and an inelastic demand for health care services. First, rising costs reflect a growing population with a rising share of elderly individuals. It costs more to treat more people; and it costs more to treat the elderly than the young (ERP, p. 162). Second, the ERP claims health care wages have outpaced productivity growth (ERP, p. 163). Third, continued advances in diagnosis and treatment have increased costs per capita (ERP, p. 164). Finally, the ERP claims health care is a “super-normal” good which means the demand for health care rises faster than income (ERP, p. 165).

Demographics account for a considerable share of rising health care costs. But there are no empirical data to support the claim that health care is excessively labor-intensive. High wages for doctors and other medical specialists more likely reflect high levels of human capital and the inability to accurately measure their real output, thus understating productivity growth in the health care sector. Most sectors of the economy rely on new technology to reduce unit costs in order to increase demand for their product. But third-party payments and government subsidies for health care distort these incentives. Rather than consuming more because their incomes are rising, Americans are consuming more because their out-of-pocket share is falling.

Medical Technology

Improvements in the quality of health care contribute to decreased morbidity, increased survival, reduction in pain, and less onerous treatment administration (ERP, p. 165).

Measurements of productivity growth should reflect these improvements in outcome as well as their increased cost. But it is difficult to accurately identify each cause and effect. Moreover, morbidity and mortality are extremely poor metrics by which to judge the quality of health care. Not all medical conditions are life threatening, and not all medical care is intended to be life extending.

Sources of Inefficiency in Health Care Spending

The ERP states that geographic variation in practice patterns and health outcomes implies that a significant portion of health care spending produces little health value (ERP, p. 167). The report suggests various causes of poor health outcomes, including fragmented delivery and poor coordination of care. The failure to adopt “best practices” and payment fraud also contribute to waste and inefficiency (ERP, p. 169).

The extent to which geographic variations in health care spending are due to differences in socioeconomic factors (such as income, insurance, smoking, obesity, etc.), rather than differences in physician practice patterns is not clear. Spending differences between Medicare Part A and Part B as well as Medicaid and private insurance do not appear to vary in any systematic way. Any effort to equalize payments would have offsetting effects, thereby reducing any potential budgetary savings or adversely affecting access to health care.

Health Insurance Coverage

The ERP states that health insurance coverage provides many benefits, especially to those who with lower incomes (ERP, pp. 171, 172). The ERP states that the Affordable Care Act (ACA) increased dependent coverage for those up to age 26 and is expected to increase coverage among all age groups next year (ERP, p. 172). The ACA will also prevent insurance plans from denying coverage or charging premiums based on health status (ERP, p. 174).

Like all other goods and services, health insurance provides a benefit, but it also has a cost. Expanded coverage and increased benefits will increase the demand for health care and result in higher premiums and additional government spending.

Quality of Care and Payment Reform

The ERP states that the ACA will improve the quality of health care (ERP, p. 174). It notes that reductions in Medicare provider payments will extend the solvency of the Medicare trust fund (ERP, p. 175). The ERP also notes that the ACA contained several initiatives designed to reduce hospital readmissions, improve coordination of care, and reduce fraud (ERP, p. 175). The ACA payments reforms provide various incentives such as shared savings and bundled payments with risk adjustments (ERP, pp. 177, 178).

The projected improvement in Medicare solvency is based on the assumption that the reductions in provider payments under the ACA will occur as scheduled. Both CBO and Centers for Medicare and Medicaid Services (CMS) actuaries have stated that such reductions will likely prove to be unsustainable due their adverse impact on beneficiaries' access to health care. The CBO also concluded that two decades of previous cost containment demonstrations have not substantially reduced federal spending on Medicare.

Is the Cost Curve Bending?

The ERP claims the real rate of health expenditure growth has declined or remained constant every year between 2002 and 2011 (ERP, p. 179). It also claims that the projected growth of Medicare spending per beneficiary will decline (ERP, p. 179).

According to CMS, national health expenditures have risen from 15.4% of GDP in 2002 to 17.9% in 2011. While that's a slower rate of growth than some previous decades, it's not clear this is a

sustainable trend. Widespread adoption of managed care techniques coincided with the slowdown in national health expenditures during the 1990s. But as these techniques became commonplace, they generated a consumer backlash, and their cost restraining influence began to wane. Projections of future Medicare growth rates are merely projections.

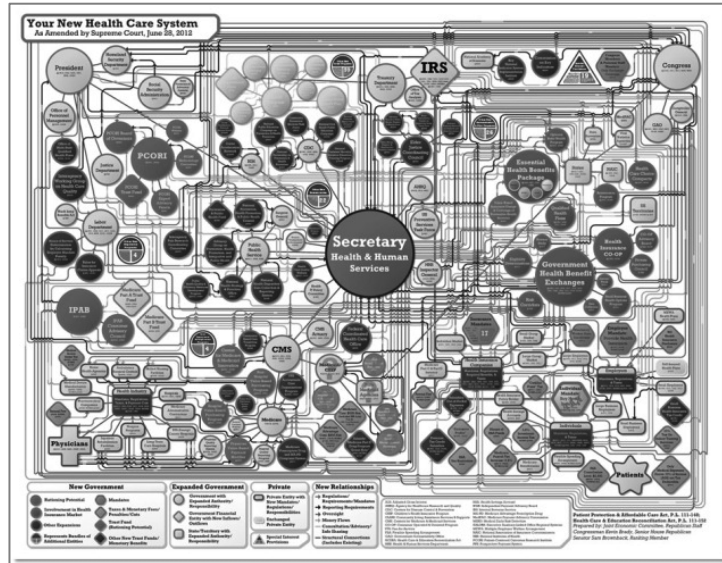
**ADDITIONAL COMMENTS ON THE AFFORDABLE CARE ACT:
THE FLAW IS THE LAW**

Introductory Comments

Much of America, including the media, seems surprised at the “coal” that is being delivered to Christmas stockings across America in the form of cancelled health insurance policies, skyrocketing premiums, and diminished access to specific health care providers.

We are not shocked by these developments. Joint Economic Committee Republicans warned about these and other issues during the Congressional debate on the ACA, popularly known as ObamaCare. We provided a vivid graphical illustration of the new health care system. It should surprise no one that the ACA is beginning to implode. And the President’s extra-legal executive actions will only delay, not prevent, the ACA’s inevitable collapse.

FIG. 24 – OUR NEW HEALTH CARE SYSTEM



In the remainder of this section, we will review several of the warnings Joint Economic Committee Republicans issued regarding the unsustainability and negative effects of the ACA.

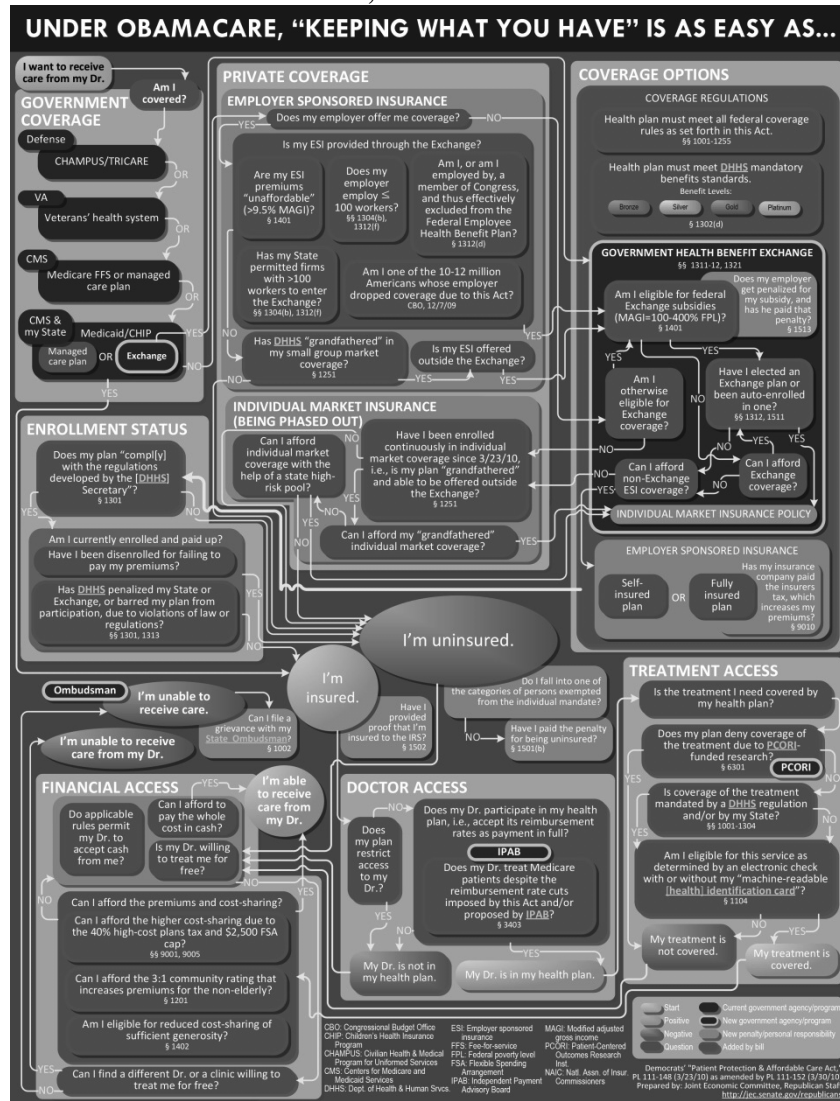
“If You Like Your Plan, You Can Keep Your Plan”

While healthcare.gov was experiencing a disastrous rollout, policymakers, the media, and the public were beginning to focus on the large number of cancellation notices that people in the individual insurance market were receiving. We noted in the 2010 Joint Economic Report, that “Despite concerns raised over the impact the reform package will have on existing health insurance coverage, President Obama has continued to assert that ‘If you like your doctor, you can keep your doctor. If you like your health care plan, you can keep your health care plan.’”³⁴ Investigative reporting revealed that for much of the time President Obama was making this public assertion, the White House knew the statement was false.

The fact that millions have received cancellation notices for their existing individual market insurance plans seems to have caught

many off guard. Joint Economic Committee Republicans warned of this eventuality during debate on the ACA in September 2009. On March 30, 2010, shortly after passage of the ACA Joint Economic Republicans made the point that under the ACA, the individual insurance was essentially “being phased out.”³⁵

FIG. 25 – PLAN CANCELLATION AND DEGRADED ACCESS TO DOCTORS SHOULD COME AS NO SURPRISE, UNLESS YOU DIDN’T READ THE BILL.



In the same *2010 Joint Economic Report*, we noted that premiums were likely to go up, not down and “[t]here are a significant number of provisions of the health care reform law that create perverse incentives and increase the likelihood that employers will choose to drop health care coverage for employees.”³⁶

We were also highly critical of the ACA’s financing mechanisms, some of which amounted to nothing more than gimmicks and sophistry. Several elements of the deal to secure votes for passage also accelerated the timing of when many negative consequences of the ACA would hit the economy and American citizens. At its core, we argued, the ACA contained all the wrong incentives.

The ACA imposed a new tax on health insurers of \$8.1 billion beginning in 2014 and rising to \$14.3 billion by 2018 (indexed for medical inflation in later years).³⁷ At the time, CBO affirmed the general consensus of economists that the new tax “would be largely passed through to consumers in the form of higher premiums for private coverage.”³⁸

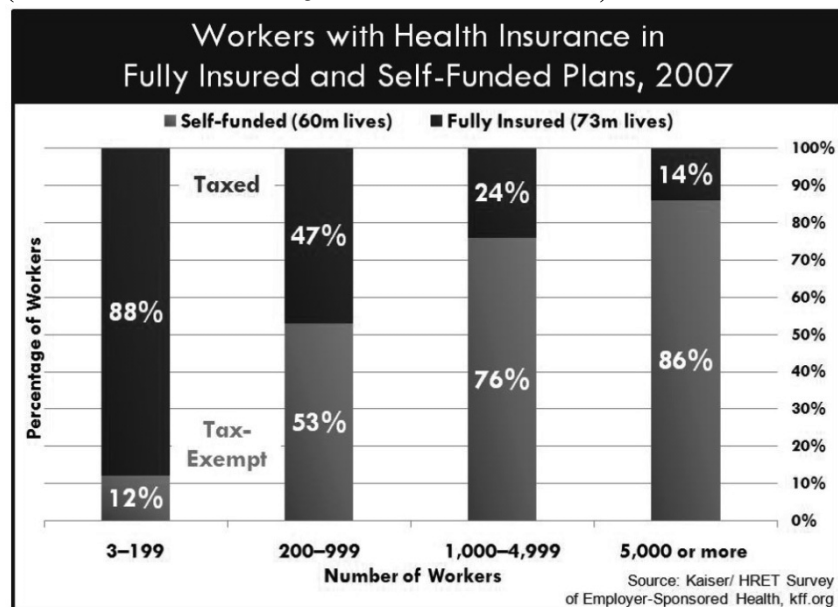
Far from reducing family health care premiums by \$2,500 a year, as claimed by President Obama, the new tax will paradoxically drive premiums upward for a typical family of four with job-based coverage, separate and apart from the bill’s other premium-increasing provisions. Unfairly, the costs of this new tax will be passed through to employees of small firms, the very firms that find it hardest to afford and offer coverage today.

Joint Economic Committee Republicans warned “the impact of the tax would not be equally shared across the board by those who ultimately pay it; rather, small businesses and their employees would bear a disproportionate burden. This is because the tax applies only to fully insured health benefits coverage. Self-funded plans, which are the most common type of plan for employers with 200 or more employees, are exempt from the tax. Self-funded plans require the employer to retain the risk of

insured employees, which is typically something small employers and the self-employed cannot afford to do because their risk pool is too small.³⁹

As the following chart (excerpted from the *2010 Joint Economic Report*), 88% of workers in businesses with 3-199 employees are in fully insured plans and would be subject to the tax, while only 14% of workers in companies with 5,000 or more employees would be subject to it.⁴⁰ Thus, the insurance tax is not only costly but disproportionately affects those workers who are employed by small businesses.

**FIG. 26 – DISPROPORTIONATE IMPACT OF HEALTH INSURANCE TAX
(REPRODUCED FROM 2010 JOINT ECONOMIC REPORT)**



Proponents of the ACA challenge the foregoing analysis on grounds that it does not take into account the new small employer health care tax credit that became available when the bill was enacted. This credit subsidizes a portion of the employer's premium contribution but is only available for a few years and only to very small firms with relatively low average wages.⁴¹ While the credit could potentially offset some of the

ultimate premium burden placed on small businesses, its existence does not alter the economic effects of the insurance tax. That tax will tend to drive up overall premium costs, regardless of any government transfer payments attempting to make the burden less onerous.

In addition to the new tax on insurers, the ACA also levies approximately \$5 billion a year in combined taxes and fees on manufacturers and importers of medical devices and brand-name prescription drugs. Since most of such therapies are paid for through insurance, public as well as private, these new taxes too will ultimately be passed on to consumers in the form of higher medical costs and insurance premiums. They may also negatively affect medical research and innovation.

Using Inflation to Hide the Cost of the ACA from Businesses and Consumers

Perhaps the most intellectually dishonest aspect of the ACA funding mechanism is the use of inflation to expand the application of various taxes imposed under the law.

For instance, the excise tax on high-cost plans (“Cadillac plans”) will hit more and more health insurance plans. In passing final legislation, the majority extolled the deal that delayed the implementation of the Cadillac plans tax. In reality, the majority engaged in a “Cadillac Shuffle” by delaying implementation but doing so in a way that insures the tax will apply to more plans at an earlier date than in the Senate passed legislation. The changes were represented as a “scaling back of the tax.” True, the effective date of the tax was delayed for five years, but beyond the ten-year budget window, the allegedly scaled-back version of the tax will actually hit even more plans and generate more tax revenue than the original tax.

Instead of adjusting by the Consumer Price Index for All Urban Consumers (CPI-U) plus 1%, the so-called “fix” adjusts those thresholds in the out years by just the CPI-U. In addition, a

special provision to adjust the initial thresholds if premiums grow faster than the Congressional Budget Office (CBO) projects will ensure that the tax will not hit federal employees' favorite plan when the tax is initially applied.⁴² The only plans that benefit in the short term under the last minute fix are plans that would have been subject to the tax under the enacted legislation between 2013 and 2017. In fact, for more modest plans, the tax bite will hit sooner and harder.

The irony is that the last minute "fix" replaced the high-cost plans excise tax revenue with revenue from a new Medicare tax on job and growth-producing investment income. In reality, while the short-term revenue under the excise tax on high-cost plans was reduced during the ten-year budget window, over the long-term the high-cost plans' tax revenues will be greater than under the enacted legislation unless the indexing level is adjusted in the future to prevent average and modest plans from becoming subject to the tax. In which case, much of the tax revenues that are supposed to pay for new health care subsidies would not be collected.

As noted, the thresholds at which the new "Medicare" taxes contained in the legislation apply are not indexed for inflation, meaning that taxes will hit taxpayers at progressively lower income levels. Beginning in 2013, so-called "unearned" income (that is, investment income) such as capital gains, dividends, and interest will be subject to this tax for individuals making over \$200,000 in 2010 dollars and families making over \$250,000. But because the tax threshold is not indexed for inflation, it will increasingly hit individuals and families with lower incomes as time passes.

The new 3.8% investment tax will be particularly damaging to the economy because taxes on investment income discourage business investment in new buildings, equipment, and intellectual property.

The downsides of this tax are hard to overstate. Investment is the

foundation for increased productivity, technological advancements, income growth, and overall economic prosperity. Reduced investment will lead to lower incomes and lower GDP, which will further exacerbate the impending fiscal disaster facing the United States as a result of the massive deficits and debt that President Obama and Washington Democrats have been piling up at a breathtaking rate. The result will be slower economic growth, fewer jobs, lower wages, and a nation less economically prepared for the future.

Opposition to the new 3.8% investment tax was undoubtedly muted by the fact that it was billed as a tax on the “unearned” income of wealthy individuals and families. People of modest incomes and those not currently receiving any “unearned” income might reasonably believe they are immune from the tax. However, failure to index this tax to inflation means that it will eventually hit middle-class individuals and families.

An often overlooked issue is the various incentives the legislation creates for employers to drop employee health coverage in favor of paying a fine and sending their employees to the public exchanges. Should this occur on any kind of scale, the cost of subsidies under the legislation will soar and even the gimmicks used to “pay for” the legislation will not sustain the illusion that the legislation is deficit neutral.

During debate over the ACA, we discussed at length the damage done to economic incentives by provisions that are included in the law.

In addition to providing incentives to employers to pay a penalty and drop employer provided health insurance for their employees, we warned that the premium support scheme contained in the ACA would undermine incentives to work by imposing large effective marginal tax rates on certain earners. Those hardest hit by these provisions will be families with modest incomes.⁴³

Worry About the IRS and Catastrophic System Failure

We have witnessed not only a difficult roll out of healthcare.gov, but growing concern over the Internal Revenue Service's role in implementing the law. Concern has ranged from fear over the use of personal data for improper purposes to questions about the massive increases in personnel and budget needed to implement the law.

We could discuss the warnings we issued regarding the deleterious effects this law would have on the economy and our citizens at even greater length, but we will end our discussion of the ACA succinctly.

We reiterate our warning from 2010: "Policy makers should be concerned that the complexity of the scheme creates significant risks – even a potentially catastrophic system failure."⁴⁴

FINAL COMMENTS

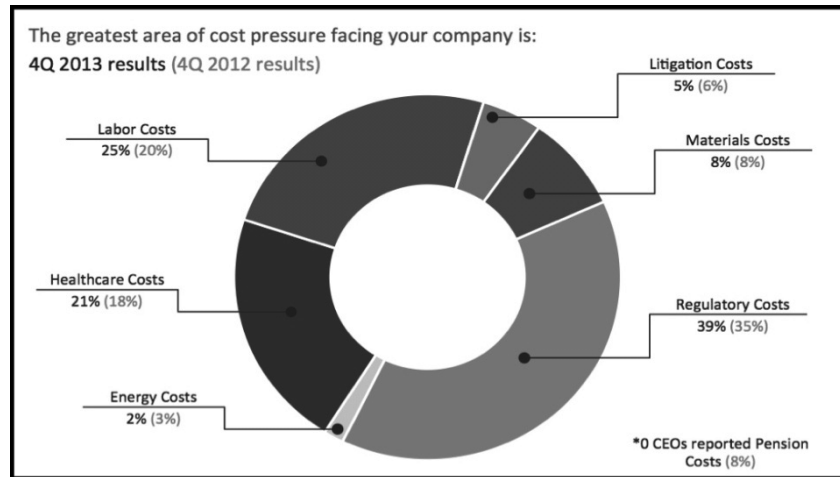
The American economy has been the greatest engine of prosperity in history. While not perfect, our historical reliance on bedrock principles of free people and free markets has brought more prosperity and freedom to more people than the world has ever witnessed. That prosperity has enabled the United States to become the strongest, most resilient nation on earth.

Unfortunately, the trend to greater reliance on the federal government and increasingly intrusive social and regulatory policies emanating from Washington threaten to condemn our nation to economic stagnation that will lower the standard of living for all Americans. In fact, our overly burdensome entitlement-program promises threaten to bankrupt the nation.

Indeed, in the Business Roundtable's (BRT) 4th-quarter 2013 CEO Economic Outlook Survey, CEOs cited regulatory costs as

“the top pressure facing their business over the next six months.”⁴⁵ Labor and healthcare costs were also of significant concern.

FIG. 27 – GRAPHIC ACCOMPANYING BRT RELEASE

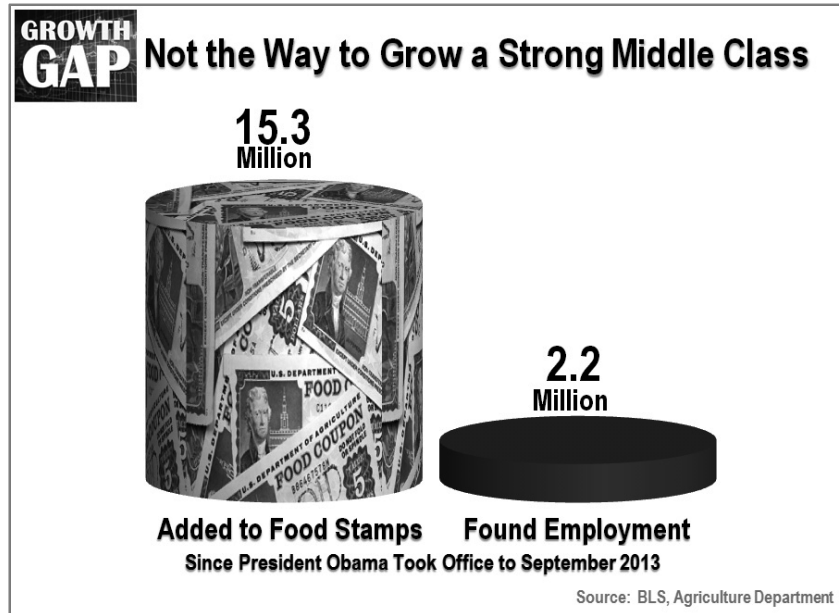


BRT’s Chairman, Jim McNerney, President and CEO of the Boeing Company, summarized the executives’ outlook noting that “In aggregate, our expectations are consistent with an economy that will continue along the path of steady, modest recovery into the first half of 2014. These soundings are also consistent with an overall economy that, despite progress, is not yet performing at its full potential.”⁴⁶

This is simply not good enough. Neither is the disturbing fact that from the time President Obama took office in January 2009 through September 2013⁴⁷ more than 15.3 million Americans were added to food stamp rolls while employment, as measured in the household survey, rose by only 2.2 million. Adding nearly 7 people to food stamps for every person that gained employment is not the way to grow a strong middle-class.

This is not an accomplishment to be proud of. We must reverse this trend before it is too late.

FIG. 28 – THIS IS NOT THE WAY TO GROW A STRONG MIDDLE CLASS



We must return to our bedrock principles and recognize that the best hopes for America's economic future are free people and free markets. We must curtail unnecessary intrusions by the federal government into the lives of our citizens and the economy.

The choice we face is simply stated. Do we trust America's future to the benevolence and competence of big government? Or do we place our trust in free people and free markets?

Joint Economic Committee Republicans will choose the proven path of free people and free markets.

ENDNOTES

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http://www.whitehouse.gov/sites/default/files/docs/erp2013/full_2013_economic_report_of_the_president.pdf.

² Calculated numbers are used here to account for rounding rather than using the single decimal numbers reported by BLS. This number is rounded up to the nearest tenth of a percentage point; the calculated decline is actually 0.852 percentage point.

³ Rounded up from a calculated difference of 4.89 percentage points.

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⁵ Congressional Budget Office, "Monthly Budget Review – Summary for Fiscal Year 2013," November 7, 2013.

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Americans earn \$0.00 per hour and live in poverty, because of the minimum wage law,” AEI, February 13th, 2013, <http://www.aei-ideas.org/2013/02/the-real-tragedy-is-that-many-americans-earn-0-00-per-hour-and-live-in-poverty-because-of-the-minimum-wage-law/>

⁸ Mark Wilson, “The Negative Effects of Minimum Wage Laws,” Policy Analysis 701, Cato Institute, June 21st, 2012, <http://www.cato.org/sites/cato.org/files/pubs/pdf/PA701.pdf>

⁹ Merrill Matthews, “It’s Not Just the Minimum Wage, It’s Also the Health Insurance Mandate,” Forbes, February 19th, 2013, <http://www.forbes.com/sites/merrillmatthews/2013/02/19/its-not-just-the-minimum-wage-its-also-the-health-insurance-mandate/>

¹⁰ John E. Silvia and Sarah Watt, “Student Loans: A Different Financial Market,” Wells Fargo Economics Group, February 11th, 2013.

¹¹ Jack Hough, “Why College Aid Makes College More Expensive,” SmartMoney, February 24, 2012, <http://www.marketwatch.com/story/why-college-aid-makes-college-more-expensive-1330033152060>

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¹⁵ Government Accountability Office, “Export Promotion: Better Information Needed about Federal Resources,” July 2013, p. 17, accessed at <http://www.gao.gov/assets/660/655947.pdf> on November 18, 2013.

¹⁶ The United States Trade Representative’s listing of free trade agreements and their entry into force can be found at http://www.trade.gov/mas/ian/tradeagreements/fta/tg_ian_002401.asp.

¹⁷ Committee on Ways and Means, “Trade Agreements Create Jobs and Economic Opportunities for U.S. Workers,” accessed at http://waysandmeans.house.gov/uploadedfiles/revise_trade_101-2.pdf on November 18, 2013.

¹⁸ United States Department of Agriculture Foreign Agricultural Service, Global Agricultural Information Network Report on Colombia, March 15, 2011, accessed at

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¹⁹ Doug Palmer, “USTR Nominee Froman Promises Push for Trade Promotion Authority,” Reuters, June 6, 2013, accessed at <http://www.reuters.com/article/2013/06/06/us-usa-trade-nominee-idUSBRE9551DP20130606> on November 18, 2013.

²⁰ United States Senate, 112th Congress, 1st Session, Record Vote #141, accessed at http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=112&session=1&vote=00141 on November 18, 2013.

²¹ It cites the 2009 assessment by the U.S. Global Change Research Program (USGCRP) on behalf of the National Science and Technology Council and the International Panel on Climate Change (IPCC 2012).

²² The closest it comes is to estimate the effects on CO₂ emissions of energy efficiency and fuel switching overall.

²³ \$5, \$22, \$36, and \$67 per ton, in 2007 dollars. The SCC covers “health, property damage, agricultural impacts, the value of ecosystem services, and other welfare costs of climate change (ERP, p. 188).” The CEA relies on the Interagency Working Group on Social Cost of Carbon (led by it and the Office of Management and Budget) that issued a document in February 2010 monetizing the future cost of emitting an additional or marginal ton of CO₂. Three of the present values it cites differ in the discount rate applied, 5 percent, 3 percent, and 2.5 percent, and the fourth is based only on the worst 5 percent of modeled climate outcomes, discounted at 3 percent.

²⁴ The closest it comes to addressing the question is to say that the new fuel economy standards “are projected to reduce annual CO₂ emissions by over 6 billion metric tons over the life of the program...” (ERP, p. 198.)

²⁵ Despite its statement that “Appropriate policies to address this negative externality would internalize the externality, so that the price of emissions reflects their true cost ...,” (ERP at 186) the CEA does not discuss carbon taxes.

²⁶ The Interagency Working Group has already increased its estimated SCCs from the levels the CEA cites, with increases of 80-140 percent by 2020 and 172-146 percent by 2050 (Technical Support Document: Technical Update of the Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12866, May 2013). For example, the new SCCs/ton in 2007\$ for 2010 are: \$11, \$33, \$52, and \$90; multiplying them by 1.093 yields SSCs/ton in 2013\$ and by 5.63 billion tons yields total SCCs in billions of \$68, \$203, \$320, and \$554 (rounded).

²⁷ “President Obama has set a goal of once again doubling generation from wind, solar, and geothermal sources by 2020 ... (ERP, p. 205),” but the closest the CEA comes to talking about cost numbers is to cite the President’s Better Buildings Challenge with \$2 billion in private-sector commitment, a 2011 investment of \$14 billion in wind generating capacity, the Administration’s support for solar energy exceeding \$13 billion since

September 2009 through DOE programs, including loan guarantees, \$6 billion in clean coal technology with \$10 billion private funds, and \$4.5 billion through the Recovery Act for smart grid investment, matched by \$5.5 billion private funds.

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²⁹“Germany Reinvents the Energy Crisis,” Holman W. Jenkins, Jr., *The Wall Street Journal*, 11/9-10/13.

³⁰“Japan in greenhouse gas emissions U-turn,” Jonathan Soble and Jan Cienski, *Financial Times*, 11/15/13.

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³³ Quote from the *Wall Street Journal* of a climatologist at the Georgia Institute of Technology in “Arctic Ice Grows Almost 30% After Record Melt in 2012,” by Gautam Naik, September 11, 2013.

³⁴ Joint Economic Committee, *2010 Joint Economic Report*, p. 98. Accessed at: http://www.jec.senate.gov/public/?a=Files.Serve&File_id=1f859d11-f43b-4dd6-9f8b-a90199b02841

³⁵ UNDER OBAMACARE, “KEEPING WHAT YOU HAVE” IS AS EASY AS ... , March 30, 2010, Available at: http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=5e400308-40bc-4555-865f-7d982488081f

³⁶ *2010 Joint Economic Report*, p. 101.

³⁷ § 9010 of PPACA. Tax is based on net premiums written. Each year, each health insurance company is to pay a share of a total amount specified in the law, equal to the company’s share of the market. Tax is not deductible as a business expense. Joint Committee on Taxation, JCX-18-10, 3/21/10. The yearly amounts total \$73b over 2014-19, but JCT estimates only \$60.1b will actually be collected. JCT, JCX-17-10, 3/20/10.

³⁸ CBO, Letter to Senator Evan Bayn, November 30, 2009, pp. 15-16.

Accessed at:

<http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/107xx/doc10781/11-30-premiums.pdf>

³⁹ National Federation of Independent Business, “The ‘Health Insurance Fee’: A Tax on Small Business and the Self-Employed,” www.nfib.com (accessed 4/9/10).

⁴⁰ Employee Benefits Research Inst., EBRI Fast Facts 114, 2/11/09. Of the 132.8m persons covered in 2006 by employer health benefits under ERISA, 55% (73m) were in fully insured plans, 45% (60m) were in self-funded plans. EBRI Issue Brief 10/07.

⁴¹ § 1421 of PPACA establishes a small business tax credit. The full credit is available to firms with fewer than 10 employees and whose workers' average annual wages do not exceed \$25,000; partial credits are available on a sliding scale for firms up to 25 workers and wages up to \$50,000. The credit is not available to sole proprietorships. In 2010-13, the credit equals 35% of the employer's contribution toward the employee's health insurance premium, if the employer contributes at least 50% of the total premium cost or 50% of a benchmark premium. After 2013, the credit amount rises to 50%, but becomes available only for coverage purchased through a health benefits exchange and for no more than two consecutive years. JCT, JCX-18-10, 3/21/10.

⁴² HR 4872 contains a provision to change the initial thresholds in 2018 based on increases in the Blue Cross Standard Option offered under the Federal Employee Health Benefits Program. If the increase in premiums under that plan, the favorite of federal employees and Members of Congress, is greater than 55% between 2010 and 2018, the thresholds would be adjusted upwards to compensate for the excess cost growth. The 55% factor implies that premiums for that plan will only grow by 5.6% a year. If they grow faster, the thresholds will be higher. Over the last ten years the annualized growth rate for the Blue Cross Standard Option Plan has been 8.6% for self only plans and 8.7% for family plans, significantly higher than the 5.6% annual cost growth factor contained in the reconciliation bill.

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⁴⁵ Business Roundtable, see <http://businessroundtable.org/news-center/ceos-forecast-uptick-in-sales-investment-and-hiring-over-next-six-mon/>

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⁴⁷ September 2013 is the last month for which both employment and SNAP data are available.

VIEWS OF VICE CHAIR AMY KLOBUCHAR**OVERVIEW**

The Economic Report of the President, published early in the year, provided a preview of the economy in 2013 along with economic justifications for key aspects of the Administration's policies. This annual report of the Joint Economic Committee reviews the state of the U.S. economy so far this year and highlights prospects and challenges that lay ahead.

The economy in 2013 has continued to grow at a moderate pace, the unemployment rate has edged down and inflation has remained low. As in recent years, the private sector continued to lead the economic expansion.

Challenges this year included the ongoing sequestration, the expiration of reduced payroll tax rates at the start of the year and another round of Congressional brinksmanship over the United States paying its bills. A disruptive and unnecessary government shutdown in October provided a further drag on the economy.

Prospects for near-term U.S. growth are brighter now than they were at the start of this year, largely because consumers and businesses are in better economic positions than they were a year ago. The outlook for economic growth has also brightened outside of the United States, improving expectations for U.S. exports in the near term.

RECENT U.S. MACROECONOMIC PERFORMANCE AND POLICY*Recent U.S. Macroeconomic Performance*

Overall Economic Growth. U.S. production of goods and services grew at a modest rate of 2.0 percent over the course of 2012, and it appears likely that production will have grown at about the same pace in 2013.⁴⁸ Economic growth for the year

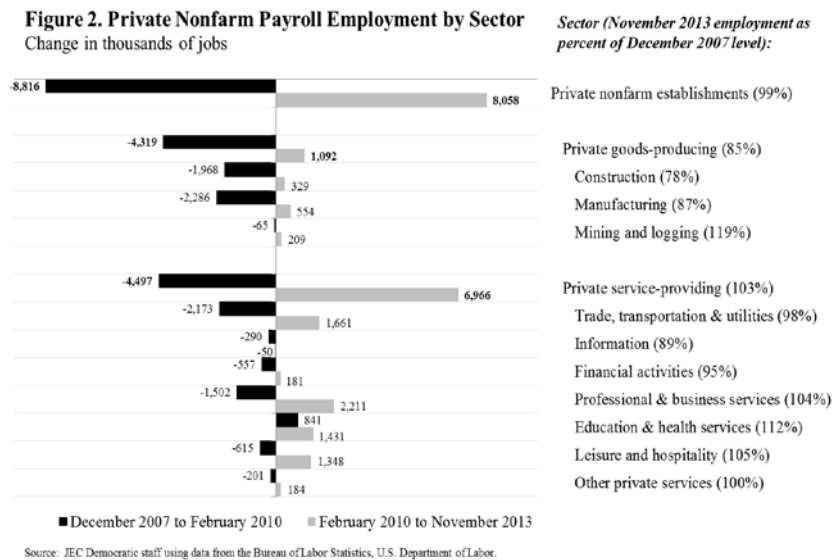
seems likely to end up fairly close to what forecasters had expected at the start of the year.

Real (inflation-adjusted) gross domestic product (GDP) stalled in late 2012, largely reflecting a sharp deceleration in private-business inventories and a substantial decline in federal purchases (see **Figure 1**).⁴⁹ While inventory accumulation accelerated at the start of 2013, federal government purchases continued to decline and, together with declines in business investment, worked to slow GDP growth in early 2013. Economic activity accelerated throughout the year: GDP grew at a 1.1 percent annual rate in the first quarter of this year before picking up the pace to 2.5 percent in the second quarter and 3.6 percent in the third quarter.



Employment and Unemployment. The labor market continued to strengthen in 2013: over the first 11 months of the year, nonfarm payroll employment increased by 2.1 million jobs, slightly ahead of the pace through the first 11 months of 2012.⁵⁰ In addition, the number of unemployed workers per job opening continued to fall

during 2013, and there are now fewer than three unemployed workers for every job opening, nearly down to the pre-recession level of two unemployed workers per job opening.⁵¹ The private sector has added jobs for 45 consecutive months, and over that period, private-sector employment has increased by 8.1 million jobs, regaining over 90 percent of the 8.8 million jobs lost during the downturn (see **Figure 2**). Most of that growth during the recovery reflects gains in the payrolls of service-sector industries which, in September 2012, surpassed the level that prevailed just prior to the recession. The service sector has now added about 2.5 million jobs beyond the pre-recession level.



Manufacturing and construction were especially hard hit by the downturn but both sectors improved in 2013. Factory payrolls had already been falling prior to the recession, and the downturn accelerated the pace of those declines. Since February 2010, manufacturing employment in the United States has increased by 554,000 jobs. The value of manufacturing exports has also increased significantly, growing by 38 percent since 2009, and productivity gains in manufacturing have outpaced productivity increases in other sectors over the course of the recovery.⁵²

Construction payrolls began declining when the housing bubble burst in 2006. By the end of 2007, construction had lost more than 200,000 jobs, and during the downturn, the sector lost an additional 2.0 million jobs. Since hitting bottom in 2010, construction establishments have added 329,000 jobs.

Government payrolls fell substantially in the aftermath of the recession. Because most state governments are required by their constitutions to keep operating budgets balanced, those governments are often pressed to reduce spending during recessions just when increased spending would be helpful in blunting the force of the downturn. That pressure was particularly acute during the most recent recession. After achieving a peak level of employment in August 2008, state and local government payrolls began to shrink, and by January 2013, 737,000 jobs had been lost. Since then, state and local governments have increased their payrolls, with 87,000 jobs added through November. However, federal government payrolls have continued to decline this year: after shrinking by 31,000 jobs over the course of 2011, and by 42,000 jobs last year, federal payrolls have declined by 93,000 jobs over the first 11 months of this year.

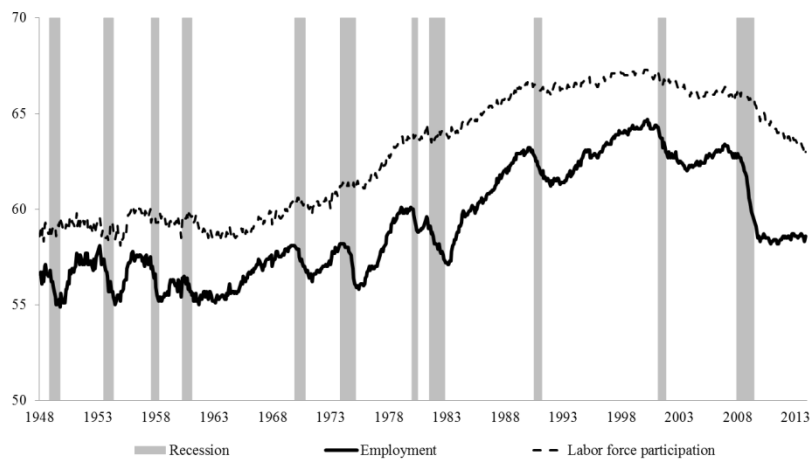
The employment recovery has been accompanied by a decline in the unemployment rate. After reaching a peak at 10.0 percent of the civilian labor force in October 2009, the unemployment rate declined by three percentage points to 7.0 percent in November 2013, the lowest level since November 2008. The unemployment rate declined 0.8 percentage point over the first 11 months of 2013.

Some of the decline in the unemployment rate over the past four years has reflected declining rates of labor force participation. Through the first 11 months of the year, the fraction of the population with a job has averaged 58.6 percent, the same fraction as at the end of each of the previous two years. Since the start of the recession in late 2007, labor force participation has declined by three percentage points (see **Figure 3**). The sharp

decline in labor force participation reflects a combination of two distinct forces. First, demographic forces that are unrelated to the business cycle (such as the retiring of the baby boomers) appear to explain much of the declining rates of labor force participation in recent years.⁵³ Second, some workers have dropped out of the labor force as a result of the slow recovery in employment.

Figure 3. Employment and the Labor Force

Percent of civilian noninstitutional population, 16 years and older, monthly through November 2013



Source: JEC Democratic staff using data from the Bureau of Labor Statistics, U.S. Department of Labor and the National Bureau of Economic Research.

Long-term unemployment remains a concern. While the short-term unemployment rate has already declined to less than half a percentage point above its level just prior to the recession, the long-term unemployment rate has declined more slowly and remains well above its pre-recession level (see **Figure 4**). Considerable research has shown that protracted bouts of joblessness erode the skills of the unemployed, making it harder for such workers to find the kind of jobs they had prior to the downturn. Long-term unemployment has also been shown to undermine social structures, leading to declines in the health and welfare of unemployed workers and their families.⁵⁴

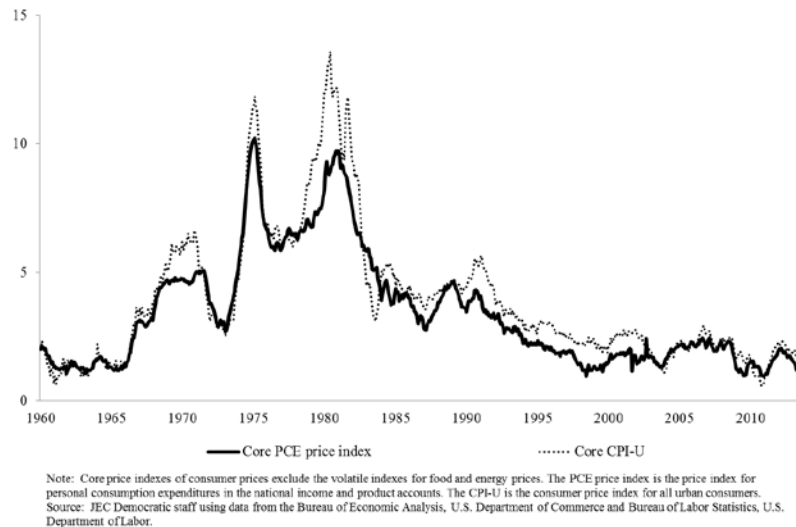
Figure 4. Unemployment Rates by Duration

Percent of civilian labor force, monthly through November 2013



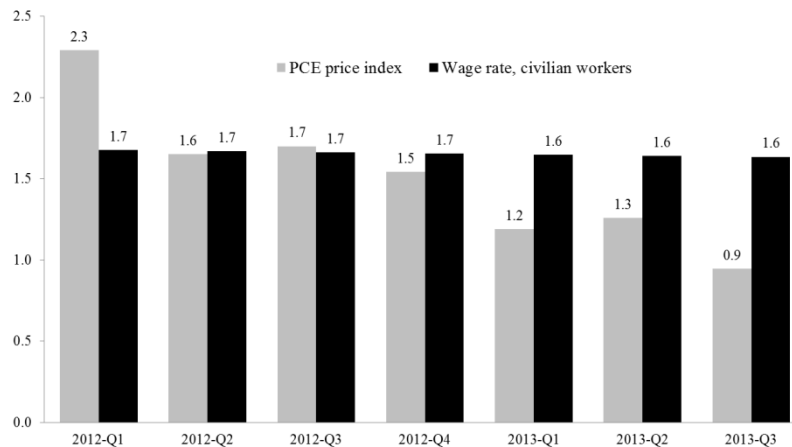
Inflation. Inflationary pressures have remained low during the past year (see **Figure 5**). Over the 12 months through October, the “core” rate of consumer price inflation, as measured by the consumer price index excluding food and energy, rose 1.7 percent. An alternative measure of underlying inflation in consumer prices, the price index for personal consumption expenditures excluding food and energy, rose by only 1.1 percent over the 12 months through October. Recent inflation readings are well below the two percent rate of core inflation that the Federal Reserve considers sustainable over the longer term.

Figure 5. Core Inflation in Consumer Prices
 Twelve-month percent change, monthly through October 2013



Wage growth has remained low but relatively stable throughout the recovery. For much of last year, wage growth approximately paralleled changes in the cost of living (see **Figure 6**). But so far this year, consumer price inflation has declined somewhat, partly reflecting slower rates of growth in food prices and declines in energy prices over the first half of the year. At the same time that price inflation slowed, wage growth held steady. The result is that real (inflation-adjusted) wages have begun to rise somewhat. Even with those recent increases, real wages are little changed from the first quarter of 2010, when the recovery in employment began.

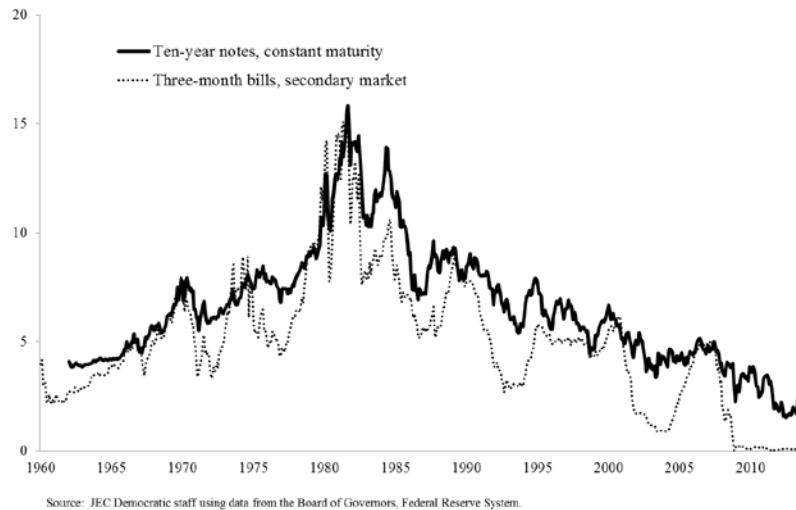
Figure 6. Growth of Wages and Consumer Prices
Percent change between the final months of adjacent quarters, annual rates



Note: The PCE price index is the price index for personal consumption expenditures in the national income and product accounts. The wage rate is for civilian workers as measured in the employment cost index.
Source: JEC Democratic staff using data from the Bureau of Economic Analysis, U.S. Department of Commerce and the Bureau of Labor Statistics, U.S. Department of Labor.

Interest Rates. The combination of relatively weak overall demand, relatively low inflation expectations, and, most importantly, aggressive quantitative easing by the Federal Reserve has kept short-term yields on U.S. Treasury debt at or near record lows for much of the past five years (see **Figure 7**). In recent years, large-scale asset purchases by the Federal Reserve and generally weak demand have worked to keep longer-term interest rates relatively low as well. Longer-term interest rates began to rise in May 2013, reflecting, among other things, shifting market perceptions that the Federal Reserve would soon slow the pace of its asset purchases. By historical standards, longer-term rates remain low.

Figure 7. Yields on U.S. Treasury Debt
Percent, end of month values through November 2013



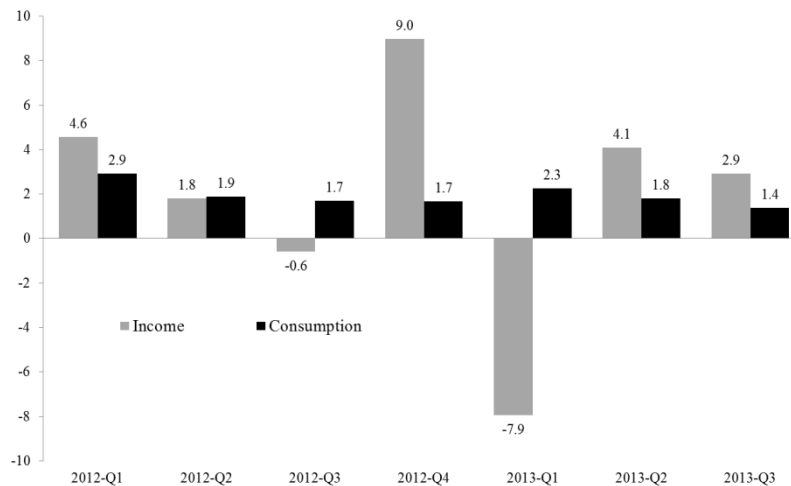
Prospects for Near-Term U.S. Economic Growth

Since the recovery officially began in mid-2009, the economy has grown at an average annual rate of 2.3 percent, a relatively modest pace when compared with previous U.S. recoveries.⁵⁵ Over the course of 2012, the U.S. economy grew by 2.0 percent, the same rate of increase as in 2011. As 2013 nears a close, it appears that the economy will have grown at about the same pace as in the previous two years.⁵⁶ But current forecasts now call for economic conditions to improve over the near term. Assuming that Congress avoids the gridlock and brinksmanship that led to the federal shutdown in October and that foreign economies continue to strengthen, many leading forecasters expect a pickup in U.S. growth over the coming year.⁵⁷

Improvements in the outlook for income and wealth bode well for household spending over the near term. Household spending turned out to be surprisingly resilient this year, as consumers maintained the pace of their spending even as they endured volatility in their disposable income related to the “fiscal cliff” at the start of 2013 (see **Figure 8**). The expiration of the temporary

payroll-tax reduction and the end of the Bush-era tax cuts on the wealthy, beginning in January, are estimated to have raised about \$200 billion in revenue. Expecting income taxes to rise in 2013, some companies shifted dividend payments and other income to the end of 2012.⁵⁸ That led to a temporary increase in disposable income at the end of 2012 and contributed to the decline in income at the start of 2013. Despite such dramatic shifts in income growth around the turn of the year, consumer spending grew at a fairly steady rate through most of this year. While that pace of growth was relatively slow, consumer spending was generally stronger than most forecasters had anticipated at the start of the year.

Figure 8. Real Disposable Personal Income and Consumption Expenditures
Percent change, annual rates



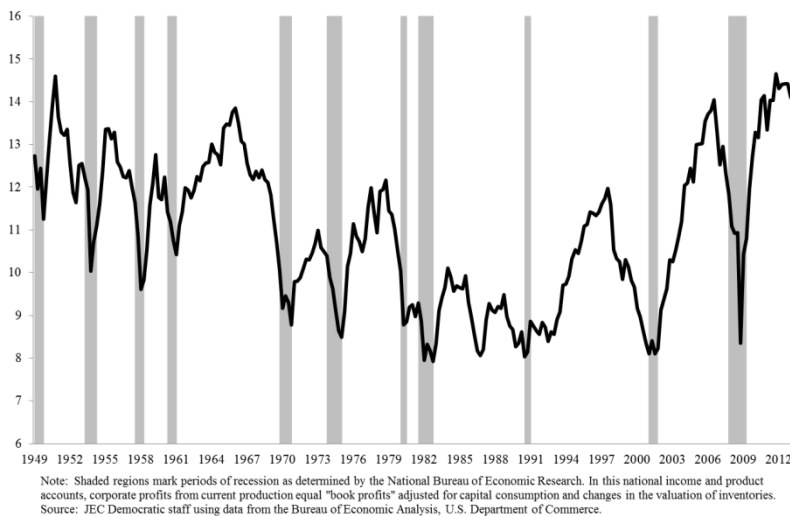
Source: JEC Democratic staff using data from the Bureau of Economic Analysis, U.S. Department of Commerce.

Households have also made significant progress in improving their balance sheets (reducing debt and increasing wealth) during the recovery. Those improvements together with firmer income growth will bolster household spending over the near term.

Business investment in 2013 was not as strong as some expected, although forecasters expect a pickup in 2014. Analysts believe

that businesses were more reluctant to invest this year than they had been in earlier years due to heightened uncertainty as to how consumer demand would hold up in the face of the tax increases early in the year. At the same time, corporate profits have remained near historical highs as a share of national income (see **Figure 9**) and credit availability continued to improve through the year.⁵⁹

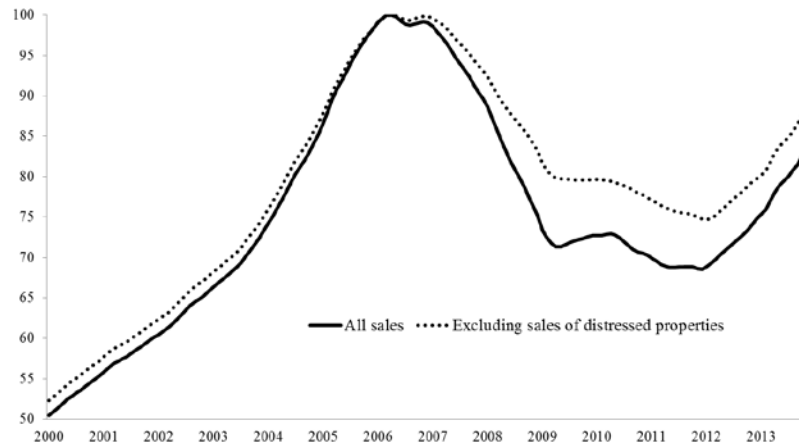
Figure 9. Corporate Profits from Current Production
Percent of national income, quarterly through 2013-Q3



Housing has continued to rebound in 2013. Residential investment grew at an average annual rate of 13.2 percent over the first three quarters. Home sales have risen, inventories of unsold homes have fallen and the pace at which builders start construction of new single-family homes is the highest it has been since 2008. As the housing market has improved, foreclosure rates have declined and home prices have risen steadily, improving the financial position of homeowners (see **Figure 10**). As was the case in 2012, housing investment has contributed about 0.4 percentage point to annual economic growth this year.

Figure 10. Purchase Price Indexes for Existing Single-Family Homes

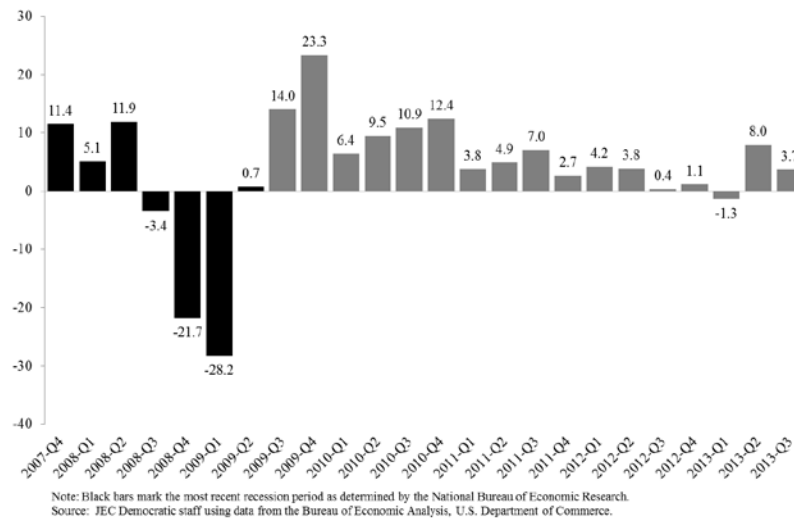
Each index equals 100 at its peak value over 2000-2008, monthly through October 2013



Note: The CoreLogic home price index is a repeat-sales index that tracks changes in sales prices for the same homes over time, including both attached and detached single-family homes. Distressed properties are REO sales or properties in default or delinquency at the time of sale.
Source: JEC Democratic using data from CoreLogic.

In the second and third quarters of 2013, real U.S. exports of goods and services picked up as economic conditions abroad brightened (see **Figure 11**). The outlook for world economic growth has improved since last year, with the eurozone beginning to emerge from recession and the Japanese economy appearing to pick up as well. The near-term outlook for emerging economies is also improved and activity is expected to accelerate next year.⁶⁰ A pickup in world growth would bolster growth in U.S. exports.

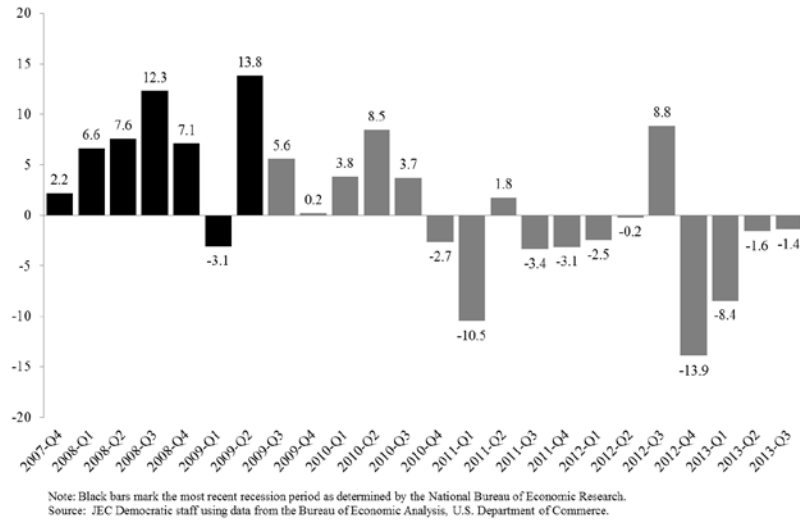
Figure 11. Real U.S. Exports of Goods and Services
 Percentage point contribution to growth of real gross domestic product, annual rates



Exports of manufactured and agricultural products have increased recently. In current dollar terms, manufacturing exports over the past year totaled \$1.2 trillion, up 38 percent since 2009.⁶¹ Agricultural exports totaled \$141.3 billion in 2012, up 37 percent since 2009.⁶² The United States has posted a trade surplus in agriculture since 1960. In 2012, that surplus totaled \$38.5 billion.⁶³

As has been the case for a number of years, government purchases of goods and services declined this year and acted as a drag on overall U.S. economic growth. State and local governments appear to be growing again for the first time in years: over the first three quarters of 2013, state and local government purchases rose at an average annual rate of 0.3 percent. In contrast, purchases by the federal government continued to decline over the first three quarters of this year (see **Figure 12**).

Figure 12. Real Federal Government Purchases of Goods and Services
Percentage point contribution to growth of real gross domestic product, annual rates



Macroeconomic Policy

Continued high unemployment and low inflation suggest that macroeconomic policy should be supporting growth. The Federal Reserve has applied downward pressure to short- and long-term interest rates, but those efforts are limited by the constraint that interest rates cannot be below zero. By the end of 2008, the Federal Reserve had lowered short-term rates as far as possible and, since then, has had to take up new approaches to support growth.

Monetary Policy. The Federal Open Market Committee (FOMC), the body within the Federal Reserve that is charged with decision-making authority over monetary policy, operates under a dual mandate to maximize employment and maintain price stability over the long run. In normal times, the FOMC does so by easing monetary conditions (lowering short-term interest rates) when unemployment is high and inflation is low and by tightening monetary policy (raising short-term interest rates) when unemployment is low and inflation is high. As part of its

aggressive response to the financial crisis the Federal Reserve had, by the end of 2008, lowered short-term interest rates to effectively zero. Since then, economic conditions have warranted additional easing of monetary policy, and the FOMC has found it necessary to use a combination of conventional and unconventional policy measures to spur the economy. Those measures include improvements in the way the FOMC communicates its policy with respect to short-term interest rates as well as unconventional direct efforts to keep longer-term interest rates relatively low.

By providing “forward guidance” on interest rates, the FOMC intends to reduce uncertainty about the future course of short-term interest rates (and, thereby, longer-term rates) by communicating how long it expects short-term rates to remain exceptionally low. The FOMC’s forward guidance has evolved in recent years from the calendar-based guidance (introduced in August 2011)⁶⁴ which expressed the likely timeframe for short-term rates to be kept low, to the conditions-based guidance the FOMC now uses, which provides broad threshold levels for economic conditions to warrant changes in short-term interest rates (introduced in December 2012).⁶⁵ Currently, the FOMC plans to keep its target interest rate on federal funds at exceptionally low levels at least as long as:

- (1) the unemployment rate remains above 6½ percent; and
- (2) two-year ahead projections of inflation are no higher than 2½ percent; and
- (3) the inflation rate expected by households and businesses remains anchored.

By the Federal Reserve’s economic projections, it appears relatively unlikely that the FOMC will begin to raise short-term interest rates before 2015.⁶⁶

The FOMC has also applied downward pressure to key longer-term interest rates by acquiring and maintaining large holdings of assets. The central bank is currently in its third wave of large-scale asset purchases (also known as “quantitative easing”). Its purchases of longer-dated Treasury debt, agency debt and agency mortgage-backed securities (MBS) have tended to keep longer-term interest rates below what they might otherwise have been, thereby working to bolster economic growth. So far this year, the FOMC has continued purchasing long-term assets at the \$85 billion-per-month pace it announced in December 2012.⁶⁷ Those purchases consist of \$45 billion per month of longer-term Treasury securities and \$40 billion per month of agency MBS. Additionally, the Federal Reserve has maintained a policy of reinvesting principal payments from its holdings of agency debt and MBS into agency MBS and of rolling over maturing Treasury securities.

The FOMC’s program of large-scale asset purchases has always been dependent on economic conditions, though less clearly than the central bank’s forward guidance on short-term rates. At the close of its meeting on May 1st, the FOMC noted for the first time that it was prepared to adjust the pace of its asset purchases (up or down) in response to changes in economic conditions.⁶⁸ That nuance, coupled with subsequent statements by senior Federal Reserve officials, led to a shift in market perceptions that the FOMC would soon begin to “taper” its asset purchases, contributing to a fairly sharp rise in longer-term interest rates in the spring. For example, the secondary-market yield on ten-year Treasury notes rose from about 1.70 percent at the end of April to about 2.90 percent in mid-August. The FOMC has not begun to taper asset purchases as of its October 2013 meeting.

Fiscal Policy. According to the Congressional Budget Office (CBO), fiscal policy is expected to continue to restrain economic growth in 2014, but to a lesser degree than in 2013.⁶⁹ The government shutdown in October triggered sharp declines in consumer and business confidence as well as income losses to workers and businesses dependent on federal activity, whether

directly or indirectly. Unemployment insurance claims spiked and worker-reported instances of hiring also decreased.⁷⁰ Leading economists estimate that the October shutdown will have reduced U.S. economic growth in the fourth quarter of 2013 by between $\frac{1}{4}$ and $\frac{1}{2}$ percentage point at an annual rate.⁷¹

The federal government shutdown and brinksmanship over the United States paying its bills raised uncertainty and undermined the confidence of households, businesses and investors, leading some to delay economic activity. Those altered decisions represent real resource costs to the U.S. economy and, if those impasses are repeated in January, growth will be further slowed in 2014.⁷²

Most observers agree that a balanced approach to gradual reduction in the deficit is desirable. The substantial fiscal tightening in recent years, implemented largely through indiscriminate spending cuts, has done little to address the nation's longer-term budget. A return to fiscal responsibility can be achieved through gradual and balanced reductions in the federal deficit without sacrificing near- and long-term economic objectives.

Senator Amy Klobuchar
Vice Chair

ENDNOTES

⁴⁸ This report reflects developments in economic data available through early December 2013. In particular, the national income and product accounts were available through the second estimate for the third quarter by the Bureau of Economic Analysis, U.S. Department of Commerce.

http://www.bea.gov/newsreleases/national/gdp/2013/pdf/gdp3q13_2nd.pdf

⁴⁹ Economists estimate that Hurricane Sandy reduced U.S. economic growth by up to 0.5 percentage point in the fourth quarter of 2012. See, for example, Council of Economic Advisers, *Economic Report of the President* (March 2013), p. 46.

⁵⁰ JEC Democratic staff calculations based on data from the Bureau of Labor Statistics, Current Employment Statistics.

⁵¹ Data on job vacancies were available through September 2013 as published by the Bureau of Labor Statistics, U.S. Department of Labor.
<http://www.bls.gov/jlt/#news>

⁵² JEC Democratic staff calculations based on data for productivity and costs from the Bureau of Labor Statistics, U.S. Department of Labor.
<http://www.bls.gov/news.release/pdf/prod2.pdf>

⁵³ The Council of Economic Advisers estimated that just under half of the decline in the labor force participation rate between 2007 and 2012 reflects cyclical factors. See Council of Economic Advisers, *Economic Report of the President* (March 2013), pp. 52-56.
http://www.whitehouse.gov/sites/default/files/docs/erp2013/full_2013_economic_report_of_the_president.pdf

⁵⁴ For more details on the problem of long-term unemployment and its economic and social costs, see Congressional Budget Office, *Understanding and Responding to Persistently High Unemployment* (February 2012), especially pages 1-8.
<http://www.cbo.gov/sites/default/files/cbofiles/attachments/02-16-Unemployment.pdf>

⁵⁵ Considerable economic research has focused on the reasons for the slow recovery. An overview of those reasons and some of the economic literature underlying that research was provided in the JEC's 2012 Joint Economic Report (http://www.jec.senate.gov/public//index.cfm?a=Files.Serve&File_id=5916be2-563d-4498-b206-eb2aa644b5d4), especially pages 11-12. An important contribution to this ongoing research was recently published by senior researchers at the Federal Reserve: Dave Reifschneider, William Wachser and David Wilcox, "Aggregate Supply in the United States: Recent Developments and Implications for the Conduct of Monetary Policy," Federal Reserve Board, Finance and Economics Discussion Series, 2013-77 (November 2013) (<http://www.federalreserve.gov/pubs/feds/2013/201377/201377abs.html>). Those authors find that the financial crisis and associated economic downturn lowered both the level and the growth rate of potential output (i.e., the level of

total production of goods and services that is consistent with full utilization of labor and capital as well as stable and low price inflation).

⁵⁶ A surprising uptick in inventory accumulation by private businesses added about 1.7 percentage points to overall economic growth in the third quarter of 2013, and most economic forecasters expect that to be reversed somewhat in the fourth quarter. At this writing, leading forecasters expect that economic activity will have decelerated sharply in the fourth quarter, largely due to an expected decline in inventory accumulation and further declines in federal purchases, partly reflecting the federal shutdown. The Blue Chip consensus average of leading private-sector forecasts has the economy growing at only a 1.6 percent annual rate in the fourth quarter of 2013 and 2.2 percent over the four quarters through the fourth quarter (*Blue Chip Economic Indicators*, December 10, 2013, Aspen Publishers).

⁵⁷ The latest Blue Chip consensus average for U.S. growth over the four quarters of 2014 is 2.8 percent (*Blue Chip Economic Indicators*, December 10, 2013, Aspen Publishers), but a number of private sector forecasters are even a bit more optimistic than that.

⁵⁸ Those policy issues were not resolved until January 2013 of this year.

⁵⁹ For example, the Federal Reserve's Senior Loan Officer Survey has indicated that standards on bank lending to businesses have continued to ease in 2013, with particular improvements in loans supplied to smaller businesses. Banks also report increases in the demand for loans by businesses.
<http://www.federalreserve.gov/boarddocs/snloansurvey/201311/fullreport.pdf>

⁶⁰ International Monetary Fund, *World Economic Outlook: Transitions and Tensions* (October 2013), Table 1.1, p. 2.
<http://www.imf.org/external/pubs/ft/weo/2013/02/pdf/text.pdf>

⁶¹ JEC Democratic staff calculations based on data from the Census Bureau. Annual export values are the sum of exports over the four quarters ending in a given quarter. Most recent data are for Q3-2013. Dollar amounts are adjusted using the GDP Implicit Price Deflator.

⁶² JEC Democratic staff calculations based on data from the U.S. Department of Agriculture, Economic Research Service, U.S. Agricultural Trade, Calendar Year, and Value of U.S. Trade--Agricultural and Total--and Trade Balance, Calendar Year. Dollar amounts are adjusted using the GDP Implicit Price Deflator.

⁶³ JEC Democratic staff calculations based on data from the U.S. Department of Agriculture, Economic Research Service, U.S. Agricultural Trade, Calendar Year.

⁶⁴ Federal Reserve press release. August 9, 2011.
<http://www.federalreserve.gov/newsevents/press/monetary/20110809a.htm>

⁶⁵ Federal Reserve press release. December 12, 2012.
<http://www.federalreserve.gov/newsevents/press/monetary/20121212a.htm>

⁶⁶ The Federal Reserve's latest available economic projections are from September: see
<http://www.federalreserve.gov/monetarypolicy/files/fomcprojtbl20130918.pdf>

⁶⁷ This report was completed prior to the FOMC's monetary policy announcement of December 18 and does not include any developments therein in this summary. The most recent FOMC statement available as of this writing is the October 30th announcement.
<http://www.federalreserve.gov/newsevents/press/monetary/20131030a.htm>

⁶⁸ Federal Reserve press release, May 1, 2013.
<http://www.federalreserve.gov/newsevents/press/monetary/20130501a.htm>

⁶⁹ CBO's latest estimates of the federal budget deficit adjusted for the effects of automatic stabilizers suggest that, under current law, fiscal policy will tighten further in 2014 and 2015, but to a lesser degree than was the case in 2013. See, Congressional Budget Office, *The Effects of Automatic Stabilizers on the Federal Budget as of 2013* (March 2013)
http://www.cbo.gov/sites/default/files/cbofiles/attachments/43977_AutomaticStabilizers3-2013.pdf

⁷⁰ Jason Furman, Prepared Testimony before the Joint Economic Committee, November 13, 2013.
http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=179b114e-1dc1-45bc-82e5-580f0fe8c041

⁷¹ An Administration study that examined the movements in key high-frequency economic indicators in early October concluded that the shutdown reduced U.S. economic growth by at least 0.25 percentage point (annualized) in the fourth-quarter; see, Council of Economic Advisers, *Economic Activity During the Government Shutdown and Debt Limit Brinksmanship* (October 2013)
http://www.whitehouse.gov/sites/default/files/docs/weekly_indicators_report_final.pdf. Studies that estimate the impacts of the shutdown by extrapolating

from the economic impacts of the 1995-96 shutdowns typically report larger impacts in the fourth quarter of 2013. For example, Macroeconomic Advisers, LLC, “The Cost of Crisis-Driven Fiscal Policy,” Report prepared for the Peter G. Peterson Foundation (October 2013) estimates that the shutdown reduced growth by 0.3 percentage point; see <http://pgpf.org/special-reports/the-cost-of-crisis-driven-fiscal-policy>. Other analyses published after the shutdown was over, report that growth was reduced by 0.5 percentage point in the fourth quarter. See Michael Feroli, “This is why we can’t have nice things,” *J. P. Morgan, North America Economic Research* (17 October 2013); and, Mark Zandi, “A Budget Battle Postmortem,” *Moody’s Analytics, Economic & Consumer Credit Analytics* (October 2013) <http://www.economy.com/mark-zandi/documents/2013-10-21-budget-battle-postmortem.pdf>

⁷² Because the increase in uncertainty is impossible to observe directly, it is very difficult to quantify the cumulative efficiency cost to the U.S. economy of congressional budget gridlock. For a recent attempt to assess the costs of the impasses to the U.S. economy since 2009, see Macroeconomic Advisers, “The Cost of Recent Fiscal Policy Uncertainty,” *Macro Focus* (November 6, 2013).