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Union Calendar No. 483

113th CONGRESS
2nd Session } HOUSE OF REPESENTATIVES { REPORT
113-644

THE 2014 JOINT ECONOMIC REPORT

R E P O R T

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ON THE

2014 ECONOMIC REPORT
OF THE PRESIDENT

DECEMBER 2, 2014. — Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON: 2014

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[Created pursuant to Sec. 5 (a) of Public Law 304, 79th Congress]

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LETTER OF TRANSMITTAL

December 2, 2014

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 2014 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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MR. BRADY, from the Joint Economic Committee, submitted the following

REPORT

Report of the Joint Economic Committee on the 2014 Economic Report of the President

CHAIRMAN'S VIEW

In his letter transmitting the *2014 Economic Report of the President* (ERP)[1], President Obama stated:

> *I believe this can be a breakthrough year for America. But it falls to all of us to grow the economy and create new jobs, to strengthen the middle class, and to build new ladders of*

> *opportunity for folks to work their way into the middle class. So in the coming months, let's see where we can make progress together. Let's continue to make this a year of action. Together, we can restore an economy that works for everybody, and our founding vision of opportunity for all.*

A year earlier, the President proclaimed that "Our top priority must be to do everything we can to grow our economy and create good, middle-class jobs."[2]

Unfortunately, the President continues to pursue economic policies that stifle job creation, hold back real income growth, and hamper economic mobility.

The President has continued to pursue an extreme environmental agenda. According to an analysis by the U.S. Chamber of Commerce's Institute for 21st Century Energy predicts that the Administration's proposed new carbon regulations will cause the loss of over 224,000 jobs.[3]

The President continues to stand in the way of construction of the Keystone XL pipeline. According to a study from one of the President's own agencies, the United States Department of State Bureau of Oceans and Environmental and Scientific Affairs, if the President approved the permit for the Keystone XL pipeline, construction alone would create over 42,000 jobs with very little environmental impact.[4]

The President continues to deny reality when it comes to his signature legislative achievement, the *Affordable Care Act* (ACA). Millions have had their insurance plans cancelled and lost access to doctors and hospitals despite the President's promise that "if you like your doctor, you can keep your doctor" and "if you like your current plan, you can keep your plan." The ACA is proving increasingly unaffordable as patients are hit with rising premiums for plans that deliver less of the coverage they need and want.

The ACA continues to create uncertainty for individuals and businesses. This means lost jobs and lost opportunities. The ACA is not sustainable over time and we must take action to replace the law with one that works for patients, providers, and taxpayers.

The American people deserve better.

The next section of this report provides an "Economic Overview" that focuses on the state of the economic recovery that continues to elude millions of Americans. Subsequent sections address:

(1) "The Economic Impact of the American Recovery and Reinvestment Act Five Years Later." This section responds to the ERP's attempt to extol the virtues of the President's 2009 economic stimulus package, known as the *American Recovery and Reinvestment Act* (ARRA), along with other "jobs measures" pushed by the Administration.

(2) "The Year in Review and the Years Ahead, Developments in 2013 and the Near-Term Outlook—Energy." This section discusses the fact that the CEA ignores critical economic issues in energy policy and notes that the sea change in oil and gas industry calls for adaptation of new federal policies.

(3) "Recent Trends in Health Care Costs, Their Impact on the Economy, and the Role of the Affordable Care Act."

ECONOMIC OVERVIEW

According to the National Bureau of Economic Research's Business Cycle Dating Committee, the "Great Recession" ended

more than five years ago in June 2009. Since then the American people have been subjected to what can only be characterized as a decidedly disappointing recovery.

Slightly more than five years since the end of the recession, the economy suffers from a significant growth gap in terms of economic output, private sector job creation, overall employment growth, and real income growth. On each of these measures, the current recovery lags far behind the average of other post-1960 recoveries.

If the economy had grown over the past 21 quarters of recovery at the average rate experienced in other post-1960 recoveries, real gross domestic product (GDP) would be $1.5 trillion (2009$) greater. If private sector payroll employment had grown at the average pace of other recoveries, there would be 5.9 million more private sector jobs in America. Because of the anemic growth of real disposable personal income, real annual per person after-tax income is more than $3,000 lower than an average recovery would have delivered.

The cost of the lackluster recovery on American families is accretive in terms of lost jobs, incomes and opportunities. Closing the growth gap in output, jobs, and incomes before the end of the President Obama's term in office is likely an insurmountable task.

As the new Congress begins its job of working to restore broad-based prosperity and opportunity to the nation's economy, it is important to have an understanding and perspective on just how large the existing growth gap is in historical context.

Economic Growth

As measured by real GDP, the economy has expanded by a total of 12.5% over the past 21 quarters. This places the recovery dead last for total growth over a comparable period among other post-1960 recoveries (Figure 1).

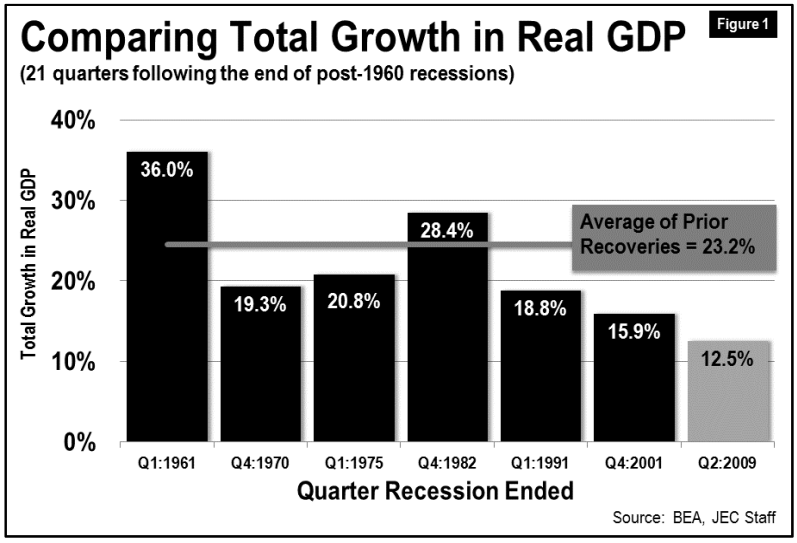
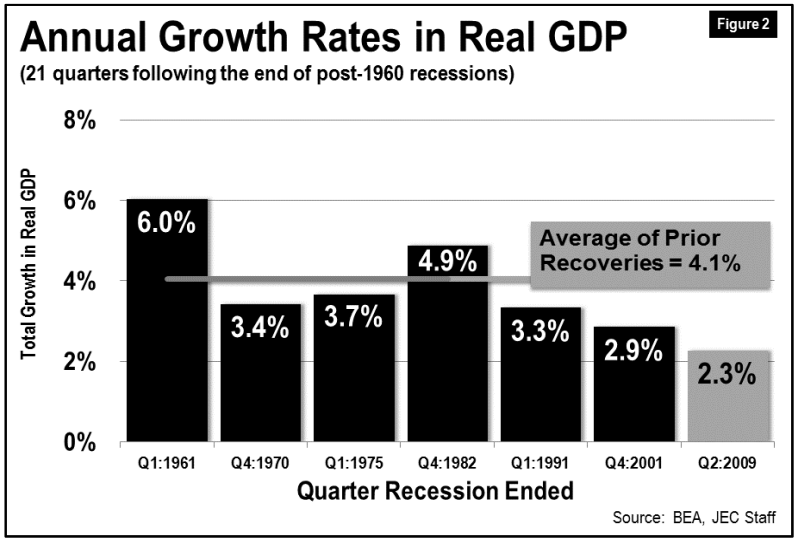
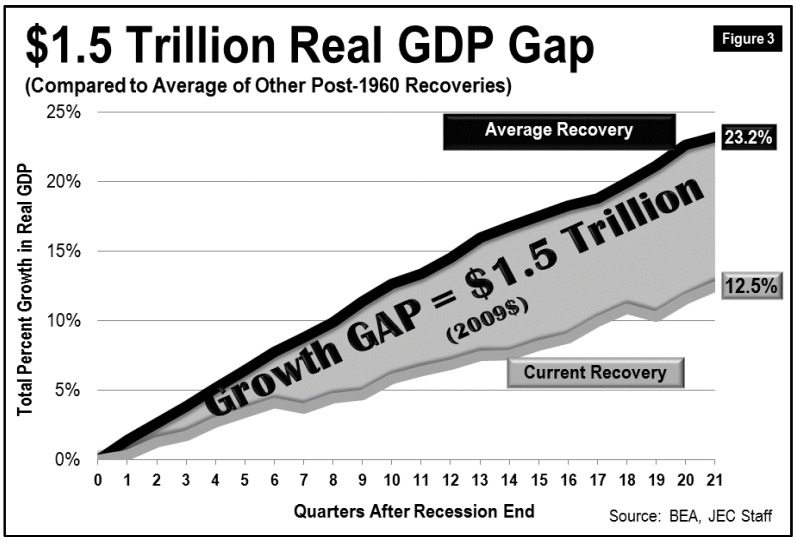


Figure 2 shows the annualized growth rates for each of the post-1960 recoveries.

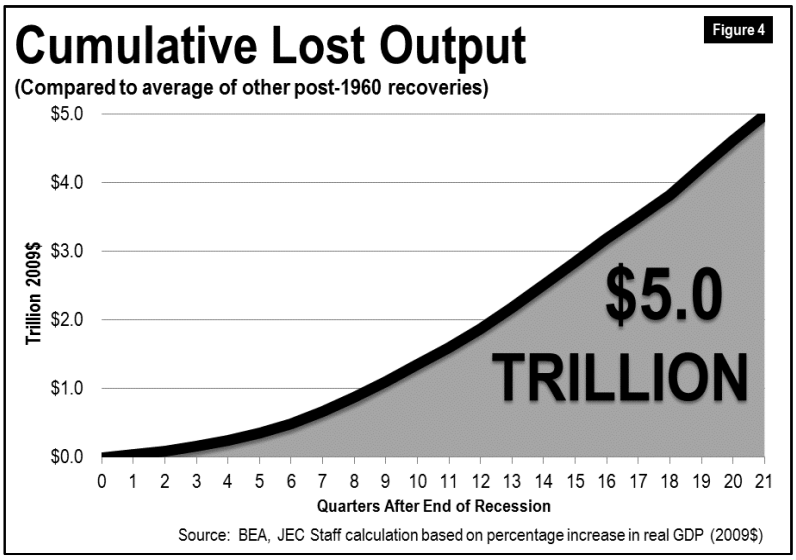


The lack of solid economic growth during this recovery can be measured a number of different ways. First, the lack of growth

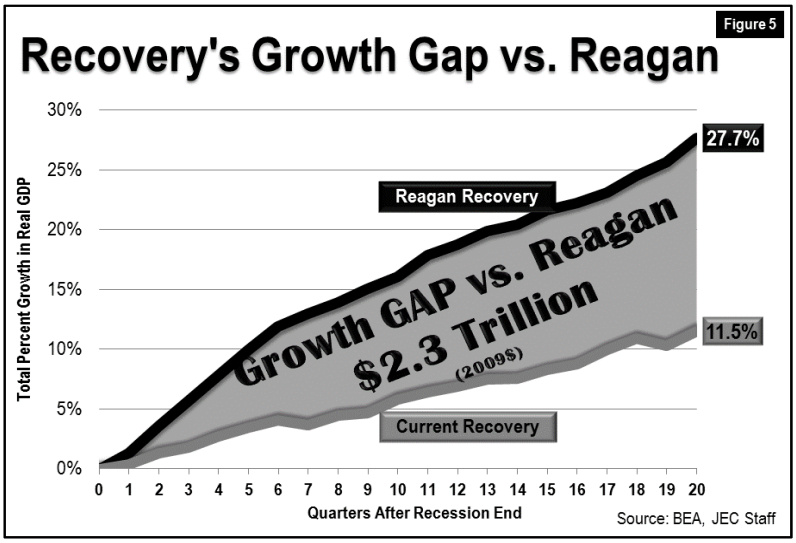
compared with the average of other post-1960 recoveries has left us with an economy that is, in real 2009 dollars, $1.5 trillion smaller than an average recovery would have generated (Figure 3).

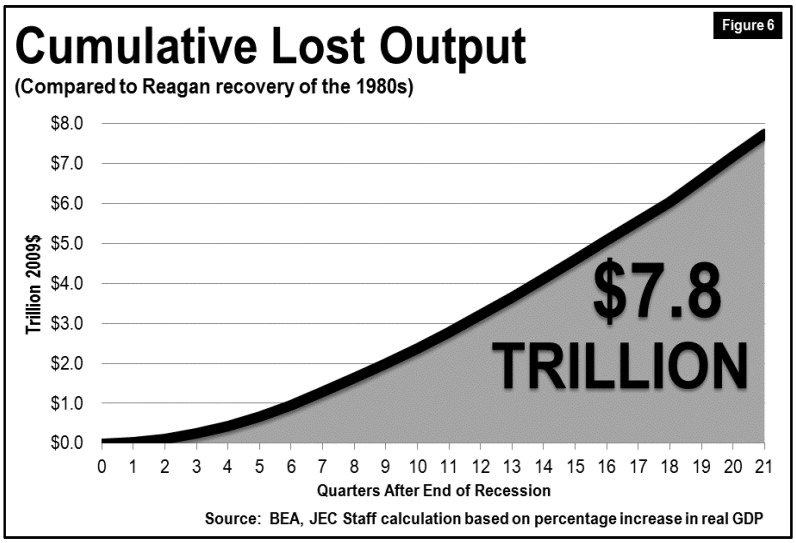


It is important to remember that a $1.5 trillion gap in real GDP only represents the difference in the size of the economy at this point in time. The amount of output lost in this recovery compared with the average of other recoveries is cumulative. The cumulative loss of real GDP in this recovery compared with the average of other recoveries (Figure 4) amounts to a staggering $5.0 trillion (2009$).

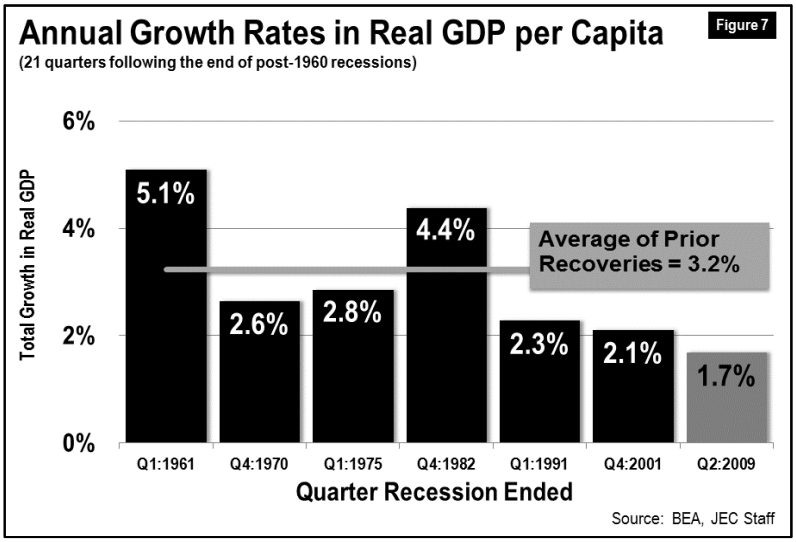


Of course, the disparity in growth is even more pronounced when the current recovery is compared with the strong recovery of the 1980s. When compared with the Reagan recovery, the gap in real GDP stands at $2.3 trillion (2009$) and the cumulative lost output is $7.8 trillion (2009$) (see Figures 5&6).

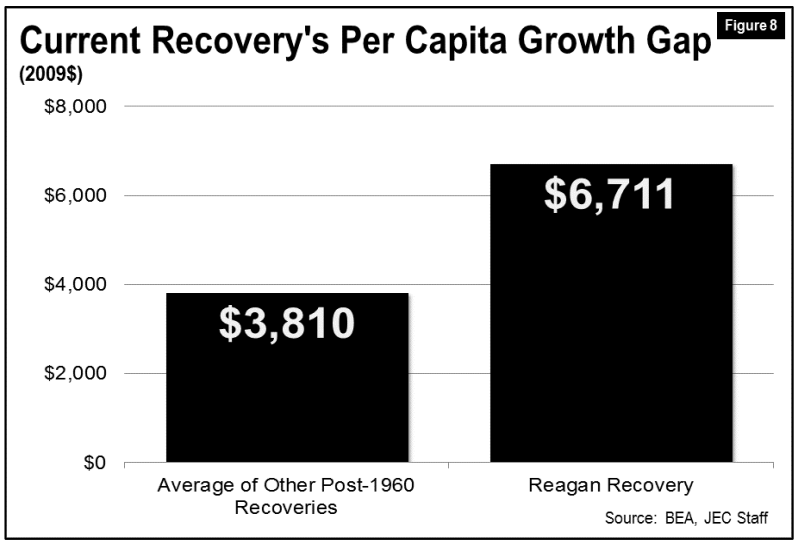




Defenders of the President's economic record often like to point to differences in population growth rates or the aging of the population as an excuse for the recovery's inferior performance compared with past recoveries. However, even when accounting for population growth differences by looking at the growth rates of per capita real GDP, the current recovery's growth gap remains large (Figure 7).



The per capita gap in real GDP compared with the average of other recoveries is $3,810 (2009$) and $6,711 (2009$) compared with the Reagan recovery (Figure 8). If you multiply the respective per capita real GDP gaps by the population, the current recovery's gap compared with the average of other post-1960 recoveries comes in at more than $1.2 trillion (2009$). When compared on this metric to the Reagan recovery of the 1980s, the current recovery's gap exceeds $2.1 trillion (2009$).

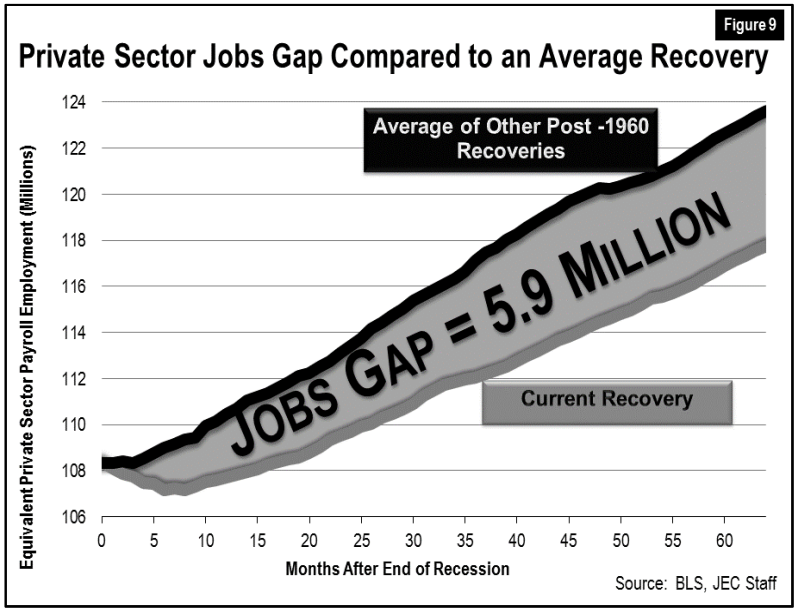


The lack of economic growth has serious implications for the American people and for the federal government. The lack of sufficient growth is at the core of the recovery's failure to create enough well-paying jobs. The lack of growth has also had a negative effect on federal government revenues.

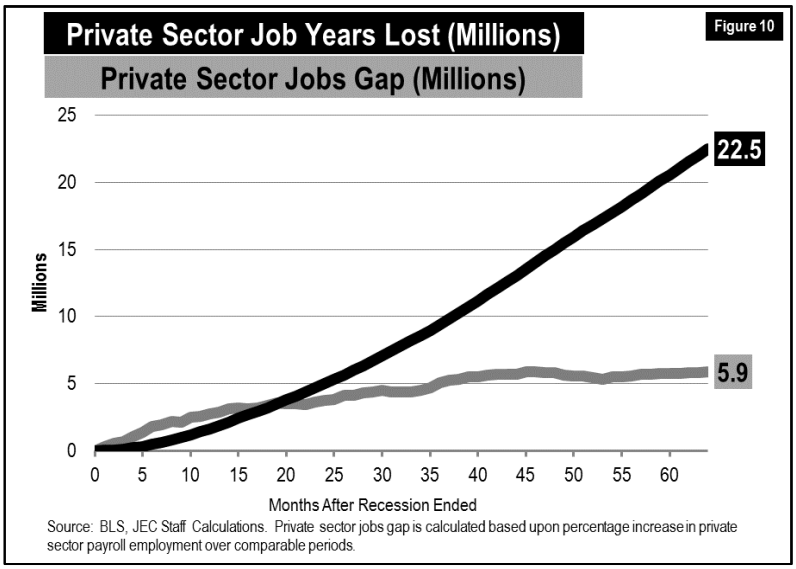
Private Sector Job Creation

From the end of the recession in June 2009 through October 2014, private sector payroll employment has increased by 9.4 million or 8.7%. The average increase over the comparable 64 month in other post-1960 recoveries was 14.1%. A 14.1%

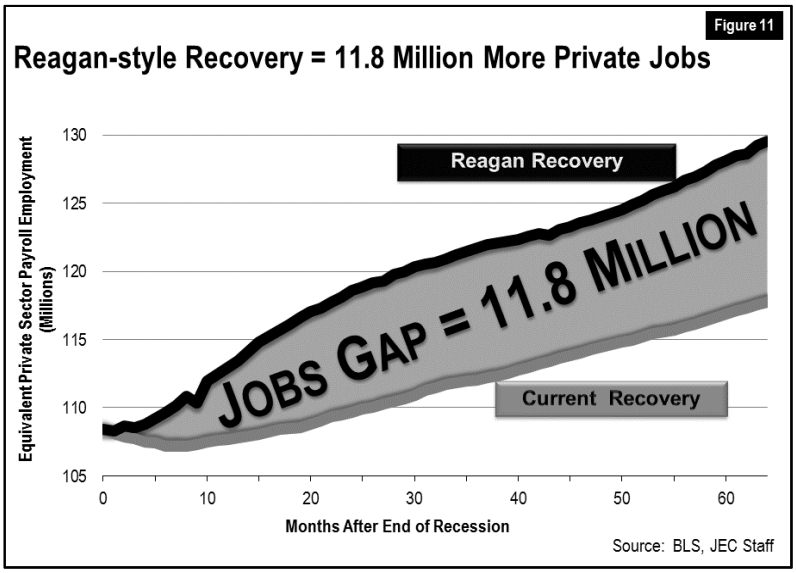
increase in private sector payroll jobs during this recovery would have yielded a gain of nearly 15.3 million private sector payroll jobs. In other words, compared with the average of other post-1960 recoveries, the current recovery suffers from a private sector jobs gap of 5.9 million (Figure 9).



If one uses the concept of "job years" used by the Council of Economic Advisers (CEA) in its report, the cumulative job years lost compared with the average of other post-1960 recoveries comes to a total of 22.5 million (Figure 10).



The Reagan recovery of the 1980s saw private sector payroll employment grow by 19.6% or the equivalent to a gain of more than 21 million or 11.8 million more than the current recovery (Figure 11).



Even when measured from points in time other than the end of the recession, the current recovery falls short of historic averages. Measured from the cycle low for private sector payroll employment in February 2010, the current recovery has added 10.6 million private sector payroll jobs, or 9.9%, over 56 consecutive months of job growth. The average of gains in other post-1960 recoveries was 13.2%, or the equivalent of 14.1 million private sector jobs.

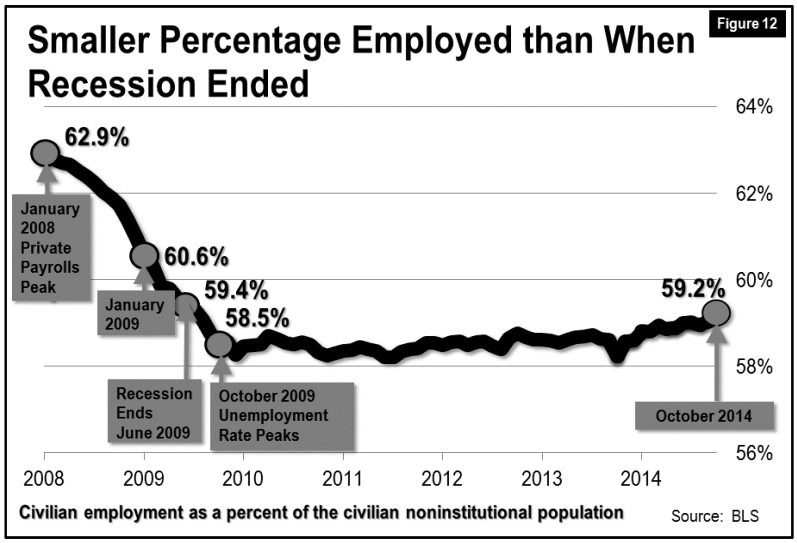
Compared with the average of other post-1960 recoveries, the current recovery falls more than 3.5 million private jobs short even when measuring from the low point for private sector payroll employment.

Over the comparable 56 months, the Reagan recovery saw private sector payrolls expand by 17.1%. The gap of the current recovery measured from the cycle low stands at 7.8 million private jobs compared with the Reagan recovery.

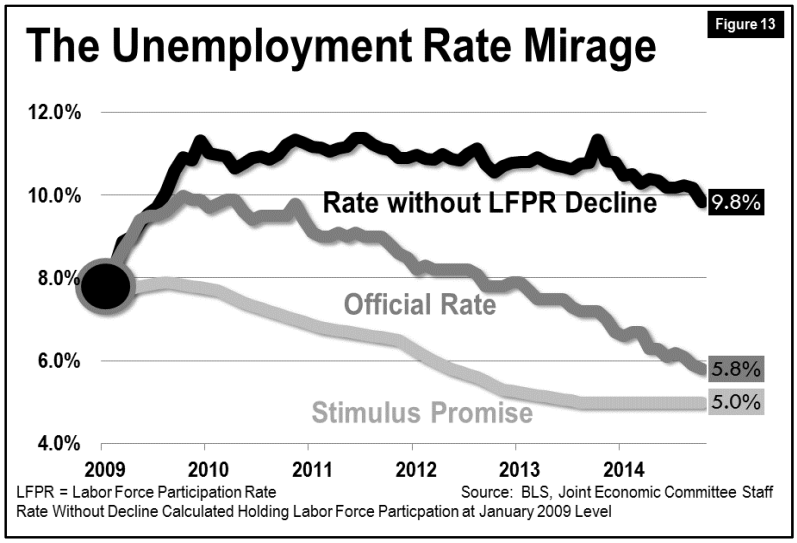
Employment and Unemployment as Measured by the Household Survey

The Obama Administration is quick to point out that the unemployment rate has declined from a recession high of 10.0% in October 2009 to 5.8% in October 2014. This rate is still nearly a full percentage point higher than the 5.0% the Administration projected would be reached by the 3rd-quarter 2013.

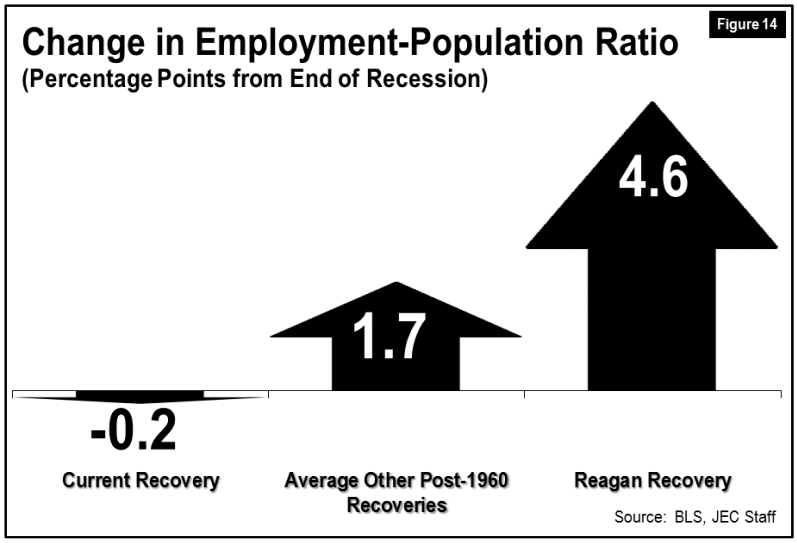
The decline in the unemployment rate by 4.5 percentage points since recession's is on its face inconsistent with the fact that a smaller percentage of adult Americans are employed than when the recession ended (Figure 12).



The decline in the unemployment rate has, in fact, been largely a mirage created by declining labor force participation. For example, if labor force participation had not declined from its January 2009 level of 65.7% to 62.8% in October 2014, the unemployment rate would be 9.8% not 5.8% (Figure 13).



The employment-to-population is actually 0.2 percentage point lower than it was when the recession ended in June 2009. By contrast, 64 months after the end of a recession the average change in the employment-to-population ratio in other post-1960 recoveries was an increase of 1.7 percentage points. In the Reagan recovery, the employment-to-population increased by 4.6 percentage points over a comparable period (Figure 14).

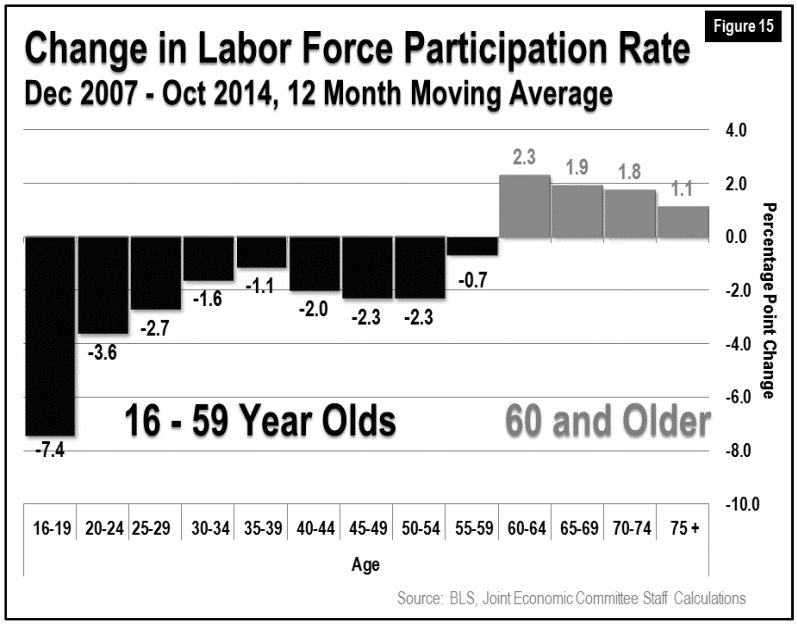


The employment-to-population ratio stood at 59.4% in June 2009. Presently, it stands at 59.2%. If the rate had increased by the average 1.7 percentage points of other post-1960 recoveries, 61.1% of adult Americans would be employed, or 4.7 million more than are presently employed. If we had experienced a Reagan-style recovery, the employment-to-population ratio would have risen to 64.0% and there would be 11.9 million more employed Americans.

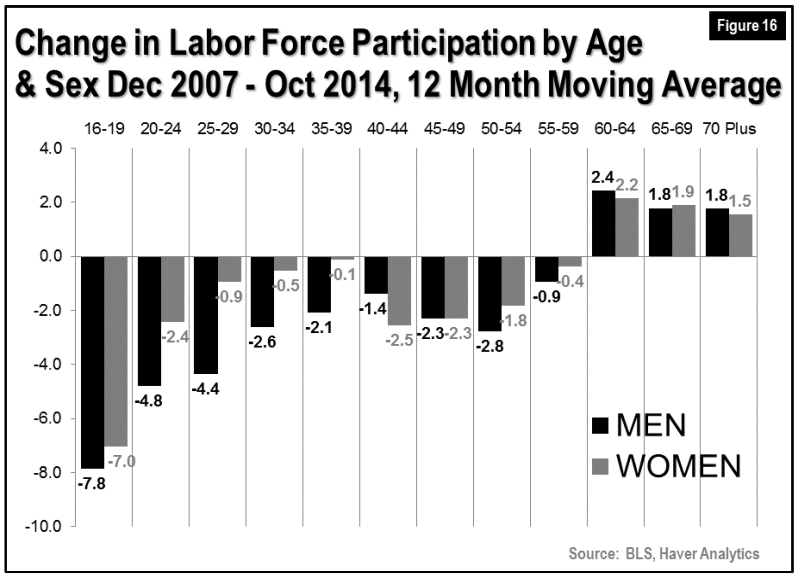
The supporters of President Obama's economic policies are quick to blame the decline in labor force participation on demographics. To be sure, the population of the United States is getting older and some of the decline in labor force participation can be attributed to demographic change. However, we estimate

that only about half of the decline from the pre-recession December 2007 level of 66.0% can be attributed to the changing age profile of the population.

The disturbing reality is that older Americans, those age 60 and older, are the only demographic participating in the labor force at higher rates than before the recession (Figure 15).



This general pattern of declines across the spectrum of younger age groups is true when broken down by sex as well. The drop off in participation is particularly pronounced among men (Figure 16).



Part-time vs. Full-time Employment

There has been a large amount of anecdotal evidence suggesting that provisions of the *Affordable Care Act* (ACA) have led to employers reducing employee hours and not hiring full-time workers, as defined in the law, to avoid the ACA's employer mandate. To date, there is little data-based research or even data available to assess the degree to which this concern is justified.

The ACA requires that employers with more than 50 full-time equivalent employees (FTE) provide health insurance to their full-time employees or pay a monthly penalty, formally referred to as the "employer shared responsibility payment." Businesses with more than 100 FTEs must provide health benefits to a minimum of 95% of their FTEs by 2016.

It is important to examine not just whether the ACA is inhibiting the hiring of full-time workers, but the degree to which it may be effecting part-time hiring as well. If nothing else, the ACA and its implementation have introduced additional uncertainty

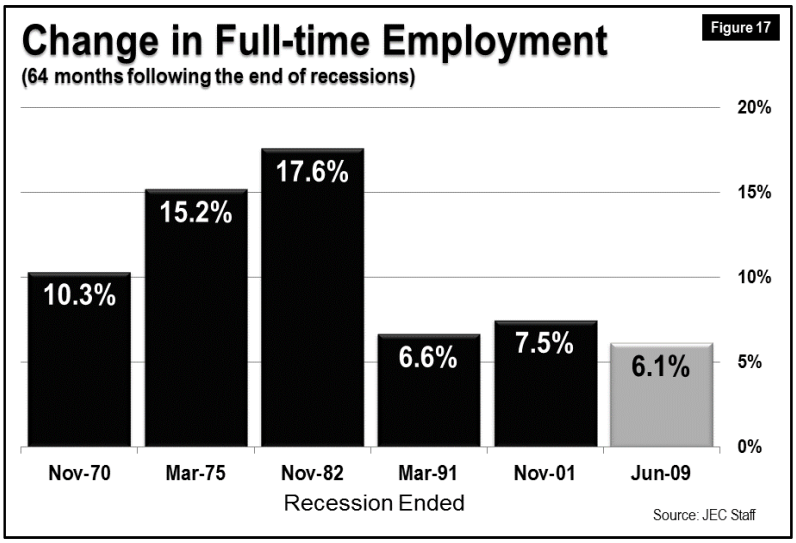
regarding costs and regulatory requirements into the hiring process.

While there may be insufficient data at this point in time to determine the effect of the ACA on full-time vs. part-time employment, we can compare the patterns of full-time and part-time employment growth in this and other recoveries.

When examining this data, it is important to remember that BLS considers people who usually work full-time as those working 35 hours or more. This differs from the 30 hours per week definition used in the ACA.

Since the recession ended in June 2009, full-time employment as measured in the household survey, has increased by 6.1% or 6.9 million. Part-time employment has increased by only 234,000 or 0.9%. Roughly 97% of employment gains during the current recovery are among those who usually work part-time. The current recovery falls short by historical measures on both fronts.

The strong recovery that began in February 1961 is omitted from this comparison, because the two data series did not begin until 1968. The average gain in full-time employment for other recoveries during the life of the data series was 11.5% compared with 6.1% in the current recovery (Figure 17). The average gain in part-time employment in other recoveries was 13.4% compared with a gain of 0.9% in the current recovery (Figure 18).



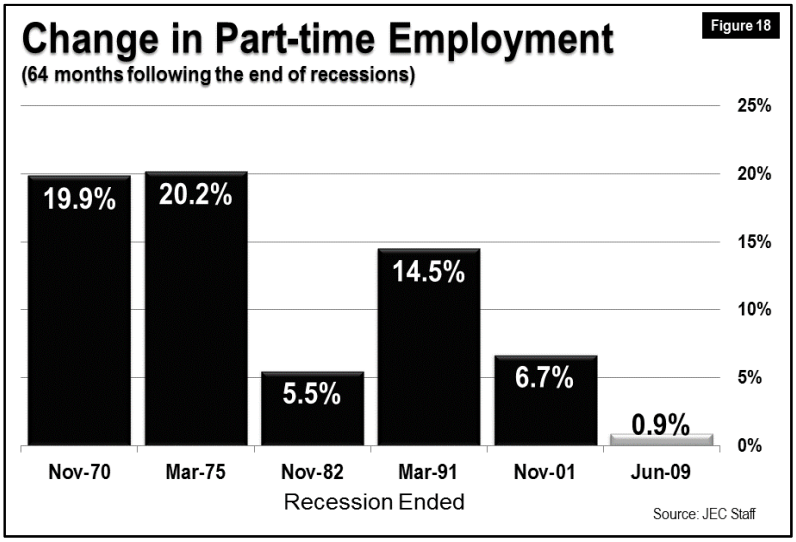
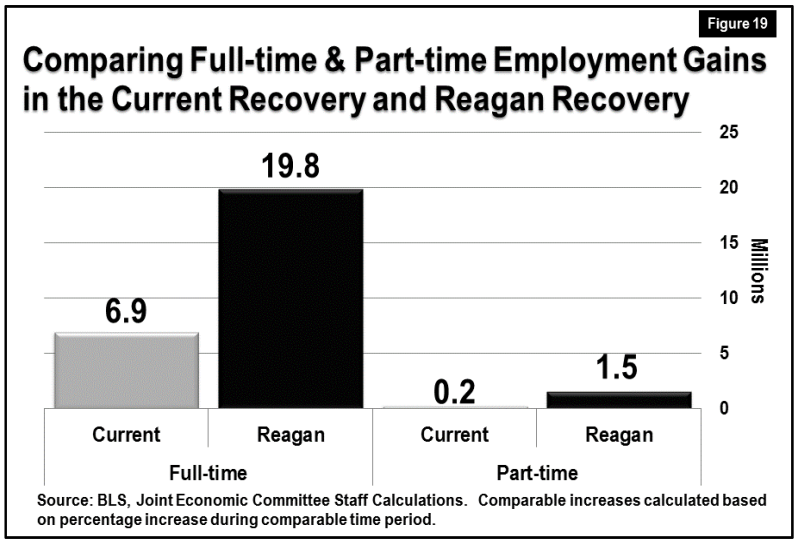


Figure 19 shows the equivalent changes in both full-time and part-time for the current recovery and the Reagan recovery. The Reagan recovery numbers are calculated using the percentage gains.



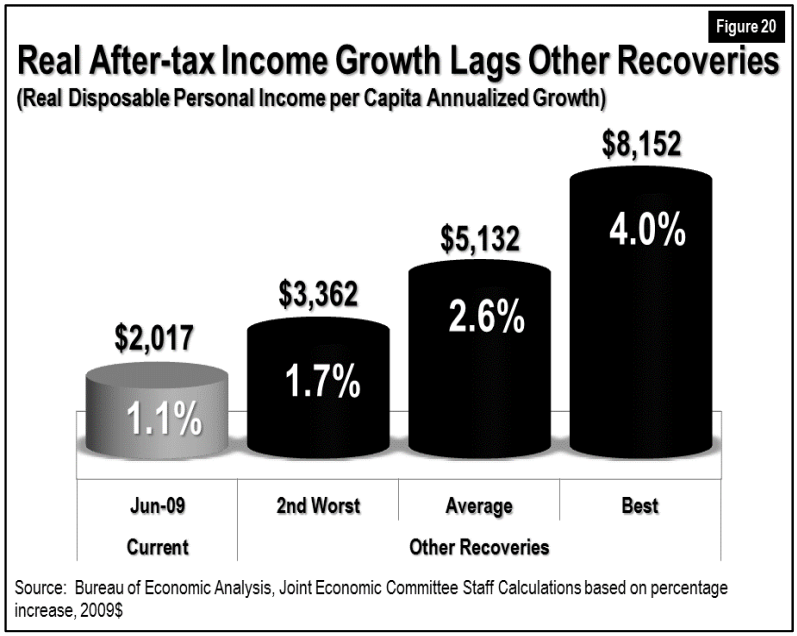
The bottom line is that the current recovery has failed to create enough full-time employment and enough part-time employment. The degree to which the ACA has stifled employment opportunity of both types cannot be quantified based upon currently existing data. It is clear, however, that the ACA has significantly altered the incentives for employers to hire and for Americans to seek work.

Personal Income Growth

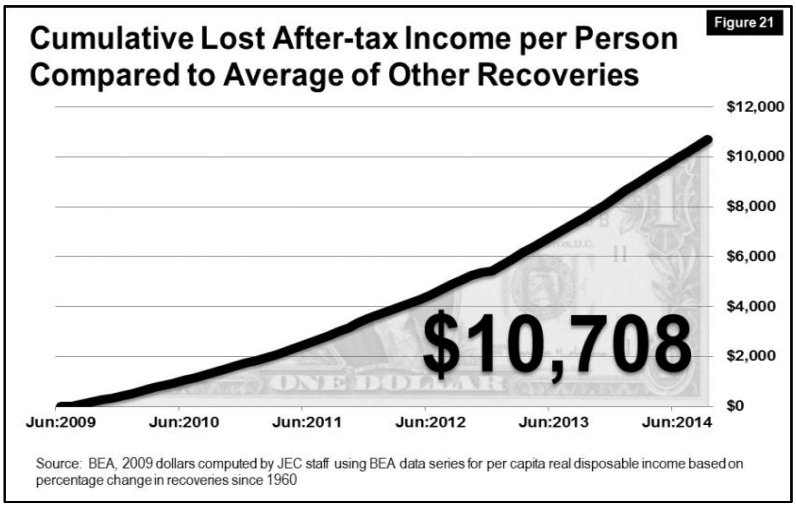
Lack of adequate growth in real GDP and in employment, particularly private sector employment, has led to a corresponding disappointing performance in personal income growth. Since the recession ended through September 2014 more than five years ago, real disposable personal income per capita has grown by a total of only 5.7% or at an annual rate of less than 1.1%.

This income growth is less than half the slightly more than 2.1% growth rate of real disposable personal income per capita since the data series began in January 1959.

When compared with other economic recoveries since 1960, the current recovery comes in a distant last place on this measure of income growth (Figure 20).

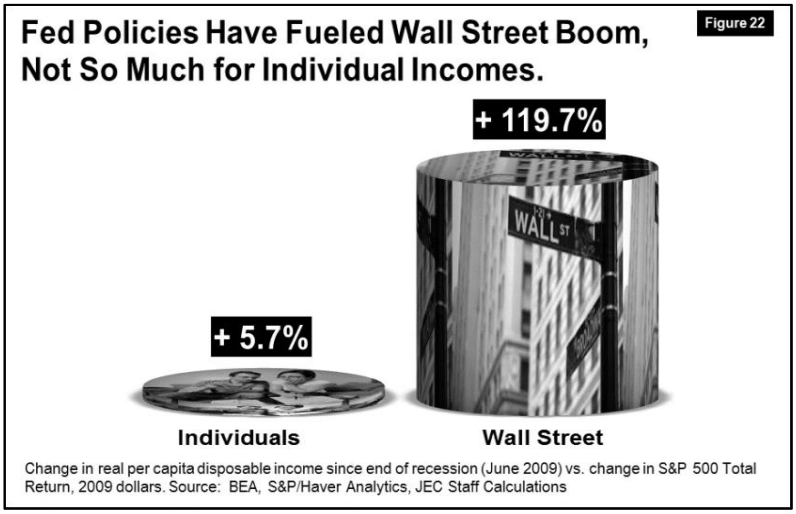


This lack of real after-tax income growth compared with the average of other post-1960 recoveries has generated an annual income growth gap of $3,115 (2009$) per person. As with the loss of output in the case of real GDP growth, the negative effects cannot be represented simply by looking at a single point in time. Taken in total, the cumulative lost real after-tax income of this recovery compared with the average of other recoveries amounts to a staggering $10,708 (2009$) per person (Figure 21).

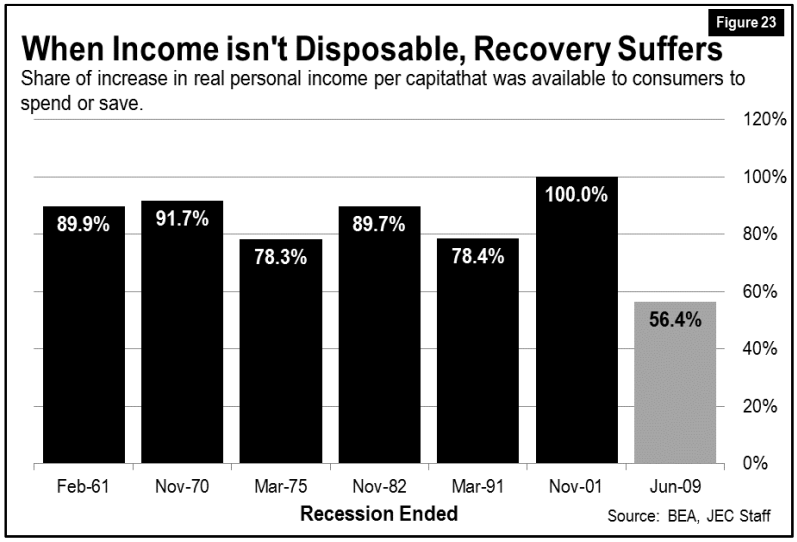


In more practical terms, this means that a four person family was missing roughly $1,040 in monthly income.

While individual incomes have stagnated during the recovery, Federal Reserve policies has helped to "juice" profits on Wall Street. Over the same period, from June 2009 through September 2014, that real disposable personal income per capita has risen 5.7%, the S&P 500 Total Return Index, adjusted for inflation, is up nearly 120% (Figure 22).



One other very stark comparison between this recovery and other post-1960 recoveries is the share of personal income growth that has translated into after-tax personal income. According to quarterly data from BEA, only 56.4% of real personal income per capita gains have translated into after-tax personal income. The average in other post-1960 recoveries was a much higher 88.0%. On this metric, the current recovery is also a distant last (Figure 23).

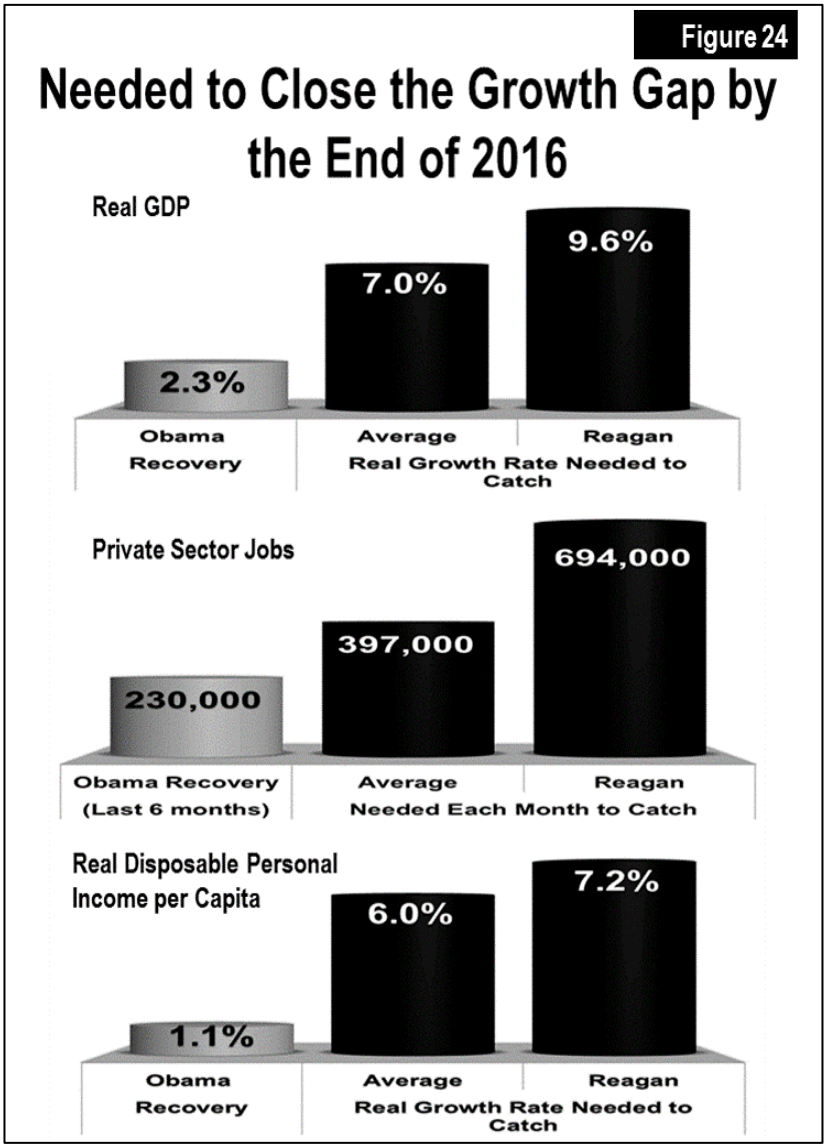


While the recovery would still languish at the bottom for real personal income per capita growth, if 88% of real personal income per capita gains had translated into after-tax gains, more than a quarter of the gap compared with an average recovery would have been eliminated.

Catching Up will be Difficult, if not Impossible

As we have discussed, this recovery suffers from a large growth gap on key metrics of real GDP, jobs, and after-tax income. The gaps generated by the current recovery are so large that they will be difficult, if not impossible, to eliminate before the end of 2016 as President Obama's term draws to a close.

The following graphic (Figure 24) looks at the performance to date of the recovery on three key metrics and what it would take to catch up with the average of other recoveries or the Reagan recovery by the end of 2016.



As stated earlier, to close the gap by the end of 2016 is likely not possible. It is important, however, that policymakers begin the process of putting the United States economy on a sustainable growth path. We cannot allow substandard growth in output, jobs, and incomes to become the new normal.

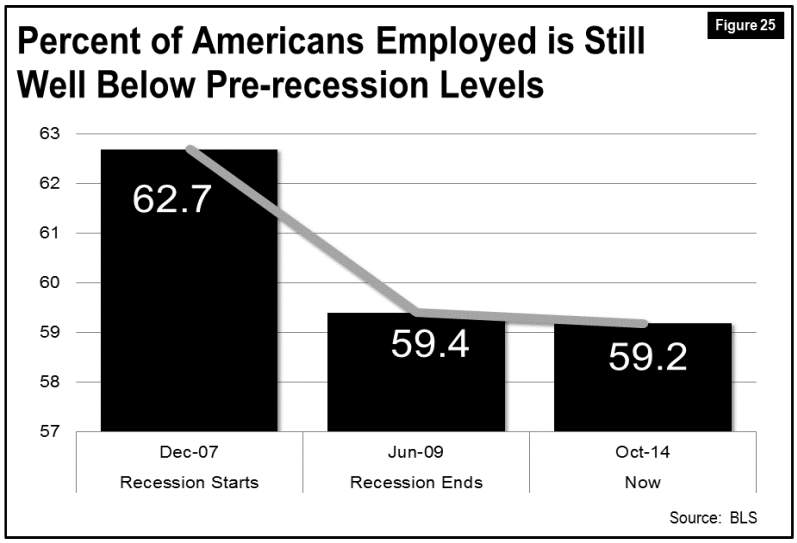
Section Summary

The President's team can make all the excuses they want for why the American people have suffered through a substandard recovery over the past five years. No excuse can explain away the massive gaps in economic growth, private sector job creation, and after-tax income growth. The President needs to come to the table and work with Congress to get the economy moving at a faster pace to grow more well-paying jobs. A good place to start is by getting the federal government out of the way and letting a free people and free markets build greater prosperity for all.

THE ECONOMIC IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT FIVE YEARS LATER

Chapter 3 of the ERP extols the virtues of the President's 2009 economic stimulus package, known as the *American Recovery and Reinvestment Act*, along with other "jobs measures" pushed by the Administration.

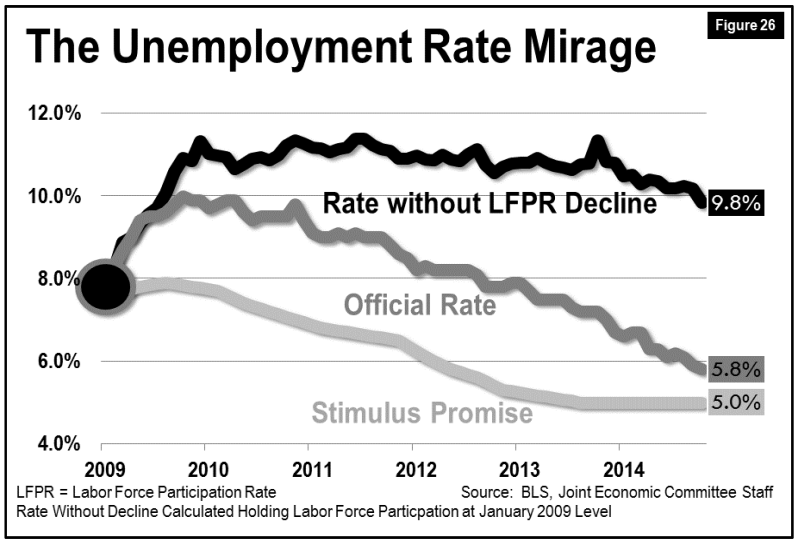
However, the percentage of the population that is employed is still 3.5 percentage points below pre-recession levels and other indicators prompt further concerns about the persistent growth gap. Much evidence suggests that rather than being a "shot in the arm" to the economy, ARRA was an extravagant waste of taxpayer dollars.



Broken Promises

Did unemployment stay below 8 percent? As the President was convincing Congress to pass ARRA, CEA released an analysis claiming that ARRA would keep unemployment below 8 percent.[5] Instead, in the months after ARRA was enacted, unemployment shot up to 10 percent. Throughout the subsequent five years, the unemployment rate remained above the stimulus promise.

In fact, it remained above the level CEA projected if Congress had passed no stimulus at all. And while the unemployment rate has declined over the past five years, the chart below illustrates that much of that decline is due to Americans dropping out of the workforce.



Was it "timely, targeted and temporary"? The second key promise was articulated by Harvard economist Larry Summers in testimony before the Joint Economic Committee when he stated that "a stimulus program should be timely, targeted and temporary."[6] This was also how the Obama Administration marketed ARRA.

In terms of timeliness, only about half of ARRA's funding was spent in the fiscal year following its passage, and CBO estimated that about 5 percent remained unspent in 2014, more than five years later.[7]

Whether ARRA was temporary remains to be seen, and is subjective depending on what length of time "temporary" is. Some ARRA programs are only beginning to wind down. For example, the temporary expansion of Supplemental Nutrition Assistance Program benefits expired in November 2013. The emergency extension of prolonged unemployment benefits expired at the beginning of 2014, and the Administration and many in Congress still support a further extension.

Research published by the Federal Reserve Bank of New York examined whether the stimulus was targeted and found that the expanded assistance to the unemployed was highly correlated with state unemployment rates, and most other state allocations had little association either positively or negatively with state unemployment rates.[8]

The CEA now wants ARRA to be considered "speedy, substantial, and sustained" (ERP, p. 95). While it is clear the spending in ARRA was substantial and the Obama administration wants sustained spending in many programs, there are serious doubts about whether ARRA led to sustained growth or employment, as discussed below.

Costs of ARRA

While the Congressional Budget Office (CBO) had originally estimated the 10-year cost of ARRA to be $787 billion when it was enacted in 2009, CBO now projects the cost through 2019 will total $830 billion, not including interest on the debt.[9]

CEA shrugs off this enormous cost as a small percentage of the 75-year deficit, only amounting to 0.1 percent if the Alternative Minimum Tax provisions in ARRA are excluded (ERP, p. 131). Using a different measure and the Administration's own data, ARRA caused 30% of the $1.3 trillion deficit in 2010. By another measure, the full cost of ARRA is almost twice the size of the budget deficit the President "inherited" when he took office.[10]

Using a 75-year timeframe is reminiscent of a glutton who overeats to dangerous levels for five years, and then states that his gluttony will have little impact on his health because the meals represent a small fraction of the food he will consume over his 75-year lifespan. It is also extremely ironic that the President continues to claim credit for cutting the deficit in half, when it is his spending policies, such as those in ARRA, that drove the deficit to record trillion-dollar levels.

Aside from its enormous dollar costs, ARRA also imposed costly waste and inefficiency. State and local governments responsible for disseminating their portion of ARRA funds were pressed for time with limited resources for oversight and speed of distribution. The Government Accountability Office notes that ARRA was measured mostly on outputs rather than outcomes, and found challenges with both existed.[11] In addition, recipients of ARRA spending programs, such as energy efficiency programs or funds to hire workers, complained of ARRA's detailed paperwork and rigorous reporting requirements, which cost time and resources.

Was it worth the cost?

Although CBO tracks the cost of the stimulus, measuring its effectiveness is much more uncertain. It is important to remember that both CEA's and CBO's estimates of jobs saved or created are exactly that—estimates, not actual data. Accurately measuring jobs saved as a result of ARRA, let alone created, is quite difficult if not impossible. So CEA and CBO apply general mathematical models with spending multipliers, using the amount and type of ARRA spending to estimate ARRA's effects on output and employment.[12]

The theory behind spending multipliers is that a dollar of government spending will sometimes produce more than one dollar of output in the economy the more likely and frequently that dollar is spent rather than saved. This theory tends to create a Keynesian bias in favor of government spending and against tax relief that might result in more savings, as if all savings is put under a mattress and does not circulate further in the economy. In reality, savings become a source of capital for financial institutions and businesses of all sizes that spurs jobs and growth in the economy.

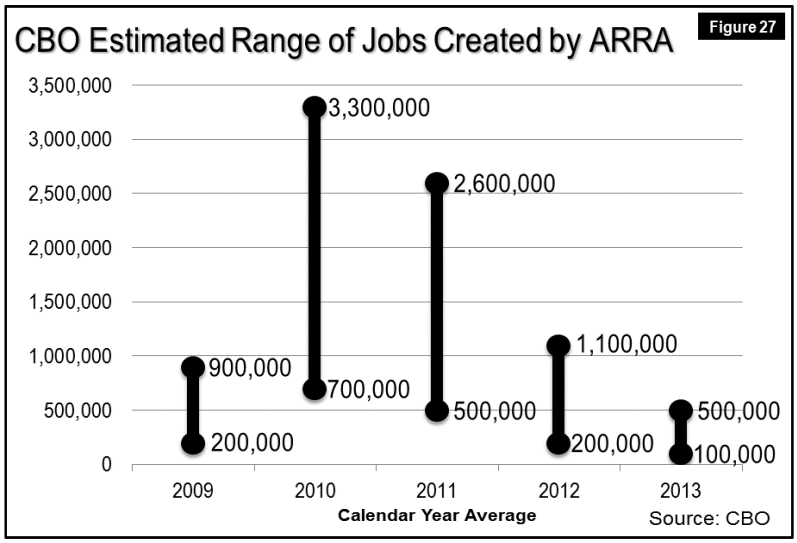
Spending multipliers also seem to ignore the fact that a dollar of government spending has to come from somewhere, and it often

comes from taxing or borrowing from the private sector, which could have used that dollar more effectively than the government to create jobs and economic growth.

There is a wide diversity of views among economists regarding spending multipliers, as discussed in a previous Joint Economic Committee publication.[13] A CBO working paper also acknowledges the uncertainty of using multipliers to predict macroeconomic effects, as well as the divergent views of economists on the subject.[14]

Under CEA's analysis, the tax policy changes in ARRA had a much smaller effect on the economy than spending increases. However, other studies suggest that the economy is highly responsive to tax changes. For example, the President's former Chair of CEA, Christina Romer, co-authored a study indicating that a one percentage increase in taxes reduces economic output by three percent.[15]

But for the sake of argument, let us assume that spending multipliers can accurately predict output and employment resulting from ARRA spending. CBO hints at the uncertainty of these multipliers, given its wide range of possible employment and output effects due to ARRA, particularly in 2010 and 2011. It is also important to remember that CBO measures the employment change in "employment years." An employment year means that one person who was previously not working gained employment for one year, regardless of whether this was part-time or full-time employment. This is not a sustained measure of employment. <u>In fact, CBO expects that there will be no impact on employment in the long run due to ARRA.</u>[16]



Alternatively, CBO provides a range of possible effects on 40-hour per week full-time equivalent employment years. A person who was working 20 hours a week and gained 15 hours of work would not appear in CBO's "employment year" column because the person was already working, but the extra 15 hours worked would be factored into the "full-time equivalent employment year" column. A person previously not working who is now working 15 hours a week would appear as a gain of one in the "employment year" column, and those 15 hours would also be factored into the "full-time equivalent employment year" column. The distinction between "employment year" as a change in employment status and "full-time equivalent employment year" as a measure of actual hours worked will be important when CEA's estimate of jobs resulting from ARRA is discussed later in this section.

Even if CBO's most optimistic estimates of employment years gained are added together, an 8.4 million increase in employment is nearly $100,000 spent to employ one person for one year, regardless of whether this was part-time or full-time employment. CBO's lower estimate of a 1.7 million increase in

employment is more accurate, then ARRA represents a cost of more than $488,000 to employ one person for one year.

Alternatively, CBO estimates more than 95 percent of ARRA's budgetary impact was realized by the end of December 2013. Using 95 percent of the latest $830 billion cost estimate and generously assuming that the net number employed persons through December 2013 was affected by ARRA, then between February 2009 and December 2013, 1.7 million people were employed for one year at a cost of nearly $464,000 per person.

These estimates are similar to findings at Dartmouth published by NBER that while a cross-state analysis suggests one additional job created by ARRA cost $107,000, a time series analysis at the state level "suggests a smaller response with a per job cost of about $400,000."[17] Additionally, a Mercatus Center study found that just 42.1 percent of workers hired at ARRA-recipient organizations after January 31, 2009, were unemployed at the time of hire, and 47.3 percent were previously employed elsewhere when hired, suggesting a roughly even split between "job creating" and "job switching."[18]

CEA, which also uses spending multipliers, estimated a total of 6.4 million "job years" created through the end of fiscal year 2013 (ERP, p. 108), with "job year" defined as one full-time job for one year (ERP, p. 92). CEA then displayed a graph showing that CEA's estimates are on the high side of CBO's range of projections and slightly exceed CBO's most optimistic projections at certain points (ERP, figure 3-6 on page 109).

However, upon closer examination, it appears that CEA selected the wrong comparison. CEA seems to compare its estimates of "job years" (representing a full-time job for one year) with CBO's "employment years" (an estimate of how many people switched from not working to working, regardless of whether it is full-time or part-time work). It is not clear whether CEA's definition of "full time" is the conventional 40-hour work week or the *Affordable Care Act's* new definition that reduced the

number to 30 hours. However, assuming that "full time" means a 40-hour work week, then CEA should have compared its estimates of job years to CBO's estimates of full-time equivalent employment years. CEA's confusion over selecting the proper data comparison is further evidence of the uncertainty and unreliability that stems from using multipliers to measure employment or job gains.

In addition, while the CEA claims that ARRA and other jobs measures laid a foundation for longer-term growth (ERP, p. 122), CBO does not seem to agree, as discussed below.

Long-term impacts

As mentioned earlier, CBO projects that ARRA will have no impact on employment in the long run. And over the long term, CBO predicts the long-term costs of ARRA will reduce GDP by between zero and 0.2 percent after 2016.[19] ARRA's long-run effect will result from the increase in government debt, as each dollar of additional debt crowds out about one-third of a dollar of private domestic capital.

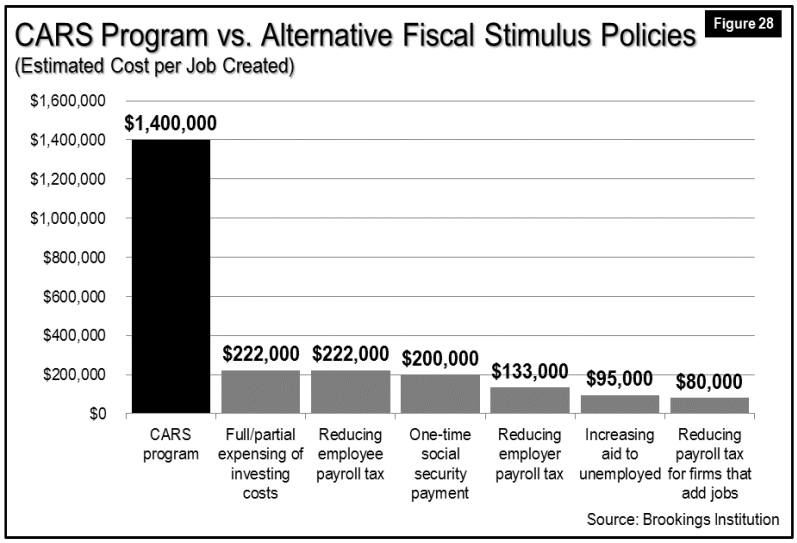
Other research from the Mercatus Center has found that federal grants such as those in ARRA (which awarded more than $200 billion in additional grants to states) can actually increase state and local taxes, creating a "permanent ratchet" in the size of state and local governments. The study found that for the long-run impact of a $1 federal grant, states must increase their total own-source revenue by $0.42 and total tax revenue by $0.33.[20]

Beginning on page 122, CEA claims that the Administration's investments in physical and human capital will boost long-term growth, including "green energy" incentives. However, the past five years revealed a plethora of cases of "stimulus waste,"[21] including $500 million spent to define, promote, and train individuals for "green jobs," which helped a mere 38 percent of the program's target of more than 81,000 jobs. In addition, nearly half of the targeted participants already had jobs.[22]

Taxpayers also lost hundreds of millions of dollars because of an ARRA-driven investment in the bankrupt solar-panel company Solyndra. This was an example of the worst kind crony capitalism in which a politically connected business received a free loan guarantee in spite of warnings within the Administration. In addition, the Administration's stimulus grant to a battery firm that went bankrupt cost taxpayers up to $149 million.[23]

CEA also highlights investments in broadband as contributing to long-term growth. However, a study of the stimulus funds spent on extending broadband to rural areas that had unserved households revealed a cost of $349,234 per unserved household—households whose median household income fell between $40,000 and $51,000 with median home prices between $94,000 and $189,000.[24]

Other examples of waste abound. According to the Brookings Institution, the "Cash for Clunkers" program cost as much as $1.4 million per job created, a sum many times over the cost of alternative stimulus policies.[25]



Damage to long-term growth and jobs

The ERP highlighted provisions of ARRA that improved the cash flow of businesses through greater up-front depreciation (known as "bonus depreciation") and allowing companies to carry back losses to prior tax years. However, the ERP seems to ignore the permanent cash-flow problem and permanent increase in the cost of capital the Administration instituted by driving up individual tax rates as well as maximum tax rates applied to capital gains and dividends.

While the President agrees with many in Congress that the corporate tax rate is too high and uncompetitive at 35 percent, the vast majority of businesses are organized as "flow-through" businesses that pay taxes at the individual rather than corporate level. While the top individual tax rate stood at 35 percent at the beginning of the Obama Administration, the President insisted that the top income tax rate increase for individuals, including flow-through businesses. As a result, the top marginal effective rate affecting flow-through companies is now 44.6 percent,[26] including Obamacare taxes and special penalties applied to higher income earners. In addition, the President drove up the

top rate on capital gains and dividends from 15 percent to 23.8 percent, including the *Affordable Care Act* tax on investment income. Dollars confiscated by higher taxes cannot be used by job creators to expand their business and hire workers, and these tax hikes will have a damaging impact on long-term growth.

In addition, CEA fails to mention the employment effects of the Administration's signature piece of legislation, the *Affordable Care Act*. Noted economist Casey Mulligan predicts that the ACA will produce "about 3% less weekly employment, 3% fewer aggregate work hours, 2% less GDP and 2% less labor income," and that these effects will be visible by 2017.[27] Similarly, CBO's own nonpartisan analysis predicts that the ACA will reduce full-time employment by two million workers in 2017 and 2.5 million workers by 2024[28].

CEA also does not mention the job loss that would result from other Administration policy objectives, such as a dramatic increase in the federal minimum wage. CBO predicts that the Administration's proposed 40% increase in the minimum wage would cost 500,000 jobs, while acknowledging that the loss could be as high as one million jobs.[29]

In another example of counterproductive policy, analysis by the U.S. Chamber of Commerce's Institute for 21st Century Energy predicts that the Administration's proposed new carbon regulations will cause the loss of over 224,000 jobs.[30]

Additionally, the Administration has refused to take action on a widely supported jobs measure that would support tens of thousands of new jobs without the need for a costly new government program. A study from one of the President's own agencies projects that if the President approved the permit for the Keystone XL pipeline, its construction alone would create over 42,000 jobs and have very little environmental impact.[31]

During this time of sub-par recovery, America would be better served if the Administration did not spend its energies on costly

policies with questionable results like the 2009 stimulus legislation, or on policies with predictably bad results, such as tax increases, the *Affordable Care Act*, burdensome new regulations, or the proposed minimum wage hike. Instead, the focus should be on removing impediments that prevent the private sector from creating jobs and boosting economic growth.

THE YEAR IN REVIEW AND THE YEARS AHEAD, DEVELOPMENTS IN 2013 AND THE NEAR-TERM OUTLOOK—ENERGY

Sea change in oil and gas calls for adaptation of federal policies

Everyone knows that a sea change has occurred in the U.S. oil and gas industry that averted the impending need to import liquefied natural gas (LNG) and, together with Canadian oil sands production, may free North America from its dependence on imported crude oil from overseas. Already, the United States has become a net exporter of refined petroleum products and is positioned to become a significant exporter of LNG and high-grade crude oil.

Just days before the ERP's release, former Federal Reserve Chairman Ben Bernanke said of the unconventional oil and gas boom:

> *It's clearly been one of the most beneficial, if not the most beneficial developments in the last few years. I mean, it's just a terrific achievement.*

He also said that the national oil and gas boom may have created a quarter of the jobs employers have added to payrolls since the economic downturn began six years ago, has greatly improved the U.S. trade imbalance, and has boosted the nation's competitive position in the world.[32]

The United States could greatly benefit from further increases in domestic oil and gas production for a number of reasons. The

country continues to import a substantial amount of crude oil (mostly heavy, high sulfur grades). As of July, petroleum still accounted for 35% of the trade deficit. U.S. crude production also has a stabilizing effect on the world oil price as it has offset reductions in supply from Iran—enabling the continuation of sanctions—Libya, and elsewhere. There are estimates that the price of crude oil could have reached $150 per barrel if it were not for the incremental supply generated by the U.S. shale boom.[33]

The oil price has been falling recently given weak economic growth in Europe and Asia, but the war against ISIS, sanctions against Russia, and any number of other sources of conflict and disruption could push the price higher again. Furthermore, U.S. oversees allies remain highly dependent on energy imports and continue to fear for their supplies. The United States could reassure them with offers to deliver LNG and possibly crude oil and thereby enhance its geopolitical influence.

Existing federal oil and gas policies shaped by an era of great scarcity are in need of revision to fit the era of relative abundance for the benefit of the economy, job creation, and geopolitical influence. The immediate requirements to achieve the goals of minimizing energy dependence and providing a stabilizing influence internationally are expanding the transport infrastructure to speed shipments from booming oil and gas production areas in the heartland as well as Canada, granting licenses for new LNG export terminals, and lifting federal restrictions on crude oil exports. Other actions include accelerating production on federal lands and offshore.

The CEA ignores critical economic policy issues

The CEA states that further increases in domestic crude oil production and reduced oil imports "are expected in coming years (ERP, p. 31)" and cites a projection by the Energy Information Administration (EIA) of continued U.S. natural gas production increases (ERP, p. 73) as though the Obama

Administration were a bystander. In fact, the Administration has a major role in either clearing the way for oil and gas development to flourish or slowing it down. The CEA says not a word about any of the aforementioned pressing policy issues in "Developments in 2013 and the Near-Term Outlook—Energy."

The "Long-term Outlook" section that follows does not address energy at all. In Energy, barely a page of text is devoted to describing the major gains in unconventional oil and gas production, and it is largely repetitive with an earlier segment on oil and gas that is also very brief.[34] The CEA even shows the same graph on page 74 that it shows on page 31, comparing domestic crude oil production and petroleum net imports.[35] Surely, the CEA could have found the space to discuss the subject matter of oil and gas supply more thoroughly before focusing on alternative energy sources, conservation, and the Administration's Climate Action Plan.

In his State of the Union address of January 2010, President Obama announced the National Export Initiative to double U.S. exports in five years, an objective that soon proved difficult to achieve. This year's ERP was released on March 10; as of February, the real value of total U.S. exports had risen by only 21%. The value of petroleum exports, however, has surged, rising by over 70% as of February and more than doubling as of July.[36] The National Export Initiative is all the more reason for the CEA to have presented a plan that facilitates increasing the petroleum supply as it can make still larger contributions to exports, which in total lag far behind the President's stated objective.[37]

Section Summary

The CEA points out the need to improve America's infrastructure but does not mention oil and natural gas pipelines or LNG export terminals. It talks about the need for America's international leadership to reduce emissions and prepare for climate impacts (ERP, p. 77), but does not discuss the nation's

potential to counteract the use of oil and gas as political weapons and curb their price volatility. The ERP acknowledges the oil and gas production increases, some of their positive economic effects, and in passing refers to "America's security (ERP, p. 30)" but it draws no policy conclusions and puts forth no "energy action plan" to make the most of the country's oil and gas resources.

Every administration has its preferences; the Obama Administration's may be to forge ahead with new executive actions that will improve fuel efficiency (ERP, p. 32). But to devote in total only three pages with duplicative graphs (out of 298 pages) to the possibly most beneficial economic development in the last few years and ignore the task of finding ways to support this development are serious shortcomings in this year's ERP.

RECENT TRENDS IN HEALTH CARE COSTS, THEIR IMPACT ON THE ECONOMY, AND THE ROLE OF THE AFFORDABLE CARE ACT

Expanding Coverage for the Uninsured

The ERP claims dramatic progress is being made in expanding access to affordable health care for millions of Americans. It credits much of this success to the enactment of the *Affordable Care Act* in 2010 (ERP p. 147). According to a recent survey by the Department of Health and Human Services (HHS), the percentage of person who lacked health insurance has declined from 16.0% in 2010 to 13.1% in the first three months of 2014.[38]

The ACA provisions to expand Medicaid coverage and establish federal and state-based insurance exchanges took effect on January 1, 2014. The ACA also gave states the option to expand Medicaid coverage prior to 2014. Following the Supreme Court's ACA decision in 2012, eight states have elected an early expansion. But even assuming the entire decline in the uninsured

since 2012 was attributable to the ACA that is less than two percent of the population.

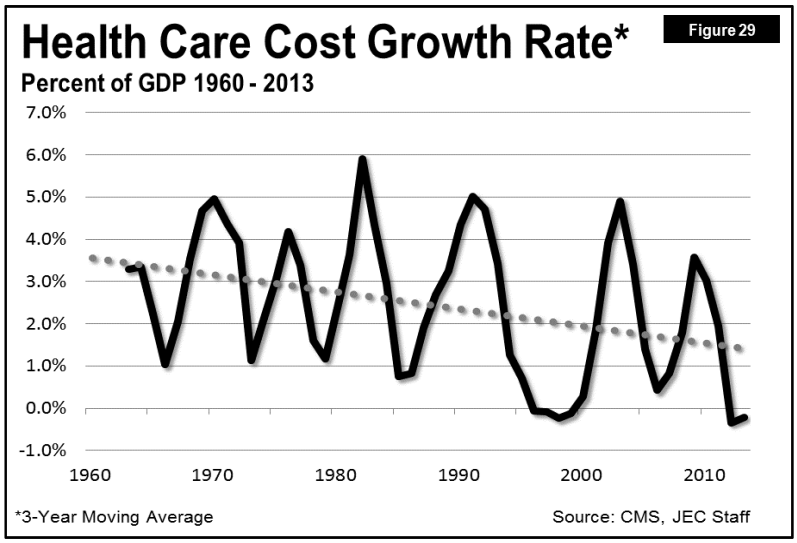
Percentage of Population Without Health Insurance				
2010	**2011**	**2012**	**2013**	**2014 (Jan-Mar)**
16.0%	15.1%	14.7%	14.4%	13.1%
Annual Change	*-0.9%*	*-0.4%*	*-0.3%*	*-1.3%*
Source: HHS				

Moreover, the Administration recently notified over 100,000 people who enrolled through the federal health exchange that they will lose their coverage because they failed to establish their citizenship or legal immigration status.[39]

Bending the Cost Curve

The ERP claims the growth in health care spending is at a record low and suggests this is due in part to structural changes in the U.S. health care system (ERP, p. 148).

The rate of growth in health care costs as a percent of GDP has been on a downward trend for decades (Figure 29).[40] But periods of slower growth have always been followed by periods of faster growth. There is no reason to believe the most recent slowdown is inconsistent with the historical pattern. Indeed, a recent analysis by CMS actuaries concluded, "From our perspective, more historical evidence is needed before concluding that we have observed a structural break in the historical relationship between the health sector and the overall economy.[41]"



According to the ERP, the ACA has contributed to the slowdown by curtailing excessive Medicare payments to private insurers and medical providers (ERP, p.148-149). But this result may be short-lived. Both CBO and CMS have stated that such reductions will likely prove to be unsustainable due their adverse impact on beneficiaries' access to health care.[42]

Reducing the Deficit

According to the ERP, the ACA will reduce the federal budget deficit by about $100 over the coming decade by slowing the growth of health care spending (ERP, p. 150). According to CBO, the ACA will increase some spending by $1.6 trillion, reduce other spending by $741 billion, and increase revenue by $1 trillion, for deficit reduction of $109 billion over ten years (2012-2022).[43] Thus, the deficit reduction attributable to the ACA is due entirely to higher taxes, not lower spending.

A Health Care Free Lunch

The ERP claims the ACA will expand coverage to the uninsured and increase total health expenditures, but have no direct effect

on the costs of those who were previously insured (ERP, p. 163). This analysis overlooks the fact that the increased demand for health care by the previously uninsured will raise health care prices for everyone. It also overlooks the fact that everyone must pay the additional taxes needed to fund the Medicaid expansion and exchange subsidies.

Less Health Care Equals More of Everything Else

According to the ERP, when we spend less on health care more resources are available for other things; and modest reductions in health care can significantly improve economic well-being (ERP, p. 171).

Health care is part of our Nation's economic output. Less health care does not automatically translate into more of everything else. The income earned by the health care sector is used to purchase goods and services produced by the other sectors of the economy. If everyone buys less health care, those who produce health care will buy less from everyone else. The net effect of shifting resources from one sector to another depends on the relative productivity of each sector. Measuring productivity in the health care sector, as well as the effect of health care on the overall economy, is extremely difficult.

FINAL COMMENTS

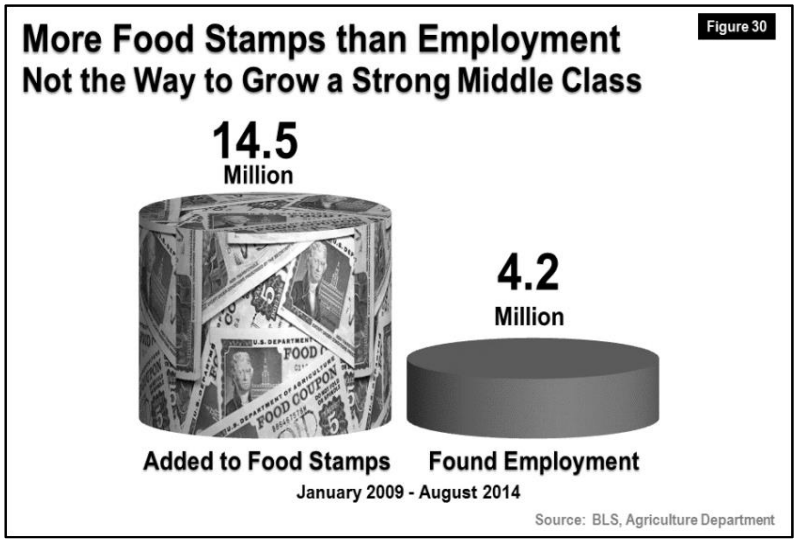
Last year I noted that:

> *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.*

That statement remains as true today as last year. Unfortunately, if we continue on the Obama Administration's path of placing faith in government instead of free people and free markets that statement will one day cease to be true.

Faith in government over free people and free markets has contributed to making the worst economic recovery in President Obama's lifetime his own.

Since President Obama took office through August 2014, the latest month for which data are available, 8.2 million households and 14.5 million individuals have been added to the food stamp rolls, the Supplemental Nutrition Assistance Program or SNAP. Over the same period, 4.2 million Americans gained employment. Adding more than three people to food stamp rolls for every person that gains employment is anything but a record of success (Figure 30).



Even if you examine this data from the end of the recession, some 11.6 million Americans have been added to food stamp

rolls. An economic recovery should see declining, not increasing reliance on public assistance programs.

The lack of economic growth has also increased the debt burden placed on the American people by the federal government. The loss of $5 trillion in economic output compared with an average recovery equates to a loss of between $840 billion and $970 billion in revenues over the course of the recovery.[44] In other words, the growth in federal debt would have been reduced by nearly $1 trillion with an average recovery.

A Reagan-style recovery would likely have trimmed between $1.3 trillion and $1.5 trillion from the growth of the national debt.[45]

President Obama needs a "Kennedy-Reagan" economic policy reset that focuses on creating opportunity, well-paying jobs, and economic growth. He needs to abandon his policies of increasing reliance on the federal government, overly burdensome regulation, and his insatiable appetite for trying to raise taxes on American families and businesses.

We must reinvigorate the American dream by focusing on job creating pro-growth policies.

We need to replace a broken tax code that is incomprehensible even to tax experts and replace it with a tax code that is built for growth.

We need to get rid of unnecessary and burdensome regulations by reforming the regulatory process to make sure that regulation is not only necessary, but cost-effective and delivers promised benefits.

While Federal Reserve policy was not a subject of the *Economic Report of the President*, we need to get the Federal Reserve out of the business of allocating credit and give it a mandate to

maintain the purchasing power of the dollar in order to maximize output and employment.

We can accomplish this, but we need the President to be willing to work with Congress in a meaningful way.

We need to trust again in the system of free people and free markets that built the greatest engine for prosperity ever known to man.

Representative Kevin Brady
Chairman

ENDNOTES

[1] *2014 Economic Report of the President* (ERP), p. 6. The entire report can be accessed online at: http://www.whitehouse.gov/sites/default/files/docs/full_2014_economic_report_of_the_president.pdf.

[2] 2013 Economic Report of the President (ERP), p. 3. The entire report can be accessed online at: http://www.whitehouse.gov/sites/default/files/docs/erp2013/full_2013_economic_report_of_the_president.pdf.

[3] "Assessing the Cost of Potential New Carbon Regulations in the United States," Executive Summary, U.S. Chamber of Commerce Institute for 21st Century Energy, page 6, accessed at http://www.energyxxi.org/sites/default/files/file-tool/Executive_Summary_EPA_Regs.pdf on October 2, 2014.

[4] "Final Supplemental Environmental Impact Statement for the Keystone XL Pipeline," Executive Summary, United States Department of State Bureau of Oceans and Environmental and Scientific Affairs, January 2014, page ES-19, accessed at http://keystonepipeline-xl.state.gov/documents/organization/221135.pdf\ on October 2, 2014.

[5] Christina Romer and Jared Bernstein, "The Job Impact of the American Recovery and Reinvestment Act," January 9, 2009, accessed at http://otrans.3cdn.net/45593e8ecbd339d074_l3m6bt1te.pdf on October 2, 2014.

[6] Lawrence H. Summers, "Fiscal Stimulus Issues," testimony before the Joint Economic Committee, January 16, 2008.

[7] "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output in 2013," Congressional Budget Office, February 2014, page 1, accessed at http://www.cbo.gov/sites/default/files/cbofiles/attachments/45122-ARRA.pdf on October 2, 2014.

[8] James Orr and John Sporn,"The American Recovery and Reinvestment Act of 2009: A Review of Stimulus Spending in New York and New Jersey," Federal Reserve Bank of New York, Current Issues in Economics and Finance, vol. 18, no. 6, accessed at http://www.newyorkfed.org/research/current_issues/ci18-6.pdf on October 2, 2014.

[9] "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output in 2013," Congressional Budget Office, February 2014, page 1, accessed at http://www.cbo.gov/sites/default/files/cbofiles/attachments/45122-ARRA.pdf on October 2, 2014.

[10] The budget deficit in 2008 was nearly $459 billion, according to the Office of Management and Budget.

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[35] The only differences between Figure 2-19 on page 74 and Figure 1-7 on page 31are that the latter starts in 2000 and uses annual data while the former starts in 1990 and uses monthly data. Figure 2-18 on page 74 also depicts petroleum net imports, going back to 1980 and with a projection to next year.
[36] The latest data shows an increase of 28% in total exports as of July with five months to go before the five years are up. Petroleum exports rose from $3.7 billion in January 2010 to $6.3 billion in February 2014 and $8.4 billion in

July 2014 (chained 2009 dollars), Real Exports, Imports, and Balance of Goods, Petroleum and Non-Petroleum End-Use Commodity Category Totals, U.S. Census Bureau.

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[44] This range represents an approximation. The numbers are calculated by multiplying the cumulative lost output by 15.5% (the average revenue collections as a percent of GDP for fiscal years 2009-2013 and 17.9% (revenues as a percent of GDP in pre-recession fiscal year 2007) times cumulative lost output of $5 trillion (2009$). Those results are multiplied by 1.0857 to convert 2009 dollars to current dollars.

[45] These estimates were arrived at by multiplying the same percentages and conversion factor used in the prior calculation multiplied by the cumulative lost output of $7.8 trillion (2009$) of the current recovery compared with the Reagan recovery.

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 2014 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.

In 2014, the U.S. economy has continued to expand at a moderate pace, the unemployment rate has continued to decline and inflation has remained low.

As in recent years, the private sector continues to lead the economic expansion. The private sector has added jobs for 56 consecutive months, creating more than 10 million jobs over that period. Through October, the U.S. economy created more jobs than in any other 10-month period since the recession that began at the end of 2007.

The unemployment rate has dropped by more than one percentage point over the past year, with the bulk of that decrease due to declining long-term unemployment (that is, joblessness among workers who have been unemployed for six months or more but have continued to search for work). Long-term unemployment has declined significantly since rising to record levels during the recession. Even so, the long-term unemployment rate remains above pre-recession levels and is a leading concern for policymakers.

The near-term prospects for the U.S. economy are bright as spending by households and businesses continues to strengthen. Exports of goods and services have been an important source of economic growth in recent years and should continue to boost the economy. However, demand for U.S. exports may slow if geopolitical risks abroad remain elevated.

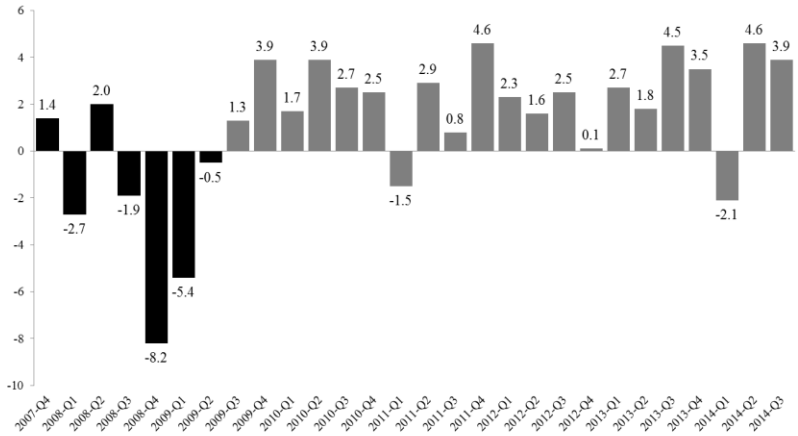
RECENT U.S. MACROECONOMIC PERFORMANCE AND POLICY

Recent U.S. Macroeconomic Performance

Overall Economic Growth. Real (inflation-adjusted) gross domestic product (GDP) rose by 3.1 percent over the course of 2013, and it appears likely that the economy will advance at a comparable pace over the second half of this year. Economic growth in 2013 was stronger than most forecasters had expected at the beginning of last year, largely due to a surge in inventory accumulation during the third quarter that boosted growth in the second half of 2013 to 4.0 percent at an annual rate.

The economy's acceleration in late 2013 was temporary and was followed by a sharp reduction in production early this year (see **Figure 1**). The economy contracted at a 2.1 percent annual rate in the first quarter as businesses increasingly sold goods from their large inventories rather than from increased production. Unusually severe winter weather and weakening growth overseas further constrained U.S. economic growth in the first quarter of 2014.

Figure 1. U.S. Economic Growth
Percent change in real (inflation-adjusted) gross domestic product, annual rates



Note: Black bars denote the most recent recession period as determined by the National Bureau of Economic Research.
Source: JEC Democratic staff using data from the Bureau of Economic Analysis, U.S. Department of Commerce.

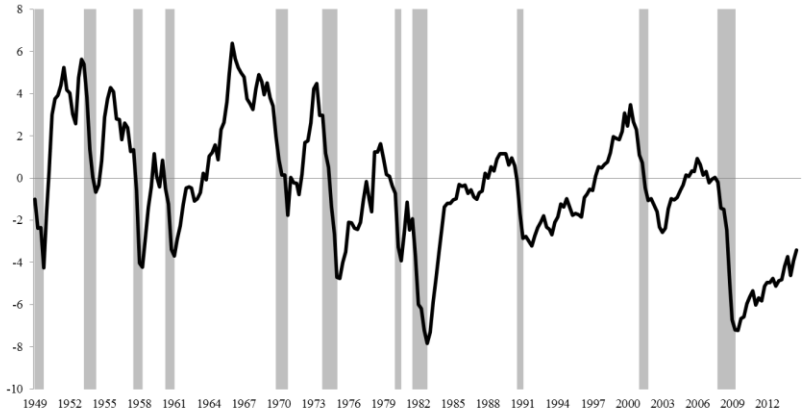
The economy resumed growing at an above-trend pace in the spring as the weather improved and the inventory adjustment subsided. GDP rebounded at a 4.6 percent annual rate in the second quarter of the year, followed by a 3.9 percent increase in the third quarter.[46]

Measuring Economic Performance. Measuring the economy's performance relative to its potential provides policymakers with critical information on the economy's overall health. A widely-used performance metric, known as the "output gap," measures the difference between the goods and services actually produced (GDP) and what the economy would have produced if it had been growing at its "potential" pace (that is, a sustainable growth rate consistent with full employment and stable, low rates of inflation).[47]

As actual GDP contracted during the recession, the output gap widened sharply to a shortfall of more than 7.0 percent of potential output (see **Figure 2**). The gap has narrowed gradually since the economy began to recover. In the second and third quarters of 2014, actual growth exceeded potential growth, and

the output gap closed further. However, the remaining gap (estimated to be a shortfall of 3.4 percent in the third quarter) indicates there is still productive slack in the economy and that labor and capital resources are underutilized. Under those conditions, businesses can expand production without putting upward pressure on wages and capital costs.

Figure 2. U.S. Output Gap
Actual minus potential real GDP as percent of potential GDP, quarterly through 2014-Q3



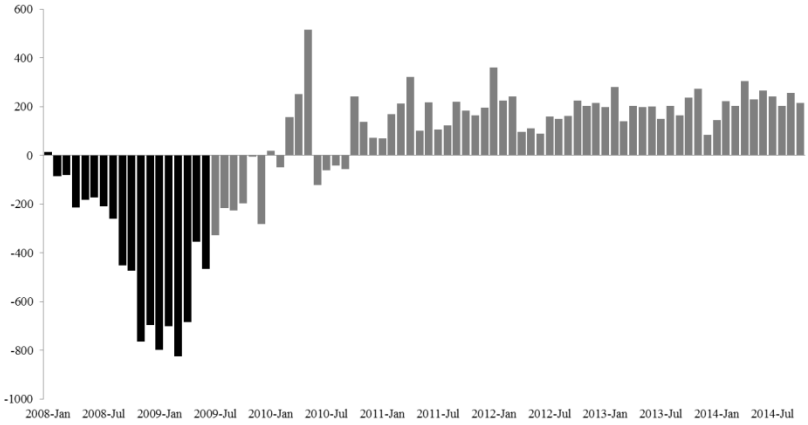
Note: Shaded regions denote periods of recession as determined by the National Bureau of Economic Research.
Sources: JEC Democratic staff based on data from the Bureau of Economic Analysis, U.S. Department of Commerce and Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2014).

The Federal Reserve Board and the Congressional Budget Office, along with leading private-sector forecasters, expect that the U.S. economy will continue to grow at an above-trend pace over the near term. Sustained growth in excess of trend will be necessary for the economy to return to full employment in coming years.

Employment and Unemployment. Employment growth has been relatively steady so far in 2014 (see **Figure 3**). Over the first 10 months of the year, nonfarm payroll employment increased by about 2.3 million jobs, adding an average of about 230,000 jobs per month. That is the strongest period of job growth over a 10-

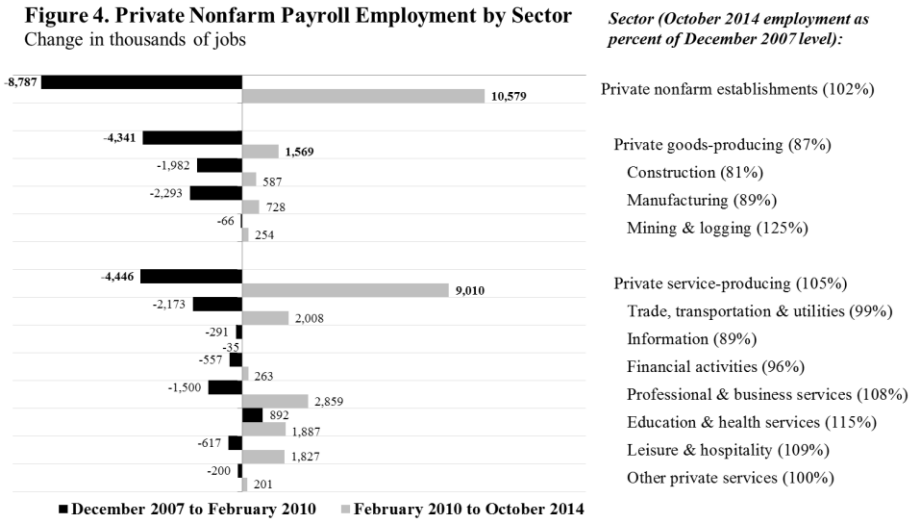
month period since 2005-2006, and nearly 16 percent higher than the pace over the first 10 months of 2013.[48]

Figure 3. Nonfarm Payroll Employment
Change in thousands, monthly through October 2014



Note: Black bars denote the most recent recession period as determined by the National Bureau of Economic Research.
Source: JEC Democratic staff using data from the Bureau of Labor Statistics, U.S. Department of Labor.

Early this year, employment surpassed the level that prevailed when the recession began. Since labor markets began to recover in early 2010, the economy has added nearly 1.8 million more private-sector jobs than had been lost during the recession (see **Figure 4**). Most of the jobs gains since the recovery began were in service-sector businesses; those businesses have already added about double the number of jobs they lost as a result of the recession.

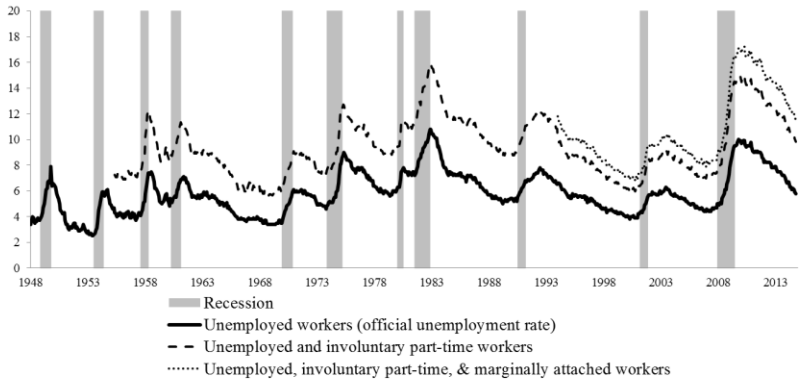


Source: JEC Democratic staff based on data from the Bureau of Labor Statistics, U.S. Department of Labor.

Employment in goods-producing industries, such as manufacturing and construction, was hit especially hard by the downturn. With the recovery, employment has grown and both sectors continued to improve in 2014.

Over the past five years, employment growth has been accompanied by a significant decline in the unemployment rate. Since peaking at 10.0 percent of the civilian labor force in October 2009, the unemployment rate has declined by more than four percentage points to 5.8 percent in October 2014 (see **Figure 5**). Over the past year alone, the unemployment rate has declined by 1.4 percentage points, dropping to levels below 6.0 percent for the first time in more than six years.

Figure 5. Measures of Unemployment and Underemployment
Percent of official or augmented labor force, monthly through October 2014

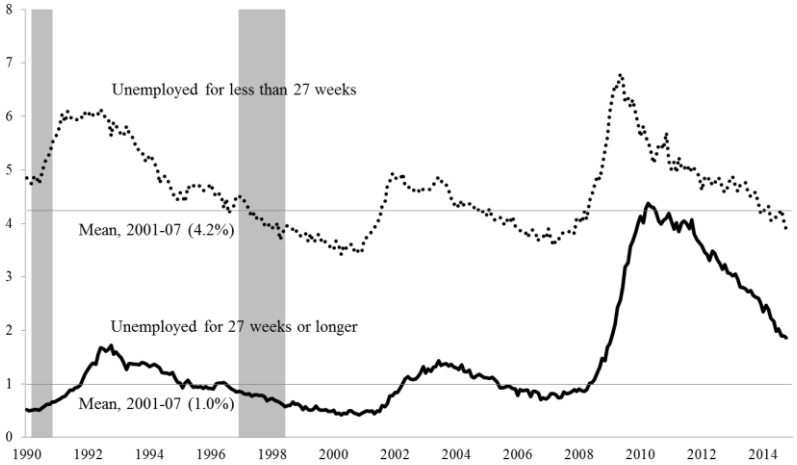


Note: Unemployed workers do not have a job but continue to actively search for work and, thereby, remain in the labor force. Involuntary part-time workers are individuals who work less than 35 hours per week for economic reasons and would prefer to work more hours. Marginally attached workers are not in the labor force (and are therefore not counted among the officially unemployed) but have looked for a job sometime in the prior year and want a job and are available to work.
Source: JEC Democratic staff based on data from the Bureau of Labor Statistics, U.S. Department of Labor and the National Bureau of Economic Research.

Underemployment also rose sharply during the recession and has come down since the recovery began. For example, the number of involuntary part-time workers (that is, workers who have had to take part-time jobs for economic reasons even though they would prefer full-time work) doubled from 3.0 percent of the civilian labor force to 6.0 percent in early 2010, its highest level in nearly three decades. Through October of this year, involuntary part-time employment had declined substantially, though it remains about 1½ percentage points higher than its pre-recession level.

Since long-term unemployment rose to a record high level of 4.4 percent of the labor force during the recession, it has declined significantly, down to 1.9 percent in October 2014. Even with that improvement, long-term unemployment remains a concern. While the short-term unemployment rate has already declined to a level just below its average during the years prior to the recession, the long-term unemployment rate has declined more slowly and remains about a percentage point above its pre-recession level (see **Figure 6**).

Figure 6. Unemployment Rates by Duration
Percent of civilian labor force, monthly through October 2014



Note: Shaded regions mark periods of recession as determined by the National Bureau of Economic Research. The means for each measure are calculated over the period running from the business cycle peak of March 2001 through the peak of December 2007.
Source: JEC Democratic staff based on data from the Bureau of Labor Statistics, U.S. Department of Labor.

Addressing long-term unemployment remains a priority for policymakers. Considerable research has shown that long periods 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 linked to declines in the health and welfare of unemployed workers and their families.[49]

Even as the number of underemployed workers has declined, the number of job openings has accelerated so far this year. Over the first nine months of the year, the number of job openings reported by private businesses rose at a 28.6 percent annual rate, more than double the pace at which openings grew during the same period last year.[50] That means that opportunities for employment are expanding and that the likelihood of finding a job is rising for currently unemployed or underemployed workers. For example, there were 2.2 unemployed workers for every private-sector job opening in September 2014, substantially below the peak of 7.8 unemployed workers per

opening during the recession and nearing the level that prevailed prior to the recession.

Inflation. Inflationary pressures have remained low during the past year (see **Figure 7**). 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 1.8 percent.[51] An alternative measure of underlying inflation in consumer prices, the price index for personal consumption expenditures excluding food and energy, rose by only 1.6 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.[52]

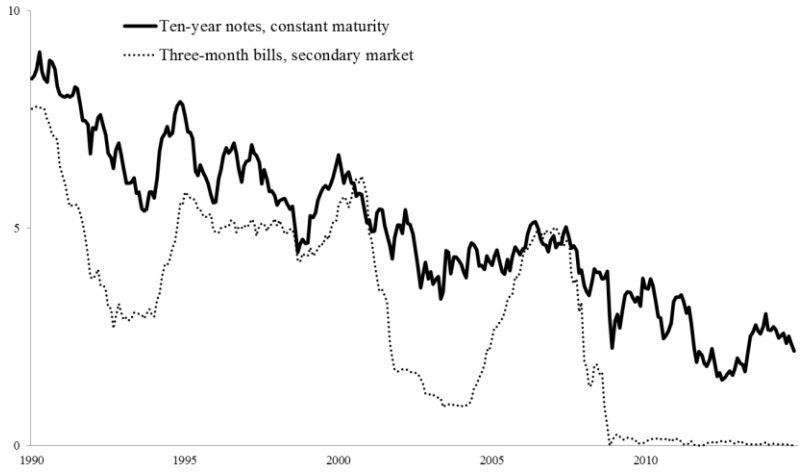
Figure 7. Core Inflation in Consumer Prices
Twelve-month percent change, monthly through October 2014

Note: Core price indexes of consumer prices exclude the volatile indexes for food and energy prices. The PCE price index is the price index for personal consumption expenditures in the national income and product accounts. The CPI-U is the consumer price index for all urban consumers.
Source: JEC Democratic staff using based on data from the Bureau of Economic Analysis, U.S. Department of Commerce and Bureau of Labor Statistics, U.S. Department of Labor.

A number of factors have tempered inflationary pressures since the recession ended. The most important factor is that the economy continues to operate below its capacity, reducing pricing power for labor, capital and suppliers of materials. For example, growth in labor earnings has been relatively weak since the economy began to recover: while labor productivity in

nonfarm businesses has increased at an average annual rate of 1.3 percent since the overall recovery began in mid-2009, real hourly labor compensation has barely changed at all. Normally, growth of labor compensation would track productivity growth more closely. Moreover, recent declines in global commodity prices (especially decreases in fuel prices) have also reduced inflationary pressures.

Figure 8. Yields on U.S. Treasury Debt
Percent, end of month value through November 2014



Source: JEC Democratic staff using data from the Board of Governors, Federal Reserve System.

Interest Rates. The combination of a gradual recovery from a severe recession, relatively low inflation expectations, and, most importantly, aggressive monetary easing by the Federal Reserve has kept yields on U.S. Treasury debt at or near record lows for much of the past five years (see **Figure 8**). Short-term interest rates have been near zero since late 2008. Moreover, in recent years, large-scale asset purchases by the Federal Reserve have also helped keep longer-term interest rates relatively low. Longer-term interest rates began to rise in the first half of last year and, since then, have remained a little higher than they were in recent years. Those increases largely reflect stronger credit demands from households and businesses along with expectations that monetary policy will become less

accommodative as the economy strengthens. Even so, longer-term rates remain low by historical standards.

Macroeconomic Policy

While the economy has improved in recent years, further progress is needed. Macroeconomic policy should support overall economic growth by strengthening labor markets, encouraging capital investment and keeping inflation stable at low levels. Clear communication of macroeconomic policy objectives and strategies is essential to improving economic performance. It reduces uncertainty for consumers and investors and allows policymakers to respond flexibly to unforeseen events without undermining longer-term objectives.

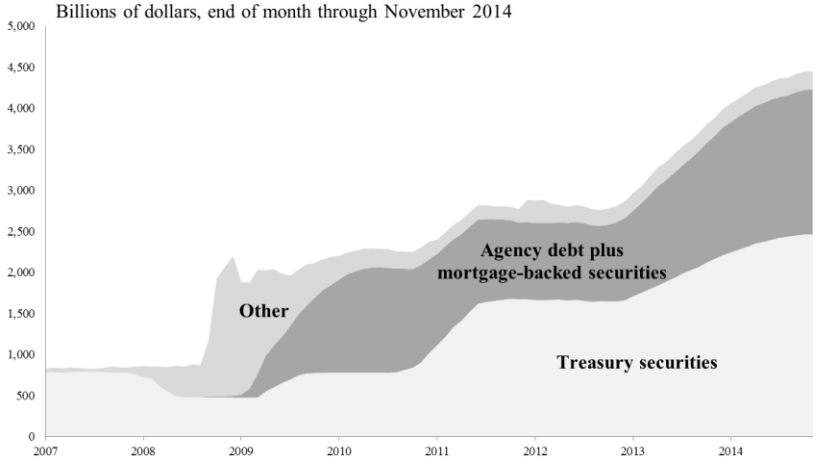
Monetary Policy. The Federal Open Market Committee (FOMC), the body within the Federal Reserve charged with decision-making authority over monetary policy, operates under a dual mandate to maximize employment and maintain price stability over the long run. In normal times, the FOMC does so by easing 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. But, since the onset of the financial crisis, the FOMC has faced extraordinary challenges in designing and implementing monetary policy.

The severity of the crisis prompted an aggressive response from the Federal Reserve. By the end of 2008, monetary policymakers had lowered short-term interest rates to effectively zero, thereby exhausting its arsenal of conventional monetary responses. Finding it necessary to ease monetary policy further but unable to lower short-term interest rates below zero, the FOMC augmented its conventional measures with new approaches to spurring the economy.

One of the most important of those unconventional policy measures in recent years has been the FOMC's efforts to put downward pressure on longer-term interest rates by purchasing

and maintaining large stocks of longer-term debt assets. Beginning in late 2008, the Federal Reserve introduced the first of three phases of large-scale asset purchases (popularly referred to as "quantitative easing"). Those purchases of longer-dated Treasury debt along with agency debt and mortgage-backed securities were designed to maintain downward pressure on longer-term interest rates in general and mortgage rates in particular. Numerous economic studies have concluded that those asset purchases were effective in reducing long-term interest rates relative to what levels might have been if the Federal Reserve had not acted, thus spurring economic growth.[53] At the same time, the Federal Reserve's balance sheet grew to an unprecedented degree (see **Figure 9**).

Figure 9. Federal Reserve System Assets
Billions of dollars, end of month through November 2014



Source: JEC Democratic staff based on data from the Board of Governors of the Federal Reserve System.

At the close of its two-day meeting at the end of October 2014, the FOMC announced the conclusion of its large-scale asset purchase program.[54] The Federal Reserve will no longer purchase longer-dated Treasury and agency securities. The FOMC intends to reduce its stock of longer-term assets very gradually. For now, the Committee will continue to reinvest

principal payments from its holdings of agency debt and securities into agency securities, and it will continue to roll over maturing Treasury securities at auction. Those actions will keep the Federal Reserve's balance sheet about constant. Only after it begins to increase its target range for short-term interest rates will the FOMC begin phasing out reinvestments of the longer-dated securities it has acquired. Once the reinvestments begin to phase out, the Federal Reserve's balance sheet will decline slowly as the debt securities mature. In order to minimize the effects of its balance sheet contraction on markets, the FOMC does not plan to sell significant portions of its current holdings of agency mortgage-backed securities at any one time. Thus, while the Federal Reserve's balance sheet has now stopped growing, it will likely be a number of years before it has returned to a size and composition similar to what prevailed before the crisis.

Regarding other aspects of monetary policy, the FOMC reiterated in October 2014 that it will continue to assess its decision to keep short-term interest rates at exceptionally low levels in light of future labor market developments. Moreover, once economic and financial conditions have improved to the point where the FOMC begins to raise short-term rates, the Committee indicates that it will do so gradually. As a result, it is likely to be some time before short-term interest rates return to their historical norms. Most FOMC participants expect that the first increase in short-term interest rates will occur sometime next year.[55]

Fiscal Policy. The federal budget deficit declined to $483 billion in fiscal year 2014, the fifth consecutive year in which the deficit has narrowed. At 2.8 percent of GDP, the federal deficit is below the average over the past four decades. At the same time, fiscal policy has constrained overall economic activity over the past year to a smaller degree than it had in previous years.

The bipartisan budget agreement reached late last year averted a potential impasse early this year and reduced the uncertainty associated with federal budget policy over the near term. In particular, the budget agreement has made near-term federal

discretionary spending more predictable than it has been for some time. The standoff over budget cuts that led to the partial shutdown of the federal government in October 2013 was costly to the economy. In avoiding such disruptive showdowns, the government avoids undermining the confidence of households and businesses and thereby adversely affecting economic activity.

Most observers agree that a balanced approach to gradual reduction in the deficit is desirable. While the substantial fiscal tightening in recent years, implemented largely through indiscriminate spending cuts, has helped to reduce the deficit in the near term, it 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

[46] This report reflects economic data available through November 2014. In particular, the latest national income and product accounts data available correspond to the second estimate for 2014-Q3 as released by the Bureau of Economic Analysis on November 25, 2014 (link).

[47] Potential output is the total amount of goods and services the economy could produce if productive resources (e.g., labor and capital) were fully utilized and overall inflation were stable at a low level. The Congressional Budget Office currently estimates that potential output is growing between 1½ and 2 percent a year; see Congressional Budget Office, *The Economic and Budget Outlook: An Update* (August 2014, link). That rate of potential growth is below the estimated pace prior to the recession. The severity and duration of the downturn significantly impaired the growth of both labor supply and productive capital, thereby slowing growth of potential output.

[48] JEC Democratic staff calculations based on data available through October 2014, as released by the Bureau of Labor Statistics on November 7, 2014 (link).
[49] 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 (link).
[50] JEC Democratic staff calculations based on data available through September 2014, as released by the Bureau of Labor Statistics on November 13, 2014 (link).
[51] JEC Democratic staff calculations based on data available through October 2014, as released by the Bureau of Labor Statistics on November 20, 2014 (link) and by the Bureau of Economic Analysis on November 26, 2014 (link).
[52] The FOMC "judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate." See Federal Open Market Committee, "Longer-Run Goals and Policy Strategy," Press Release, January 25, 2012 (link).
[53] See, for example, the many research papers cited in Diana Hancock and Wayne Passmore, "How the Federal Reserve's Large-Scale Asset Purchases (LSAPs) Influence Mortgage-Backed Securities (MBS) Yields and U.S. Mortgage Rates," *Finance and Economics Discussion Series #2014-12*, Federal Reserve Board, February 2014 (link). In their own comprehensive approach to assessing the effects of the LSAPs, Hancock and Passmore find that, the Federal Reserve's asset purchase program has exerted significant downward pressure on MBS yields, thereby supporting housing markets and overall economic growth.
[54] Federal Open Market Committee, Statement on monetary policy, October 29, 2014 (link); and New York Federal Reserve Bank of New York, Statement Regarding Purchases of Treasury Securities and Agency Mortgage-Backed Securities, October 29, 2014 (link).
[55] The Federal Reserve's latest available economic projections were released in September (link).