

Maine Center for Economic Policy
2010 Tax and Budget Conference
Keynote Address by Larry Mishel, President, Economic Policy Institute

Opening Remarks

Let me congratulate you on your braveness for coming to hear an economist at 9 o'clock in the morning. You know the definition of an economist, someone who is good with numbers but didn't have the personality to become an accountant.

What I'm going to address today, there's not much humor to it. There is great irony to many parts of it because I'm going to address the "great recession" that we're in. This is one of the largest economic challenges that this nation has faced since the 1930s.

There is a dramatic amount of pain out there among working families – loss of income, loss of hours of worked – and what's going on right now is going to scar the country, its productive capacity, and its children for years to come.

This is also an important time for debates about policy. What is going on right now are lots of different interventions by government. Historically, we've had 30 years where we said, "just get government out of the way." We've had a hesitancy to use government for public purposes. This has been reflective of both parties.

The American people have decided that the idea that government should not ever intervene in the economy is no longer to be blindly followed. They were not persuaded by any particular refereed journal article that this laissez-faire philosophy didn't really work. The onset of the financial crisis and the recession has persuaded people that we should not necessarily believe those who say "if the government does anything it is going to be wrong or make things worse." That doesn't mean however that anyone who gets up in an audience and says government can actually fix the economy is going to be persuasive.

This is the moment where those of us who believe that government has a very useful role to play need to demonstrate that. We need to do so in a way that actually changes people's lives for the better. If we do that then we will have reversed a 30 year period where people who wanted to use government to make things better were on the defensive. Now, we actually have more credibility.

What I'm going to talk about today is the recession, how it's been so far, what it looks like going forward, the damage that's been done, what the federal government has done so far, how that's worked, what it needs to do more of, and what the implications are for public policy in Maine.

30 Years of Growing Income Inequality

The first thing I want to point out is that even before we got into the great recession we had quite a mess. It's important to understand this because we need to be conscious of what we do now so that we try to rebuild an economy that's going to work better for working people.

In the last 30 years, incomes of the typical middle class family didn't really move much except for one small period of time in the late 1990s. The 2000 to 2007 business cycle was the very first time that incomes of working people were lower at the end of the business cycle than at the beginning. In other words, of all the growth, all the productivity growth, the 13 to 15% that the pie grew from 2000 to 2007, none of that got to the typical working family. That's one of the reasons why many people thought we were in a recession way before we actually got into the recession.

One of the main reasons for this is that we had tremendously unbalanced growth. Of all the income growth the economy generated from 1989 to 2007, only about 16% went to the bottom 90% of families. The upper 1% got 55% of the total income growth. The upper tenth of the upper 1%, that's 1 out of 1,000 families, received over a third of all the income growth during that period of time. That was no accident. It was a very conscious set of policies.

It took a lot of political power to implement policies to distort an economy that much. That's not the natural workings of the economy. It is the result of a very conscious effort to apply power to politics to policy. The underlying theme I want to leave you with is that over this period of time we had growing productivity measured as the output of goods and services per hour worked. That's the growth of the pie. That's what allows us all to eat more each year, when we create more pie.

The hourly compensation of the typical worker during the first part of the postwar period up through the 1970s grew along with productivity. Since then, compensation has hardly grown at all despite continued productivity growth. The biggest gap between productivity growth and the compensation growth enjoyed by the typical worker was actually during the last recovery from 2002 to 2007. On average, the hourly compensation of people with a high school degree or a college degree didn't grow at all even when overall productivity was growing at very high rates. So that's the mess we've been in.

Unemployment and Underemployment in the "Great Recession"

Now we're in the great recession. The unemployment rate has more than doubled. Before the recession officially began in December 2007, the unemployment rate rose from 4.3% in the spring of 2007 to 4.9% by the end of 2007. Now we're up to 10.0% unemployment and 15.3 million people unemployed.

That's not all the damage. Quite a few people are working part time who would rather have a full time job, called involuntary part-timers. Since the unemployment measure requires that you are available to begin work now and you've looked for work in the last four weeks, it doesn't include people who have dropped out of the job market.. If you include involuntary part time workers and people that have looked for work sometime in the last year and are available to work, there are 27 million people that are unemployed or underemployed right now. That's not a good situation.

Job Growth in Perspective

Here's what's going on with jobs. We had job growth leading up to the start of the recession. Since then we've lost 5.8% of our job base – 8.1 million jobs. That's not the size of the hole we're in because naturally you need to be creating jobs every month to absorb a continuously growing population and labor force. If you count how many jobs we would need to create to get back to the pre-recession unemployment rate of 4.9%, we'd need to create 10.6 million new jobs. Thus we have a lot of work ahead of us over the next 3 or 4 years to try to get back to where we were.

The Recession's Human Impact

One of the things that happens in a recessions besides people losing their jobs and having fewer work hours is that wage growth gets smacked down. That means even those with a job aren't doing so well. During the first six months in 2009, the annual wage growth rate was 1.3%. This is really pretty low. In the beginning of 2007, the same figure was 3.7%.

Unemployment and underemployment talk about the average person. We know in this country that minorities have thirty to sixty percent higher unemployment and that blue collar workers have forty percent higher unemployment than average. White collar workers have lower than average unemployment but are experiencing the greatest unemployment on record going back to the late 1940s. So the situation I'm describing is much worse for different parts of the population.

What are we likely to see going forward? There are two potential messages. One, most recently touted by House Minority Leader John Boehner, is "get out of the way, the private sector is going to deliver us." If you believe that I've got beach front property to sell you in the Rocky Mountains. My view is that it is hard to not see that there is a ton of pain here and that more pain is forthcoming.

The unemployment rate was 9.3% in the spring which is when economists are going to tell you that the recession is officially over. That just means that the economy stopped shrinking. If the economy starts growing then economists will say you're in a recovery. That's not a recovery that any human being would recognize.

There is a disconnect between what you'll hear in the press and what a Wall Street economist will say and what a normal human being experiences. There's plenty of

economic projections that say unemployment will get to 10.6% or so, after rising throughout most of 2010. We've already had 2 years of rising unemployment. It's likely to rise for another 9 months to a year. And remember again that when we have 10% unemployment, unemployment for minorities and others is much higher.

Underemployment will also be higher. Overall underemployment is projected at 18% for 2010. For blacks and Hispanics this figure is 25% and 26% respectively. Of course, bear in mind these figures provide a snapshot of the number of people unemployed or underemployed at a given point in time.

People that are unemployed one week are not necessarily the same people who are unemployed the following week. There's a flow in and out. Some unemployed people get jobs, some people with jobs become unemployed.

It turns out that the number of people that experience unemployment during the course of the year is almost double the number that experience it in a given month. If unemployment is 10% in 2010 and underemployment is 18% each month then over a third of the workforce is going to be unemployed or underemployed at some point in 2010. This is important because some people seem to believe that when you get 10% unemployment, it means 90% of the people are okay. That's just not true.

This recession has tremendous impact on people. 10% unemployment is going to bring child poverty up to 27%, from 18% in 2007. In 2007, one in three black children was in poverty. By the peak of the recession fully one out of every two black children will be poor.

Wages are not keeping pace either. This affects every family, but low-income families more than most. From 2007, incomes for low-income families will decline and be \$1,160 or 7.2% lower over the 2008 to 2011 period. For middle income families, the picture isn't much better. They'll see an income loss of approximately \$3,460 or 5.6% each year over this period. This has a dramatic impact on families.

Here's a snapshot of what's going on with Maine. The unemployment rate in Maine in the 3rd quarter up through the end of September was 8.5% percent which was less than the national average of 9.6%. Going forward Maine is going to see its unemployment rise by 1.6%, a bit faster than the national forecast of 1.1%.

Let's shift now to federal policy. What the federal government has done to get people working and what needs to be done.

Assessing the Recovery Act

How's the Recovery Act, the stimulus going? You hear that it's a waste of money, the money didn't get out quickly, it didn't affect jobs. However, all the evidence from any fair-minded person would say that it really has had a positive effect. The problem is that we're in such a deep hole that it takes a tremendous amount to get us out of it.

In November, when President Obama was elected, economic forecasters projected a decline in GDP for the nine months ending March of 2009 of 1.5%. In fact, the decline was 4.9%, more than three times what was projected. Similarly, they projected that unemployment would be 6.9% in the first 3 months of this year. It was actually 8.1% in those months and 8.5% in March. Thus, even before the Recovery Act started having an effect in April, the economy was dramatically worse than anyone had thought before.

The administration's economists projected that absent the recovery act the unemployment rate wouldn't exceed 8%. However, it was already more than 8% before the stimulus even hit. Despite this, the administration is hit over the head all the time with "you said that unemployment would be no more than 8% and therefore the recovery act isn't working."

So what happened to economic activity? Without the recovery act GDP was expected to continue declining into the fourth quarter of 2009. With the stimulus GDP was expected to hit bottom in the second quarter of 2009 and begin a gradual improvement.

Either way you look at it, the decline in GDP is dramatic and the hole in our economy is huge. But the stimulus has helped. Where you would have seen declines in the summer and fall you actually see economic growth. This is validated by a wide range of sources from the Congressional Budget Office to Goldman Sachs Forecasting to Economy.com. The consensus is that the recovery act actually lifted economic growth by 3% meaning that it created around 750,000 jobs. This helped us move from a place where we were losing 650,000 to 750,000 jobs per month to losing a lot less.

How does it work? First, roughly \$12.4 billion hit the street in the form of infrastructure spending. That wasn't the biggest part of it. The biggest part of it came in the spring when the stimulus plan put out \$25.1 billion in aid to states for Medicaid and \$21.2 billion to states for education and other activities funded by states.

Aid to states help with economic growth because as states cut their budgets or raise taxes, they're taking demand out of the economy. This actually exacerbates the recession. Avoiding this preserves both public jobs and private sector jobs. So the fact that we minimized service reductions did a lot to preserve public jobs and private sector jobs.

Another \$41.5 billion went to people including \$13 billion to social security recipients. The remaining funds went toward unemployment insurance and food stamps. Again, when you give money to people who don't have it, they spend it. By spending it they help create jobs and help the economy. That's a good thing.

There are also some tax cuts. The discussion about the fact that the money wasn't spent is unfounded. In total \$92 billion was spent in the spring that wasn't there in the winter. So there was a lot of money put out into the economy. This money makes for confidence and greater support of economic growth.

The same thing happened in the summer and even more funds will be disbursed in 2010. The 2010 funds are much more heavily weighted to infrastructure and things like that which is a good thing for the economy because we're going to get jobs now but have enhanced productivity into the future.

What More Needs to Be Done

We need to do much more. It is unacceptable that we're going to see unemployment rise throughout this year and stay high for a very long period of time. We're unlikely to get back to any reasonable level of unemployment until 2014 or 2015. The administration itself projects that at the end of 2011 the unemployment rate will be near 8%. To put that in perspective, 8% is worse than any other period of time except for the 1980s recession. In other words, we had two recent recessions where unemployment never got as high as 8%. We're now projecting that we're going to have 8% unemployment at the end of next year. That's unacceptable and there are a few things that we need to do about it.

First we have to continue with all the extended benefits we have – food stamps, support for unemployed, health care and unemployment insurance. Right now you can get up to 99 weeks of unemployment insurance. That's a good thing to do. There are more than six people unemployed for every job opening so it is a very cruel game of musical chairs. One chair is the job and six people are circling around it.

We need to do more to provide fiscal relief to states and also to local governments. This could easily create 1 million jobs. This support not only creates jobs in the public sector and keeps people from being laid off, it also creates jobs in the private sector. When the state provides health care spending, that money is spent in private hospitals. If you cut that spending, you lose private sector jobs.

If the state cuts budgets, it cuts private sector employees not just public sector employees. All the wages that those people are spending are no longer circling out in the economy. That almost doubles the impact. Most of the so-called respending effect is almost all going to be private sector jobs. Based on this we estimate that over half the jobs gained or that benefit from providing fiscal relief to states are in the private sector.

More needs to be done to boost public investment in infrastructure as well. In particular we're favorable to a plan to rehab and modernize schools over the summer. The average school district across the country has a big backlog that doesn't require building a new school.

We need direct job creation working with municipal governments. It's really cost effective. \$40 billion dollars would get us 1 million jobs. At the national level, we need a jobs tax credit. That's not something that states should do, but at this point when the economy is growing and if you want to encourage employers to hire earlier than they might not otherwise do, that might help.

Clearly there are lots of things that need to be done and this is a great time to do them.

Maine Solutions

So what about Maine?

One, I need your help. I'm trying to move Washington to provide more relief to state and local governments. You send a few folks from here to there – HELP! On relief to states, they should really be there. I'm not saying where your representatives stand on these issue but they really need to be there and it's no time to be timid, no time to be timid whatsoever.

State government itself is going to have to balance its budget and those are difficult choices. There are no easy answers but let me offer an economists view about the fact that spending cuts are more damaging to local employment and incomes than revenue raising.

Think about what happens. A tax takes away a dollar from someone's pocket. What were they going to do with that dollar if it weren't taxed? One thing they were going to do is they were going to save part of it. The part they save doesn't really stimulate the economy. It doesn't create demand for goods and services and jobs. We're also seeing a rising savings rate because people were very much in debt – they're de-leveraging is what economists call it. Secondly, when they do go out and spend, some of what they spend they spend is on imports and that stimulates China, that doesn't stimulate the U.S. Third, some of what they spend in the United States gets spent outside of Maine.

Contrast that to government spending. With government spending there is no savings. It's all spent. Imports – well not so much, the kind of things that are done, there's not so much imports involved. How much of it is spent in Maine versus other states? Much more heavily Maine.

To the extent that you can lean toward preserving spending versus having to raise revenue, I would lean more towards preserving spending and services because you are preserving jobs in Maine.

We also have this long term problem of needing to make good jobs. Things like a higher minimum wage would actually increase the amount of income in the workforce and boost spending. I'm a big believer that we need high labor standards. That all employers meet a certain sense of decency, that bad employers don't undercut good employers. Things like paid sick leave fall into that. You can also imagine that we need to do whatever we can to link whatever government does to support good jobs. All the economic development aid, all the ways you can do that would be important.

Conclusion

With that I'm going to close. It's important to sound the alarm. This is something we really need to address. We do have a problem with big federal deficit. That is sometimes

used to say that we can't do what I think we need to do, but the reason we have a large federal deficit is because we are in a large recession. We have a lot less people working and paying taxes. That's the primary reason we have that problem. We've taken some measures that are only going to affect the deficit for a year or two but they don't build in long-term deficits.

It is very appropriate at this point in time to borrow some more money to put people to work. The way to reduce deficits and get fiscal responsibility going is to create more taxpayers and more people working. The path to deficit reduction lies in job creation first and foremost.

Lots of polls show that people are rightly concerned about a big federal deficit because they think things are out of control. They're not really out of control; the economy is out of control. We need to do what we need to do to get the economy moving again – to get more taxpayers and that's what we're busy doing and we look forward to working with Kit and all of you to bring that together. Thank you very much.