Testimony before House Committee on Education and Labor

Building an Economic Recovery Package:
Creating and Preserving Jobs in America

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Thank you, Chairman Miller, Ranking Member McKeon and members of the Committee. I welcome the opportunity to be here today to testify on behalf of the ten million members of the AFL-CIO and share our views on the state of the economy and the importance and the urgency of building an aggressive economic recovery program.

I want to begin by mentioning that I serve on the board of Baltimore Branch of the Richmond Federal Reserve Bank. I want to make it clear that I am speaking today exclusively in the role of chief economist of the AFL-CIO and nothing I say should be taken to reflect the views of the Bank or the Board of Governors.

As we meet today, we face the most complex and dangerous economic crisis since the Great Depression. A bursting housing bubble last year has triggered a global credit crisis and together they are now dragging the U.S. and other economies into recession and slowing growth globally.

As a result, the American economy has been shedding jobs at an accelerating rate since the beginning of the year. The economy lost 168,000 jobs in September alone, bringing total private sector job loss to nearly 900,000 so far this year. The unemployment rate has increased 1.2 percentage points since January and now stands at 6.1 percent. Adding the millions of workers who want a job, but who are not now looking, would bring the 'under-employment' rate into double digits.

Nearly ten million workers are now unemployed and seeking work, over two million of whom have been unemployed for over 27 weeks. Unemployment claims are now running at over 500,000 a week, indicating a sharp recession is well underway. A majority of private sector economists now consider the economy as either in, or entering, a recession of uncertain depth and duration. And, with job loss projected to continue for several quarters, private economists are forecasting a rise of the unemployment rate to between seven and eight percent by the end of next year.

In my judgment, we are clearly in the early stages of a potentially very serious recession that will likely be as deep as anything we have experienced in a generation, last longer than most recessions and is becoming increasingly global in scope. Just how deep and protracted this recession will be depends on a timely, aggressive and well-focused economic recovery package.

The current economic crisis is a conjunction of a housing crisis, a credit market crisis and an employment crisis. Each of these crises is a serious enough in itself, but their interaction is now making for a particularly complex and dangerous dynamic. Housing prices have already lost 20 percent of their value on average and can be expected to fall another 10-15 percent even if they do not overshoot their fundamental values. Home foreclosures have spiked to between 9000-10,000 a day and trillions of dollars have been drained from household net worth. Consumers are pulling back sharply as their wealth declines, slowing the economy and forcing employers to shed jobs and cut wages and benefits. The continuing decline of housing prices also aggravates the credit crisis as the value of mortgage-backed assets continues to undermine the balance sheets of under-capitalized financial firms.

Unfortunately, the complexity of the forces dragging us into recession makes formulating and calibrating an economic recovery plan particularly difficult. We truly are in uncharted territory. Nevertheless, in designing and building an economic recovery plan, Congress should bear in mind three considerations that bear on the size and shape of

a recovery package that flow from the distinctive features of the most recent expansion and the forces behind the crisis.

First, Congress must act with appropriate urgency to address the acute pain and anxiety that the current economic crisis is producing in the lives of millions of working families. The current crisis brings to an end the slowest recovery in terms of job creation, wages and family incomes of any business expansion since the Second World War. And it comes at the end of a generation-long stagnation of wages and rising economic insecurity.

American workers are the most productive workers in the world and we are now working longer hours than workers in any other developed country. Nevertheless, wages and family incomes have stagnated, making it very difficult for workers to sustain their living standards. Since 1980, productivity has grown 70 percent, but wages have increased by only 5 percent. Real median family income has only increased by 15 percent, but only because each worker is working longer hours and more jobs and especially because each family is sending more family members into the labor force. The only reason median family income has increased at all is because of increased female labor force participation.

Productivity increased by 16 percent in the recovery from the 2001 recession, but real wages and earnings increased only 2 percent. As a result, the recovery just ended was the first business expansion on record that left real median family income below its pre-recession level (-$2000) and even below its level in the 2001 recession year (-$1000). Because of stagnating wages, working families have exhausted their savings and have increasing turned to personal indebtedness to maintain their living standards.

Any economic recovery program should move with the same urgency in addressing the acute pain and anxiety of working families as shown in addressing the global credit crisis. At a minimum, this means the recovery program should contain measures to extend the unemployment benefits for the hundreds of thousands of workers

who are now exhausting their unemployment benefits. It should also greatly expand the food stamp program for our lowest-paid workers. And it should aid state and local governments who are otherwise forced to cut back their expenditures on health care in order to balance their budgets.

Second, any economic fiscal package must be aggressive enough to make a difference against the powerful and still developing forces dragging the economy into recession. The economic expansion from the 2001 recession – like the previous recovery from the early 1990s recession – was very different from all other post-World War II recoveries. The earlier recoveries ended as a result of policy actions by the Federal Reserve to stanch inflationary pressure by slowing economic growth by raising interest rates. The last two recoveries ended with the bursting of asset bubbles – equities in the late 1990s and housing prices since 2000.

The importance of this difference between the older business cycles and the newer is in the usefulness of traditional monetary policy instruments in mitigating the damage of recessions and aiding in the subsequent recoveries. In policy-induced recessions, monetary authorities could expect a reversal of policy – lowering interest rates – could be counted on to provided much of what was needed to spark a recovery of interest sensitive industries and restart growth. In response to asset deflation, a lowering of interest rates cannot be counted on alone to restart growth. Instead, counter-cyclical fiscal policy is necessary to arrest the decline and help power a recovery. Moreover, the deflation of housing values in the current recession is much more serious than the decline of equity values in the 2001 recession and, therefore, the current recession is likely to be much more serious than that recession and will require much more aggressive fiscal policy to stabilize.

The recent aggressive lowering of interest rates by the Federal Reserve is certainly welcome, but they are not sufficient to restart robust and sustainable growth under current circumstances. For this reason, the first $168 billion economic stimulus package passed by Congress in the Spring was especially appropriate and timely, but it

was simply too small to counteract the combined depressing effects of a bursting housing bubble and the global credit crisis it triggered.

Congress acted with great dispatch to enact the $700 billion package to address the credit crisis and help maintain the stability of global capital markets. The same energy and imagination is called for in shaping an economic recovery package if we are to stabilize the rapidly deteriorating conditions in the real economy. This is not the time for undue caution or misplaced concern for federal budget deficits.

Third, an economic recovery package should target the underlying fundamental economic imbalances that have produced the current crises if we are to avoid repeating them in the future. Three imbalances are particularly worth noting:

The imbalanced between the U.S. and global economy. The unsustainable U.S. external account imbalance requires us to borrow five to six percent of our national income to pay for the things we consume as a nation but no longer produce. Our external imbalance with our Asian trading partners is maintained by our partners buying large quantities of dollar-denominated assets – U.S. Treasuries, of course, but also mortgage-backed securities – to maintain their competitive advantage. These trade surpluses in this way have fueled what Fed Chairman Bernanke refers to the " global savings glut" which has powered the housing bubble that has now burst and is the proximate cause of the current crises. Either we find a way to produce more of the value equivalent of what we consume as a nation or, one way or another, we will be forced to consume less.

Correcting this imbalance suggests that any economic recovery program focus the needed fiscal spending on improving our nation's competitiveness through public investment to create a world-class workforce and a world-class national transportation, information and communications infrastructure. A public investment-led recovery program would focus needed spending on longer term needs that we must find a means to address if we are to support our living standards in an increasingly competitive global

economy, crowd in private investment and provide a more sustainable basis than that provided by asset inflation for our nation's economic growth.

The imbalance between finance and the real economy. In a well functioning economy, finance is supposed to be the servant of the real economy, not its master. But a combination of financial deregulation and financial innovation has allowed the bursting housing bubble to trigger a global financial crisis. Correcting this imbalance is more a matter for the regulatory reform of our capital markets than the economic recovery program. Nevertheless it is an essential component of a comprehensive program to build a strong, sustainable and internationally competitive national economy.

The imbalance of bargaining power between workers and their employers. This imbalance is responsible for the stagnation of wages and the rupture of the crucial relation between wages and productivity that has served as the foundation of the American social contract. The stagnation of wages has motivated American workers to work more, save less and borrow imprudently against appreciating assets to maintain their living standards. Correcting this imbalance requires sufficient demand from public and private investment to produce something close to full employment, a meaningful minimum wage and reforming our labor law to allow workers to freely associate with their fellow workers and form a union to bargain collectively. Again, this is beyond the concern of an economic recovery program, but is essential to restoring an American economy that is strong, sustainable and internationally competitive, but also one whose prosperity is broadly shared.

And finally, although it is not the subject of today's hearing, Congress must find away to address the continuing decline in housing prices, the proximate cause of the credit market crisis and the current recession. RealtyTrac reports a record 775,000 foreclosures in the third quarter, a 71 percent increase from the same period last year. Whether a part of an economic recovery package, or parallel to it, the Congress must

address the housing crisis with an aggressive program to keep families in their homes. The AFL-CIO has long supported a moratorium on foreclosures and action to allow the terms of mortgages on primary residences to altered in the bankruptcy process. Given the scale of the housing crisis, and the central role it plays in resolving the credit crisis and mitigating the employment effects of the recession, even more aggressive steps should be considered to restructure mortgages more broadly.

Other panelists will address more specific recommendations for the composition of an economic recovery program, but I am prepared to offer the views of the AFL-CIO on these suggestions in answer to the Committee's questions.

Thank you again for the opportunity to be with you today and share the views of the American labor movement.

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