VIEWS OF VICE CHAIRMAN KEVIN BRADY, SENATOR DAN COATS, DR. MICHAEL BURGESS, AND REPRESENTATIVE MICK MULVANEY

We submit these views without the benefit of reviewing the contribution of the Chairman and other Democratic members of the committee:

OVERVIEW

Had the Joint Economic Committee filed this report, responding to the 2012 Economic Report of the President (ERP), closer to the date that it was released by the White House—in February 2012—we would have provided a detailed chapter-by-chapter evaluation of the report. We would have explained that the submission revealed the Administration's misplaced faith in bigger government and attempts to re-engineer the American economy would lead to substandard economic growth and subpar job creation.

Instead, since we are filing this report at the close of the 112th Congress, it is not necessary to express our belief that the Administration's policy prescriptions would not work. We have the benefit of simply looking at the data to understand the scope of the failure of the Administration's economic policies.

As Republicans on the Joint Economic Committee have consistently highlighted, the current economic recovery ranks as the weakest recovery, lasting longer than a year, since World War II. We have witnessed unacceptably low economic growth and sluggish job creation. Apologists for the Administration are quick to shift blame by noting that the "Great Recession" was the most severe economic downturn since the Great Depression. However, Administration apologists conveniently ignore the fact that historically deep recessions are normally followed by strong recoveries.

Serious concern exists that if the Administration's economic and fiscal policies become embedded in the American economy that historians will look back and refer to the current period as the beginning of the "Great Stagnation."

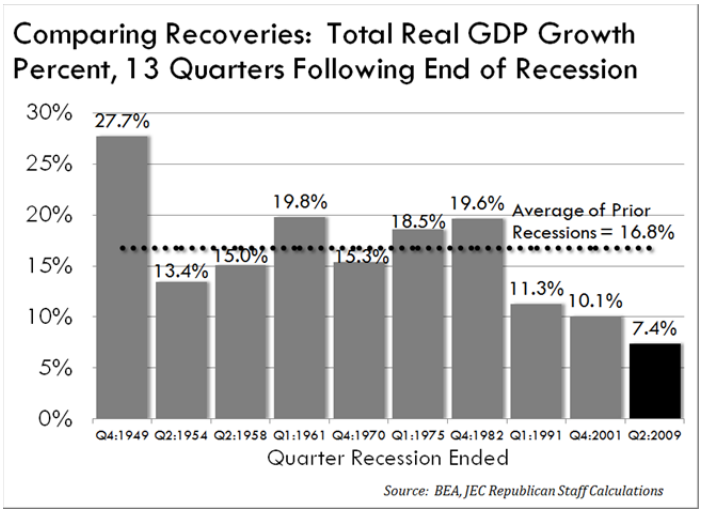
For the American people to prosper, we need to accelerate significantly the pace of economic growth. Stronger economic growth will produce faster job creation and will accelerate the growth in federal tax receipts, ameliorating our huge federal budget deficits, which have exploded to dangerous levels under the leadership of the current Administration.

In the following pages, we will review the current economic recovery in historical context in terms of both economic growth and job creation in the private sector. Additionally, we will discuss various aspects of the ERP that illustrate this Administration's lack of understanding when it comes to the free enterprise system.

While we hold little hope that this Administration will suddenly wake up and realize that its policies are making a bad situation worse, we would implore the President and his economic team to abandon their quest for economic equality and focus on the one thing that can create greater opportunity for everyone– economic growth.

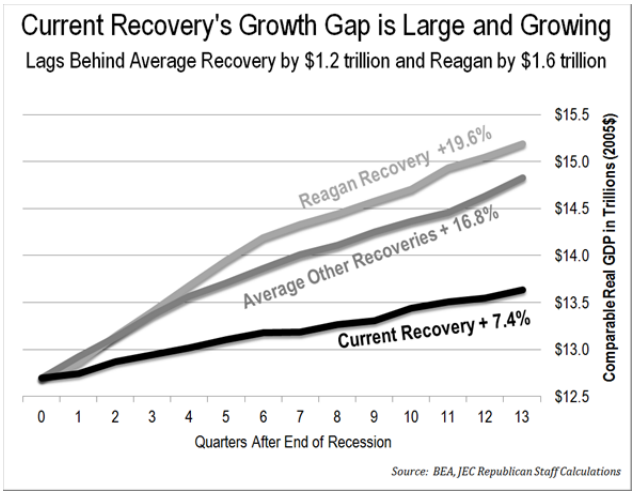
The Record on Economic Growth

The President and his economic team like to boast that the economy has expanded for 13 consecutive quarters since the recession ended in the 2nd quarter 2009. What they do not talk about is the anemic nature of economic growth over that period. Since the recession ended, total real gross domestic product (GDP) has grown a total of 7.4%—or an annualized growth rate of 2.2%—earning this recovery the dubious distinction of being worst among the ten post-World War II recoveries lasting more than one year.



The average total growth in real GDP of the other nine recoveries was 16.8% or an annualized growth rate of 4.9%. In other words, growth in this recovery has been less than half of average.

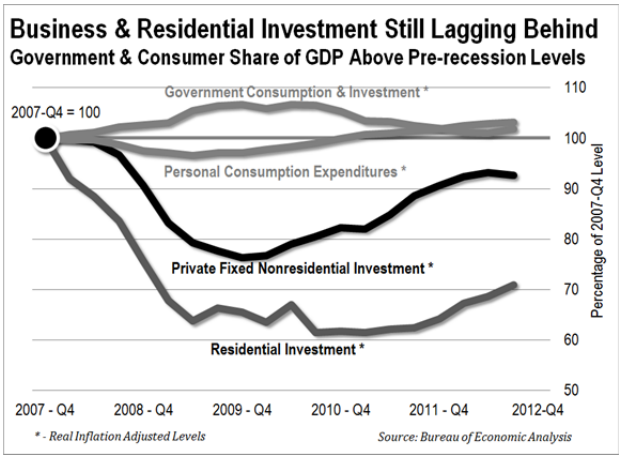
The strong Reagan recovery of the 1980s saw real GDP expand over the comparable period by 19.6%. As the following chart illustrates, the anemic nature of this recovery equates to a loss of $1.2 trillion (2005) in real GDP compared to the average of other recoveries and more than $1.5 trillion compared to the Reagan recovery.



For perspective, the average recovery achieved more in 5 quarters than what the Obama recovery has taken more than three years to accomplish. The slow rate of growth in this recovery means that it would take 32 years for real GDP to double compared to just 15 for an average recovery.

Investment is "Missing in Action"

The Administration's Keynesian focus on growing demand continues to be misguided. And blaming reduced spending by government for the slow recovery is wrong. The missing component in this recovery is fixed private investment—both residential and nonresidential.



Personal consumption expenditures (PCE) account for slightly more than 70% of GDP. Real PCE are higher than at the start of the recession in the December 2007. And despite recent declines from its peak during the recession, real government consumption and investment is higher than the 4th quarter 2007.

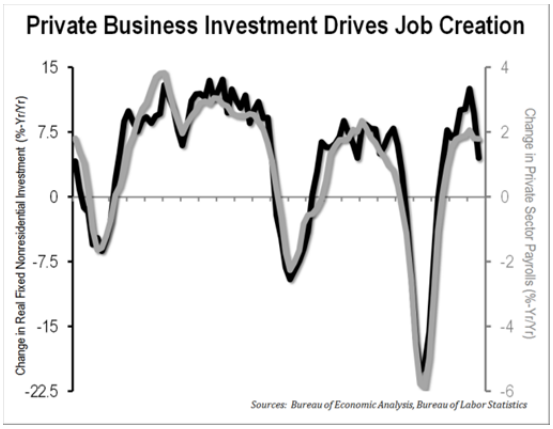
Neither residential fixed investment nor nonresidential fixed investment has recovered to their pre-recession levels. Residential investment remains roughly 30% lower than at the beginning of the recession and less than half its peak in the 4th quarter 2005. However important the housing sector is to the

U.S. economy, it is investment by private business in structures, equipment, and software—fixed nonresidential investment – that drives private sector job creation. And despite some gains earlier in the recovery, business investment growth has shown troublesome signs of weakness in recent quarters.

BEA's revised estimates of 3rd quarter 2012 GDP represent a step backward. Fixed nonresidential investment declined at an annual rate of 2.2% on a real basis during the quarter, it also declined on a nominal basis at an annualized rate of 1.5%. This represents the first decline on a real basis since the 1st quarter 2011 and the first nominal decline since the 4th quarter 2009. On a year-over-year basis, real fixed private nonresidential investment has only increased by a total of 4.5% in the past four quarters and remains 7.3% lower than in the 4th quarter 2007.

Policymakers should be concerned by the lethargic growth in private business investment because private investment drives job creation.

Changes in private sector payrolls are highly correlated with changes in real fixed nonresidential investment. The following chart illustrates the relationship since 1990.



It is because of this relationship that policy-makers must insure that any actions taken to address the "fiscal cliff" do not adversely affect private business investment.

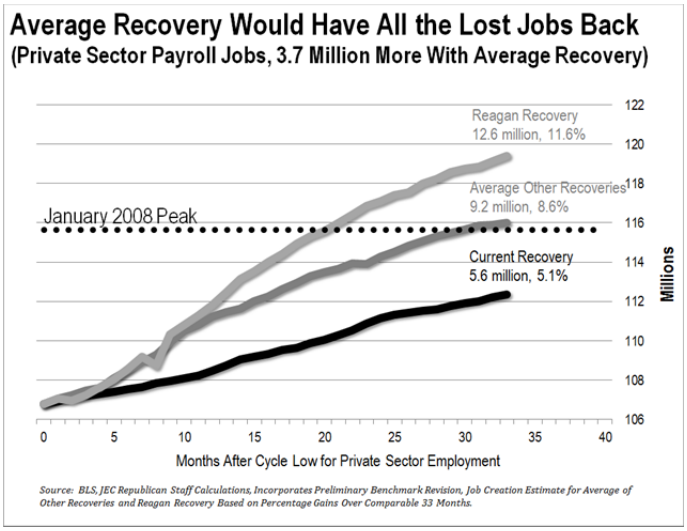
The substandard pace of job creation in the present recovery can be traced in large part to the failure of private business investment to regain its 4th quarter 2007 levels. Faster growth in private business investment will lead to higher growth in private sector job creation.

Lack of Growth = Lack of Jobs

The recession that began in the 4th quarter 2007 was the deepest recession of the post-World War II era in terms of output lost and the number of job losses experienced in the private sector. From January 2008, when private sector employment peaked at 115.6 million through February 2010, when private sector employment bottomed out at 106.8 million, the economy lost 8.8 million private sector jobs.

Since that time, the economy has regained 5.6 million of those jobs. The 5.1% increase in private sector payrolls is not insignificant but it leaves the economy still 3.3 million private sector jobs in the hole.

As the following chart indicates, if we had experienced an average recovery in the private sector job market, the economy would have added 9 million private sector jobs instead of 5.6 million. An average recovery would have regained the January 2008 private sector employment peak. A strong recession like the Reagan recovery would have added 12.6 million jobs or 3.8 million jobs above the prior peak.

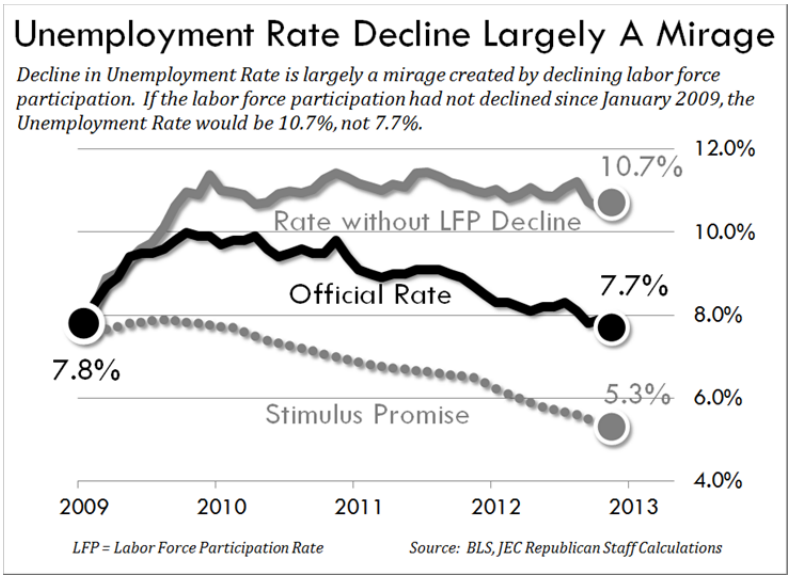


The magnitude of failure is illustrated not just by this type of number, but by the struggles of millions of American families. And the lack of a solid, or even average, recovery has magnified the nation's precarious fiscal position.

The Administration has trumpeted recent declines in the unemployment rate from its peak 10.0% peak in October 2009 to the most recent reading of 7.7% for November 2012. Unfortunately, there is little to cheer about in the recent declines. The declines have been driven by people dropping out of the labor force, not by employment growing faster than the population.

When President Obama first took office in January 2009, the unemployment rate stood at 7.8%. The percentage of American adults with jobs or actively seeking work, the labor force participation rate, was 65.7%. In the most recent employment report, labor force participation came in 2.1 percentage points lower at 63.6%. The decline in labor force participation over the past for years has created the mirage of a steadily improving unemployment rate. If labor force participation had remained at the January 2009 level of 65.7%, the unemployment rate would stand at 10.7%, not 7.7%. At 10.7%, the unemployment rate

would be more than double the rate of 5.3% promised when the massive stimulus legislation was passed in February 2009.



More Growth Means Smaller Deficits

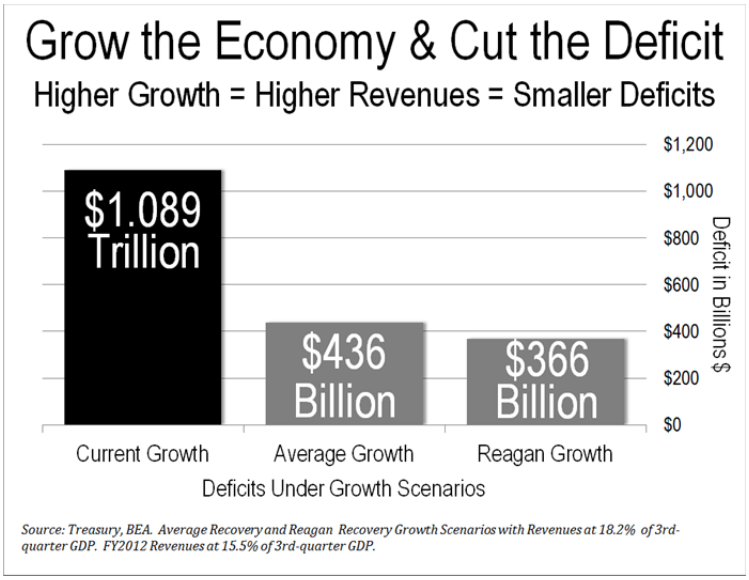
The President could have honored his pledge to cut the deficit in half in his first term if he had focused on growing incomes and wealth instead of focusing on how to re-divide the pie.

Prior to the start of the recession, fiscal year 2007, revenues rose to 18.2% of 3rd quarter GDP. Federal government receipts stood at roughly $2.6 trillion in fiscal year 2007, the highest on record and 25% greater than in fiscal year 2000. In the fiscal year just ended, the Treasury collected $2.4 trillion in revenues or 15.5% of 3rd quarter GDP.

If the economy had grown by 16.8% as it averaged in the other post-war recoveries and revenues had returned to the 18.2% of 3rd quarter GDP that they were in fiscal year 2007, the Treasury would have collected an additional $653 billion in revenue. That

would have cut last year's deficit by more than half. And that's before you even begin to take into account the lower spending that would result from fewer Americans needing public assistance.

A Reagan-style recovery would have generated even more revenue. At 18.2% of 3rd quarter GDP, revenues would have been $722 billion higher and the deficit chopped by two-thirds. And that's without raising anyone's taxes. By focusing on pro-growth policies and generating even an average recovery, the President could have kept his promise to cut the deficit in half.



As policymakers consider how to resolve the so-called "fiscal cliff", they should remember the salutatory effects that stronger economic growth would have on the federal government's fiscal position. It should go without saying that policies that inhibit growth and job creation should be avoided.

Conclusion

Recent gains in private sector payrolls and economic growth are unacceptably small bordering on stagnation. Acceptance of this

lethargic growth in output and job growth would condemn the United States to a bleak economic future. We find such a course of action unacceptable and implore the President and members of his party to abandon their ideological crusade to redefine America's greatness as rooted in government. We urge them to change course and embrace the power of liberty and the free market system as the best hope to restore rapidly prosperity and opportunity for all Americans.

SUPPLEMENTAL COMMENTARY ON PARTICULAR SECTIONS OF THE 2012 ECONOMIC REPORT OF THE PRESIDENT

Housing

At the time of its February release, the 2012 ERP offered an overly optimistic and incomplete account of developments in the U.S. housing market. It overstated the effectiveness of the Administration's policy responses to housing market woes. The implicit assumption of the ERP is that private market actors alone were responsible for the housing market bubble that lead to the Great Recession, and that government intervention in the market is the most efficient and effective method for improving the anemic housing recovery. Within that context, the Administration lauded its policy responses as stabilizing forces in the housing market during from 2009 to 2011. Yet, it was not until recently—over 9 months after the 2012 ERP was first released and nearly four years after the President took office and first implemented his policies—that signs of a housing market rebound have manifested.

The singularly pro-government perspective of the Administration has prevented it from addressing housing market woes comprehensively and instead focuses the Administration on government-mandated solutions. The ERP ignores the role the government policy played in causing the unsustainable rise in home prices that lead to the housing bubble. Myriad federal tax and regulatory policies created incentives for investors to invest

their capital in housing market-related assets instead of other alternatives. Moreover, the ERP virtually ignores the largest players in the housing finance market—the government-sponsored enterprises Fannie Mae and Freddie Mac. Fannie and Freddie leveraged their government-granted funding advantages to both influence the market in the lead up to the bursting bubble, and to disproportionately contribute to the deterioration in underwriting standards over time as they pursued increased market share.

The Administration does correctly recognize the critical contribution a housing recovery will make to the broader economic recovery. After all, for most Americans, a home is the largest single investment they make. Further, homes serve as collateral through which many entrepreneurs and small business owners secure financing for new business ventures. The Administration also correctly recognizes the harmful effect of negative equity, which resulted from the steep drop in residential real estate prices. Negative equity has decreased labor mobility in America and has increased the number of foreclosures in the market. These foreclosures have, in turn, further lowered home prices as they are sold off under distressed conditions.

Fortunately, home values across the country have begun to tick up once again, increasing 1.3 percent in the third quarter of 2012. However, one-fifth of all homeowners still owe more on their home than it's worth.[1] Home prices remain 29.2% below the peak price level reached over six years ago, resulting in approximately $6 trillion in lost household wealth.

Although the Administration has correctly identified the problem, its biases have prevented it from taking decisive action to ameliorate the disruptions in the housing market. One of the Administration's most touted initiatives is called Making Home Affordable (MHA), which includes the Home Affordable

[1] Gudell, Svenja, "Negative Equity Falls in the Third Quarter, But Fiscal Cliff Could Derail Momentum," Zillow Real Estate Research (November 14, 2012).

Refinance Program (HARP) and the Home Affordable Modification Program (HAMP). It is difficult to objectively conclude that MHA has had a material positive effect on the housing market. According to the Inspector General of TARP, just 13.4% of the $29.9 billion allocated to MHA under TARP have been spent by the Administration in the three years since its programs were first created.[2]

Individual MHA programs have also underperformed. At the time the ERP was released, the Administration noted that 930,000 permanent loan modifications have been achieved through HAMP (the inspector general of TARP found 762,839 over the same time period). However, the Administration failed to note that its inflated modification number represents just 19 percent of the loan modifications HAMP was originally projected to facilitate. The Administration has tacitly admitted the failed structure of HAMP and other MHA programs by implementing several program modifications in recent months. These modifications focus on creating the proper incentives for private market actors to cooperate with homeowners in order to facilitate additional loan modifications and refinancing activity.[3]

Actions by the Federal Reserve to support the ailing housing market echo the lackluster performance of MHA. Through its first quantitative easing program, the Federal Reserve purchased over $1 trillion in agency mortgage-backed securities in order to lower residential real estate mortgage rates. The hope was that falling rates would spur additional home refinancing activity. Although the excess liquidity risks the possibility of harmful future price inflation, the benefits of lower mortgage rates for ailing homeowners was anticipated to outweigh the possible downside risks. However, as the Administration admited in the

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[2] Inspector General of TARP, Quarterly Report to Congress (October 25, 2012).

[3] Massad, Timothy, "Expanding Our Efforts to Help More Homeowners and Strengthen Hard-Hit Communities." Making Home Affordable Blog (January 27, 2012); Editorial, "Obama Housing Plan," The New York Times (February 1, 2012).

2012 ERP, the widespread effect of negative equity "undermines the effectiveness of monetary policy that aims to lower borrowing costs to businesses and households and thus encourage greater economic activity."[4] Put another way, the Federal Reserve's efforts to aid those borrowers have been largely in vain. The risk-reward calculus the Federal Reserve made appears to have been wrong, and now the economy faces the prospect of rising price inflation without much to show for it. Even despite having attempted this maneuver before with little benefit and much risk, the Federal Reserve recently announced a third quantitative easing program that consists of $40 billion a month in agency mortgage-backed securities purchases for the foreseeable future. The likely impact of this action is minimal at best, but the risks of price inflation are even higher than before.

Though the Administration has tried several different command-and-control strategies to revive the economy, it has yet to address the now defunct government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. The GSEs have cost American taxpayers $187.5 billion since they were first placed under government conservatorship in 2008, and may eventually cost $30 billion more. Further, the Federal Housing Administration (FHA), which provides government-backed mortgage insurance for low down payment loans, has recently exhausted its loan loss reserves and now has a negative economic value of $16.3 billion. The likelihood that FHA will need to U.S. taxpayer bailout by drawing funds from the U.S. Treasury is greatly increased. The final cost to U.S. taxpayers is currently unknown, although one analysis suggests the FHA's insolvency is already worse than it reports, to the tune of another $20 billion.[5]

Although the U.S. housing market has begun its long road to recovery, the market cannot enjoy a truly robust recovery until private firms reenter the housing finance market. Yet, the government accounts for "essentially all issuance of mortgaged-

[4] ERP at 106.
[5] Pinto, Ed, FHA Watch, American Enterprise Institute (November 2012).

backed securities" as of the end of the second quarter of 2012.[6] Rather than tinker on the margin with inefficient and ineffective government programs, the Administration would do well to provide a comprehensive solution to our nation's housing finance system—one that incentivizes the responsible deployment of private capital into the market and limits government subsidies only to those borrowers that truly need assistance.

Eurozone Crisis

On the international front, the Administration's overarching economic prejudices are especially evident in the ERP. In particular, the ERP attributes the Eurozone's sovereign debt crisis not to overspending, but rather to slower economic growth. Further, it then blames some of the near-term economic growth problems on the fiscal austerity measures needed to bring countries at risk of default back from that precipice.[7] To be sure, a poorly focused fiscal austerity package can harm economic growth in the near term, but the Administration is wrong in finding fault with well-intended, albeit imperfect, solutions, while failing to recognize that the sovereign debt crisis is primarily driven by ill-advised, unsustainable government spending.

Economic growth would be especially helpful in alleviating the Eurozone's sovereign debt crisis, but this would ultimately be a band-aide on an untreated, festering fiscal wound. As noted in the 2011 Joint Economic Committee Republican Study, "*Spend Less, Owe Less, Grow the Economy*," a credible fiscal consolidation, wherein spending cuts are perceived as credible and sustainable by the private sector, can mitigate the otherwise harmful near-term economic effects of the spending cuts. Such a package can actually stimulate the economy because, if a fiscal austerity package is perceived as credible, the private sector may respond by making more investments and hiring because the

[6] Federal Housing Finance Agency, Conservator's Report on the Enterprises' Financial Performance (Q2 2012).
[7] ERP at 129.

private sector will anticipate a more favorable business climate moving forward.

Economic Mobility in America

Notwithstanding the ERP's assertion that the United States has had low rates of income mobility for decades—an assertion for which it is not clear what exact time span is indicated—analysis from the Treasury indicates that the degree of relative income mobility over the 1996 to 2005 period is very similar to that of the prior decade (1987 to 1996). Though increasing income inequality widened income gaps, this was offset by increased absolute income mobility so that relative income mobility has neither increased nor decreased over the past 20 years.[8]

Research from economist Scott Winship confirms that claims of rising inequality are overstated. Winship found claims describing that upward mobility fell 10 percentage points between midcentury and 1980 to be untrue. Using real-world data, Winship established there was no change over the period—a finding that is also consistent with previous academic research.[9]

By another data set, the Federal Reserve Bank of Minneapolis has also demonstrated earnings mobility of U.S. households using income data from the Panel Study of Income Dynamics that followed the same households from 2001 to 2007. The empirical results demonstrate that 44 percent of the lowest quintile moved up at least one quintile by 2007, and 34 percent in the highest quintile moved down at least one quintile over the same time period. In addition, when taking into account

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[8] "Income Mobility in the U.S. from 1996 to 2005," Report of the Department of the Treasury, November 13, 2007, http://www.treasury.gov/resource-center/tax-policy/Documents/incomemobilitystudy03-08revise.pdf

[9] Scott Winship, "Guest Post: Scott Winship on the Obama Administration's Questionable Mobility Claims," National Review Online, January 17, 2012, http://www.nationalreview.com/agenda/288306/guest-post-scott-winship-obama-administrations-questionable-mobility-claims-reihan-sal

household size and differing price indexes, median household income for most household types increased by somewhere between 44 percent to 62 percent from 1976 to 2006.[10] Median hourly wages, including fringe benefits, also increased 28 percent between 1975 and 2005.[11]

Economic Inequality

The Administration also takes a very static and narrow view when addressing income inequality. The data clearly shows that the highest income earners are not the same people over time, but a constantly changing set of taxpayers. Hence, the different reasons for wealth and income inequality call into question the justification as well as the likely efficacy of government redistribution efforts.

An updated article from the Federal Reserve Bank of Minneapolis' *Quarterly Review* in February 2011 found that many low-income households continue to hold substantial amounts of wealth, and many wealthy households have very little or negative income.[12] For example, the wealth gap between the elderly and the young has reached a record high, doubling since 2005 alone.[13]

In fact, a recent study of Census Bureau data explains a majority of income inequality by household demographics. In 2010 alone,

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[10] Terry J. Fitzgerald, "Where Has All the Income Gone?" *The Region*, The Federal Reserve Bank of Minneapolis, September 1, 2008, http://www.minneapolisfed.org/pubs/region/08-09/income.pdf

[11] Terry J. Fitzgerald, "Has Middle America Stagnated?" *The Region*, The Federal Reserve Bank of Minneapolis, September 1, 2007, http://www.minneapolisfed.org/pubs/region/07-09/wages.pdf

[12] Javier Diaz-Gimenez, Andy Glover, and Jose-Victor Rios-Rull, "Facts on the Distributions of Earnings, Income, and Wealth in the United States: 2007 Update," *Quarterly Review* 34, No. 1, The Federal Reserve Bank of Minneapolis, February 2011: 2-31, http://www.minneapolisfed.org/research/qr/qr3411.pdf.

[13] Chairman Paul Ryan, "A Deeper Look at Income Inequality," House Budget Committee, November 17, 2011, www.budget.house.gov/UploadedFiles/CBOInequality.pdf

there were significantly more income earners per household in the top income quintile of households, at 1.97, than earners per household in the bottom quintile of households, at 0.43. Additionally, married-couple households represented a larger share of the top quintile, at just over 78 percent, relative to single-parent families or singles. The top quintile had the largest share of full-time workers (over 77 percent), while 68 percent of those in the bottom quintile did not work. Family members in the top income quintile were five times more likely to have a college degree and 12 times more likely to have finished high school than those in the bottom quintile.[14]

Intergenerational Elasticity and the "Great Gatsby Curve"

The ERP also highlights research that suggests that intergenerational elasticity (IGE) of earnings may have increased over time, implying that intergenerational mobility has fallen in the last 30 years. However, use of IGE can be very limiting. There are also reasons that international comparisons can be difficult when discussing income inequality. As highlighted by Jim Manzi, potential reasons for differences in the IGE of amongst countries could include population size, as countries with larger populations tend to have greater income variety, and thus higher IGE. Other variables Manzi mentions include degree of specialization of a given country and religious fractionalization. In actuality, real drivers of mobility in America are far more complicated.[15]

Winship recently argued that the use of the "Great Gatsby Curve"—which described a positive relationship between IGE and inequality and which the ERP presents as evidence of a

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[14] Mark J. Perry, "Income Inequality can be explained by household demographics," *The American*, American Enterprise Institute, October 21, 2011, http://blog.american.com/2011/10/income-inequality-can-be-explained-by-household-demographics

[15] Jim Manzi, "The Great Gatsby, Moby Dick, and Omitted Variable Bias," National Review Online, February 7, 2012, http://www.nationalreview.com/corner/290053/great-gatsby-moby-dick-and-omitted-variable-bias-jim-manzi

shrinking middle class—has given the illusion of precision in attempting to prove that today's children will encounter less mobility than their parents. However, not only did Winship find that Gatsby Curves covered a wide range, between -0.15 to 0.87 for mobility-inequality correlations, but also found that for five countries where wealth Gini coefficients were comparable, the correlation was flat, indicating that there is no relationship between inequality and mobility.[16]

A compelling statistic that the report fails to mention in discussing intergenerational mobility is the absolute mobility that children have experienced relative to their parents in the United States. According to a recent study by Pew Charitable Trusts, more than four out of five Americans have higher *absolute* family incomes today than their own parents had approximately 30 years ago, and children born to parents in the bottom quintile are more likely to surpass their parents' income than children from any other quintile as shown in Figure 2.[17]

Limitations to Current Measurements of Inequality

The upward bias of the consumer price index (CPI), which is estimated to add more than one percent annually to official estimates of the growth of mean and median wages, likely resulted in an upward bias in the CPI of 38 percent cumulatively between 1977 and 2006. This can be remedied by using different

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[16] Scott Winship, "Guest Post: Scott Winship Offers His Closing Argument in the Great Gatsby Curve Wonk Fight of 2012," National Review Online, January 20, 2012 http://www.nationalreview.com/agenda/288748/guest-post-scott-winship-offers-his-closing-argument-great-gatsby-curve-wonk-fight-201

[17] Susan K. Urahn and Erin Currier, et. al., "Pursuing the American Dream: Economic Mobility Across Generations," Economic Mobility Project, Pew Charitable Trusts, July 2, 2012, http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/Pursuing_American_Dream.pdf

inflation rates to account for the differences in consumption patterns between the bottom and upper quintiles.[18]

As highlighted in recent analysis from the House Budget Committee, Christian Broda of the University of Chicago found that those in the lowest earnings decile have seen a 30 percent real wage gain from 1979 to 2005 when using a corrected price index that accounts for the significant decreases in relative prices for most basic goods that lower income households disproportionately consume.[19]

Regarding the ERP's highlight of the share of total U.S. income earned by the top one percent, while one could argue that income inequality has grown between the 99 percent and the top one percent, this phenomenon is not unique to the United States; in fact, there is very little evidence to suggest that this disparity is a result of the top gaining at the expense of the 99 percent. This is possible because the economic pie can grow in size that benefits the top one percent immensely while concurrently advancing the bottom 99 percent as well.[20]

The CBO report from October 2011 that the CEA cites to demonstrate the changes in income over time also accounts for after-tax income including transfers for the income category minimums for each quintile and the top one percent. When adjusting market income for transfers and federal taxes, the minimum income threshold (adjusted for household size) for the top quintile is just $60,557; the top one percent is $252,607 for

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[18] James Pethokoukis, "Shining more light on income inequality myths," *The American*, November 1, 2011, http://blog.american.com/2011/11/shining-more-light-on-income-inequality-myths/

[19] See Endnote 11: Ryan, 2011

[20] Scott Winship, "Assessing Income Inequality, Mobility and Opportunity," Testimony before the Senate Budget Committee, February 9, 2012, http://www.brookings.edu/testimony/2012/0209_inequality_mobility_winship.aspx

2007, demonstrating that the top one percent is not exclusively millionaires.[21]

In addition, the top one percent of income earners has not seen their share of the income tax burden decline, and the share of income that the top one percent earns is approximately the same as in 2000. While the capital gains tax reductions that took effect in 1997 and 2003 resulted in lower average tax rates among the top 400 returns, the share of total income taxes paid by these returns actually increased. Additionally, more than half of returns reporting positive income of less than $75,000 in adjusted gross income had no positive federal income tax liability.[22]

As Winship testified before the Senate Budget Committee investigating this issue, the facts of income inequality and mobility are nonpartisan, incomplete, and subject to revision: "But in order to guide policy, facts must be as accurately understood and conveyed as possible. Doing so is often difficult not only because the world is complicated, but because new evidence routinely appears to muddy the picture we previously managed to discern."[23]

Absolute income has increased as the costs of basic goods decreased, and there is much more that can be afforded with less income than in the past. In this sense, the inequality of well-being has tremendously declined over the past century, including over the past two decades. As time has passed, the perceptions of economic inequality and well-being have skewed the focus from addressing the needs of those at the lowest end of the scale towards the perceived injustice of how much the wealthiest earn.

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[21] "Trends in the Distributions of Household Income Between 1979 and 2007," Congressional Budget Office, October 25, 2011, http://www.cbo.gov/sites/default/files/cbofiles/attachments/10-25-HouseholdIncome.pdf

[22] "Debunking the Obama-Buffett Myth on Taxes," Joint Economic Committee, http://jec.senate.gov/republicans/public/index.cfm?p=Studies&ContentRecord_id=C0FDA591-B533-44BD-A484-C6A8E06EBC93

[23] See Endnote 19: Winship, 2012

This has derailed the discussion in policy from successful solutions addressing economic immobility in favor of ensuring everyone receives a "fair" share.[24] Rather than remain concerned with "concentrations" of income and wealth among the one percent, which is a constantly changing set of individuals, it is important to identify barriers to economic mobility, and ensure that programs intended to aid the lowest quintile don't end up inadvertently pricing the poor out of opportunities for upward economic mobility.

Safety Net Programs & Moral Hazard

The ERP claims federal safety net programs protect families against major risks and reduce the likelihood that temporary economic shocks will cause permanent harm. They claim increased funding for UI, TANF, Medicaid, and EITC provided in the 2009 stimulus bill helped stabilize the economy by supporting aggregate demand, and suggest these programs prevented millions of American from falling into poverty.[25]

Admittedly, government programs provide valuable cash and in-kind assistance to millions of Americans. While the short-term benefits are easy to see, the long-term costs are often hidden. Safety net programs and taxes that fund them create a moral hazard and distort economic incentives. The benefits reduce precautionary savings, undermine personal responsibility, and weaken the voluntary support of families and communities. The taxes raise the cost of labor and capital, thereby reducing investment, employment, and output.

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[24] "Economic Inequality and Mobility," Republican Staff Commentary, Joint Economic Committee, June 19th, 2012, http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=8187f1f2-eb54-4ab2-844c-5b0aafcd87fd. See: "Identifying Economic Inequality," Republican Staff Commentary, Joint Economic Committee, June 18th, 2012, http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=d4d8a9a9-042e-43b0-aae6-642fb798732d

[25] ERP at 197.

Temporary government spending can increase short-term economic growth by stimulating aggregate demand. But these temporary policies reduce long-term growth by reducing savings and investment, and diverting workers and resources from more efficient and sustainable uses.

The unemployment insurance (UI) program provides weekly cash benefits to covered workers who lose their job through no fault of their own. While many workers use these benefits to meet urgent needs, many others use them to delay seeking and accepting other employment. The Administration admits that extended UI benefits increase the number of people who claim they are looking for a job until they've collected the maximum weeks of benefits, whereupon they drop out the labor force.[26]

The Administration claims UI benefits help the economy by boosting aggregate demand.[27] This claim assumes the unemployed spend, rather than save, all of their benefits. Yet more than two-thirds of families with an unemployed worker have another family member who is employed. Thus, many families likely might spend less than 100 percent of their benefits because uncertainty about their future job prospects increases the need for precautionary savings.

Providing cash payments to unemployed workers may boost the demand for consumer goods, but it also reduces the supply of labor needed to produce those goods. The net result of more demand and less supply is higher prices, not real economic growth.

The Affordable Care Act (aka ObamaCare) & Healthcare

The Administration claims the Affordable Care Act (ACA) will increase the number of Americans with health insurance and provide new protections and benefits to those already insured.[28]

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[26] ERP at 202.
[27] Ibid.
[28] ERP at 209.

This claim ignores the impact that the increased demand for health care services will have on medical price inflation and the cost of government health programs and insurance exchange subsidies.

Much of the increase in insurance coverage comes from expanded Medicaid eligibility, but many doctors refuse to accept Medicaid patients due to the low reimbursement rates provided by the States. Having a Medicaid card in no way assures prompt access to medical care.

Soaring Medicaid costs already threaten to bust many state budgets. The expanded eligibility provided by the ACA will only exacerbate this problem, despite the enhanced federal matching payments.

The Administration claims expanded eligibility for Medicaid and CHIP improves children's access to care.[29] This result is largely due to the crowding-out effect whereby these government programs reduce private coverage, shifting more of the cost of health care to the taxpayers.

The ACA has already increased the cost of employer-provided insurance due to the imposition of various mandated benefits. The new exchange subsidies will increase costs even more due to the increased demand for health care. Increased demand will result in additional medical price inflation which will result in higher premiums, as well as larger taxpayer subsidies for the exchanges.

The Administration claims the ACA will benefit seniors on Medicare by providing new benefits and reduced cost-sharing.[30] But these potential benefits will be offset by the negative effects of the $500 billion (2012-2021) reduction in provider reimbursements.

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[29] ERP at 212.
[30] ERP at 219.

Medicare already pays significantly less than private insurance. Further reductions would widen the gap and jeopardize beneficiaries' access to care.

Social Security Reform

In the ERP, the Administration claims Social Security is a critical element of the social safety net, proving a stable source of retirement income.[31] This claim ignores the fact that without reform, Social Security will be unable to pay promised benefits within two decades. The disability program is facing insolvency within a decade. Yet, the Administration has failed to propose any solution to this looming crisis.

Energy & Regulation

The ERP advocates for government regulation of the economy and an active role for the government in innovation, energy, and infrastructure—with infrastructure including the wireless broadband network. The contention is that the government can properly identify and correct market failures. In coming to these conclusions, the ERP relies heavily on the tool of cost-benefit analysis, making the suspect claim that regulation does not come at the cost of prosperity or living standards.

While exuding confidence government's ability to "improve the quality of life" through its activism, the ERP never sets forth a principled framework for federal economic intervention or what should be the preferred nature and limits of the intervention.

Irony might be found in that the February release date of the ERP coincided with the publication date of an edition of *The Economist* whose cover declares "Over-regulated America." This February 18, 2012 issue of *The Economist*, illuminates the state of regulation in the United States and the problems confronting the economy, flowing from federal intervention. The subtitle of the issue's lead article declares "The home of laissez-

[31] ERP at 220.

faire is being suffocated by excessive and badly written regulation," and concludes with the words "regulation may crush the life out of America's economy." Regrettably, based upon the discussion of regulation in the ERP, it seems that the President's Council of Economic Advisers may be completely out of touch with respect to the effects and tremendous difficulties of the Administration's regulations.

Here, the implication from the ERP is that the government is moving beyond the claim that regulation is needed for the benefit of the public to presuming that consumers need help making rational choices about private costs and benefits. For instance, those who see a role for government regulation of environmental effects likely would be surprised to learn that the government does not consider them fully competent to buy a washing machine. Yet the ERP makes it clear its confidence that the Administration knows better.

Also surprising is that much of the claimed benefits of regulation are so-called 'co-benefits,' which—when carried to the extreme—constitute a bait-and-switch. For example, the EPA has standards for safe emission levels of fine particles, but that does not stop it from crediting other rules with a so-called co-benefit for reducing fine particle emissions much further. The EPA claims annual benefits of $90 billion compared with annual costs of $10 billion for its new mercury emission rule, but the mercury part of the purported benefit is less than 0.01%. Almost all of the claimed benefits come from reductions in fine particle emissions incidental to the rule.[32] The EPA presumably made the attribution to the more alarming sounding mercury emissions because it hoped to bolster support for its action. The reliance on co-benefits has expanded to about 65% of all benefits claimed for rules considered economically significant in 2010, with another 20% coming from private benefits, according to a former head of

[32] *Economist,* February 28, 2012, p.77.

the Office of Information and Regulatory Affairs (OIRA), Susan Dudley at George Washington University.[33]

The ERP describes government energy innovation initiatives with the same confidence as regulatory interventions. For instance, DOE's Advanced Research Projects Agency-Energy (ARPA-E) is said to focus on transformational energy research that the private sector by itself is unlikely to support.[34] Yet it ignores problems with ARPA-E identified by the Government Accountability Office (GAO); the Department of Energy's Inspector General, and the Science, Space, and Technology committee staff. A significant number of companies have received private sector investment *prior* to their ARPA-E award. It appears that ARPA-E at times is following, not leading, private venture capital investment for a greater chance to show success.

The ERP also credits the government for the success of hydraulic fracturing and horizontal drilling techniques that have increased domestic natural gas and oil production. However, it fails to mention private oil company use of hydraulic fracturing as early as the 1940s and the persistent pioneering work of one company—Mitchell Energy—which developed the technique to the point that has enabled the remarkable shale gas and oil production boom. Further, the ERP fails to mention that while oil production has increased on private land, which is regulated by the states; it has fallen on public land, which is regulated by the federal government.

The ERP implies that broadly, there really is no cost to regulation: "Even though smart regulations can impose restrictions on the private sector, … the resulting benefits do not come at the cost of prosperity or sacrifices in U.S. standards of living. Over a period of decades, air quality has improved while the economy has grown."[35]

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[33] Ibid. See graph "Moving the Goalposts."
[34] ERP at 255.
[35] ERP at 243.

Unfortunately, the ERP has it reversed. Regulation should be evaluated against a rising standard of economic growth and prosperity in its absence. Regarding Clean Air Act Amendments (CAAAs), Michael Greenstone, MIT economics professor and director of the Brookings Institute's Hamilton project, advises: "The CAAAs are controversial, because reliable evidence on their costs and benefits is not readily available. For instance, there is not even a consensus on whether the CAAAs are responsible for the dramatic improvements in air quality that have occurred in the last 30 years."[36]

Economic growth and technological progress bring society the great benefits. Modern plants are much more efficient and cleaner as a result of advancing technology, and it is preposterous to assume the state of industry would not progress but for federal regulation. Moreover, regulation takes place at the state and local levels as well, and the federal government cannot simply lay claim to any regulatory induced benefit for itself.

Further, in the ERP, cost-benefit analysis is no more than an artificial construct whose value lies in introducing at least some limited recognition of cost to rulemakings. Considered as a guide for government to shape entire industries, the Administration's cost-benefit analysis is essentially a cover for discretionary governance. Even within the ERP, it is noted that, "The prospective benefit-cost analysis that goes into crafting smart, efficient regulations is necessarily fraught with uncertainty.[37]

Retrospective analyses of benefits and costs are also subject to uncertainty, because they require evaluation of a counterfactual scenario in which the rule was not adopted. Identifying that counterfactual is often difficult, in part, because changes that

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[36] "Did the Clean Air Act Cause the Remarkable Decline in Sulfur Dioxide Concentrations?" Michael Greenstone, *Journal of Environmental Economics and Management*, Elsevier, vol. 47(3), pp. 585-611, May 2004.
[37] ERP at 238.

occurred due to the rule are difficult to distinguish from changes that the industry would have adopted voluntarily.[38]

To what then does the premise of the Administration's regulatory policy come down? Shockingly is that when the Administration sees something it does not like, it can declare a "market failure" and impose requirements that it claims are corrective. Beneath the veneer of analytically derived net benefit findings, it is easy to skew the results to show what regulators want. A cost-benefit analysis can be designed to show large positive net benefits, and as if the leeway to produce such a showing were not great enough already, Executive Order 13563 authorizes consideration of values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.[39]

There is no explanation in the ERP of how cost-benefit analysis should incorporate such considerations. The Administration and the various agencies can do this any way they want. Of course, that is no departure from the variation in the conduct of much of the rest of the analysis.

The current regulatory philosophy has no limiting conceptual framework for how to conduct regulation; it sets no boundaries on what the government can justify. Regulation, therefore, is neither "smart" nor democratic. Truly smart regulation would respect the process it regulates and aim to enhance its functioning. Regulators would take pains to understand what makes the process work and what can make it work better without dictating the outcomes. The result would be a minimum of rules that are well understood and widely accepted. Rules should be least intrusive, enduring, and give rise to few exceptions. Regulation then would be more predictable, less arbitrary, and less prone to capture by special interests. That means regulating with a light touch, not heavy-handed.

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[38] ERP at 239, footnote 1.
[39] ERP at 235.

The regulatory tangle in the United States described by *The Economist* is the result of a governance philosophy that believes in trying to force specific outcomes. That is how we get 2,000-plus page laws with thousands of pages of regulations added by the regulatory agencies. The ensuing entanglements and confusion are symptomatic of a central authority overwhelmed by the complexity of what it is trying to micromanage.

We have been in a similar situation before. In the 1970s and 1980s recognition set in that while one could identify all manner of imperfections in real world markets, government could not necessarily correct them and likely made things worse. Government and the political process are not perfect either. Much so-called "economic" regulation of airlines, railroads, trucking, and other industries was undone and the Interstate Commerce Commission abolished. It is time we gain similar recognition of the limits of government with respect to "social" regulation, attempts to improve on individual choices, and attempts to outdo the market in innovation.

Representative Kevin Brady
Vice Chairman

Senator Dan Coats

Dr. Michael Burgess

Representative Mick Mulvaney