114th CONGRESS
1st Session

SENATE

REPORT
114-xxx

THE 2015 JOINT ECONOMIC REPORT

R E P O R T

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ON THE

2015 ECONOMIC REPORT
OF THE PRESIDENT

TOGETHER WITH
MINORITY VIEWS

MARCH XX (legislative day, MARCH XX), 2015.—Ordered to be printed

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LETTER OF TRANSMITTAL

March 17, 2015

HON. MITCH MCCONNELL
Majority Leader, U.S. Senate
Washington, DC

DEAR MR. LEADER:

Pursuant to the requirements of the *Employment Act of 1946*, as amended, I hereby transmit the 2015 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,

Dan Coats
Chairman

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MR. COATS, from the Joint Economic Committee, submitted the following

REPORT

together with

MINORITY VIEWS

Report of the Joint Economic Committee on the 2015 Economic Report of the President

CHAIRMAN'S VIEWS

Built on the theme that the President first crystallized in his *State of the Union* address, the *Economic Report of the President and the Annual Report of the Council of Economic Advisers* (CEA) (ERP, or *Report*) expand upon the goals that the President and his Administration hopes to achieve through policies intended to promote "middle-class economics." Many such policies have laudable goals, including increased labor force participation, productivity, growth in well-paying, skilled jobs, increased international competitiveness, and expansion of free trade. In many of these areas, there is common ground to pursue pro-growth policies that will lay the foundation for sustainable economic expansion.

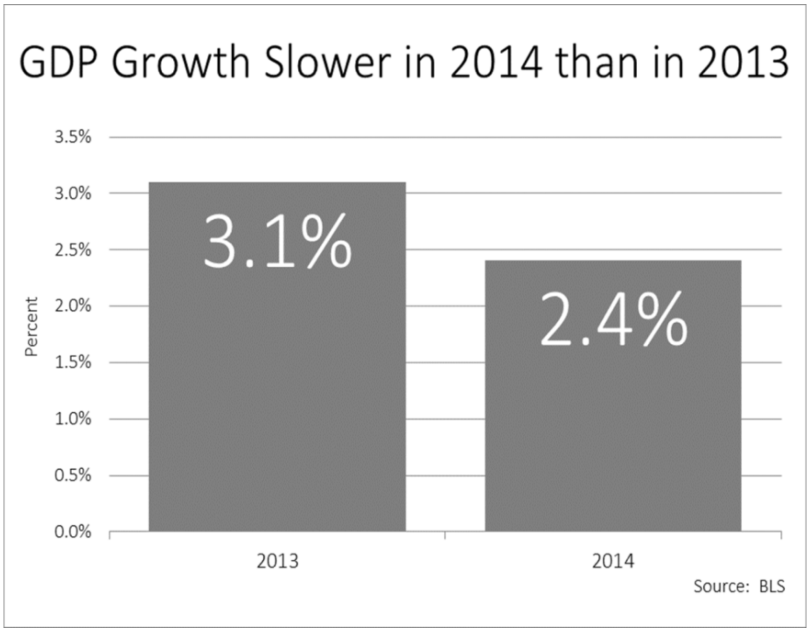
Yet many of the policies that the Administration details in the *Report*, despite best intentions to aid an obscurely defined subset of Americans, would do very little to promote the middle class without causing greater harm to the economy and would further delay the fiscal realities that must be addressed in the federal budget. Furthermore, the assumptions underlying said policies, promoted in the anticipation of boosting the productivity and participation of American workers, serve to complicate any hope of addressing the greatest threats to America's fiscal sustainability under seemingly untenable assumptions about how the economy and the budget will perform over the next decade and in the long term.

ASSESSING THE ECONOMIC RECOVERY

In the *Report*, the Administration profiles the state of the "middle class" through various time frames: comparing Great Depression and Great Recession household wealth; showing an acceleration of GDP growth and employment from 2008 to 2014; and tracking the change in family income from 1985 to 2013. It then chronicles how economic growth, labor force participation, and productivity affected U.S. and Group of Seven (G-7) household incomes from 1945 to 2013. It concludes with the promise to "consider the recovery and our economic future from the perspective of the typical American family."[1] However, while measures of wealth, growth, and employment are important indicators for the well-being of middle-income Americans, objective analysis cannot be achieved until policy makers use standard measures and equivalent time frames. To set achievable goals and measure progress, it is necessary to agree on the metrics. The "typical American family" today looks much different than in previous decades; today, more than one-quarter of adults live by themselves,[2] four in ten children are born out of wedlock,[3] and less than half of households are married.[4]

Just short of six years since the end of the recession, the *Report* claims that "the U.S. economic recovery continues to accelerate. The economy grew at an annual rate of 2.8 percent over the past two years, compared with 2.1 percent in the first three-and-one-half years of the recovery."[5] The notion that the recovery is accelerating is dubious since economic growth slowed to an annual rate of 2.4 percent in 2014 from a rate of 3.1 percent in 2013 (Figure 1), as measured from fourth quarter to fourth quarter.

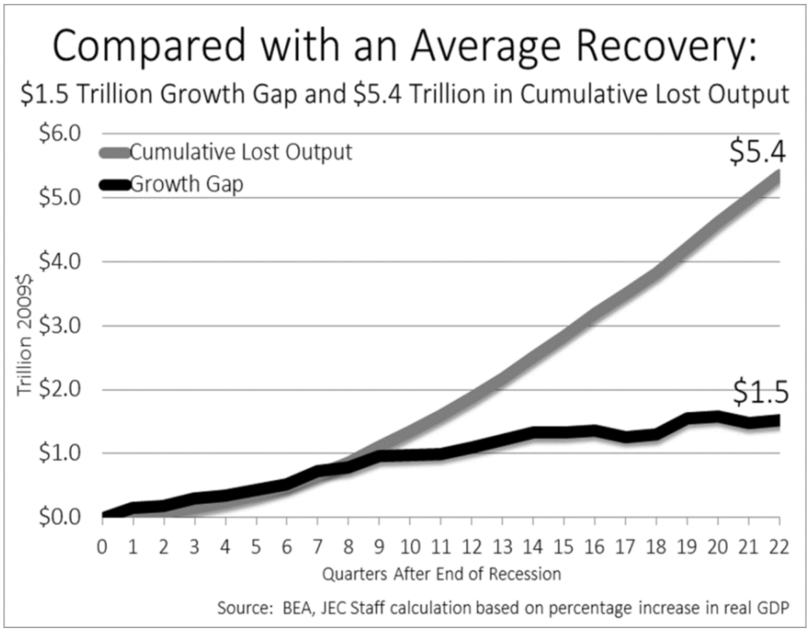
Figure 1



Gross Domestic Product

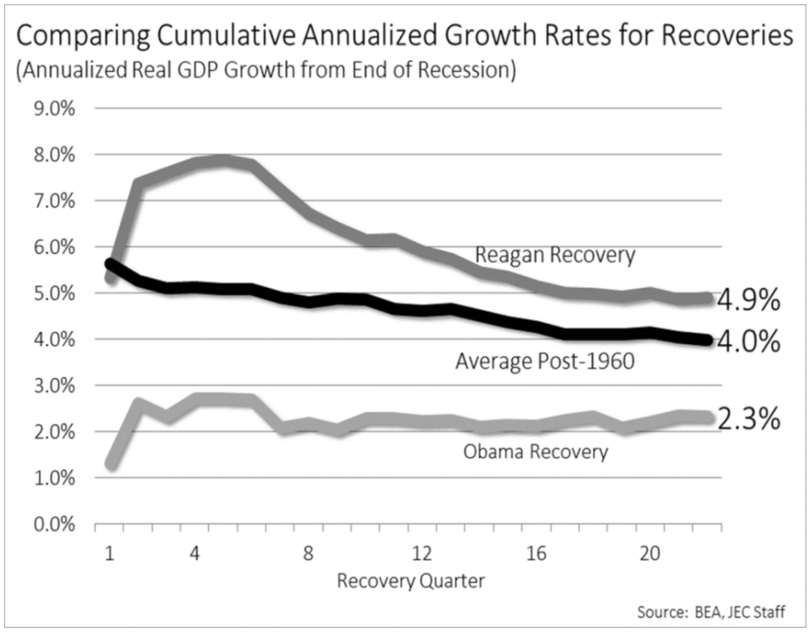
The economy continues to suffer from gaps in economic growth, private-sector jobs, and real income growth, lagging far behind the average post-1960 recovery. If real GDP had grown at the average rate of other post-1960 recoveries, real GDP would be $1.5 trillion (2009 dollars) larger. Even if the Administration's economic forecast of 3.0 percent growth over the next two years turns out to be accurate, the growth gap in real GDP will still be $1.5 trillion when President Obama leaves office. It is important to remember that the $1.5 trillion growth gap represents a point in time estimate (see Figure 2). Taken cumulatively, the lost output of this recovery compared with the average of past recoveries is a staggering $5.4 trillion.

Figure 2



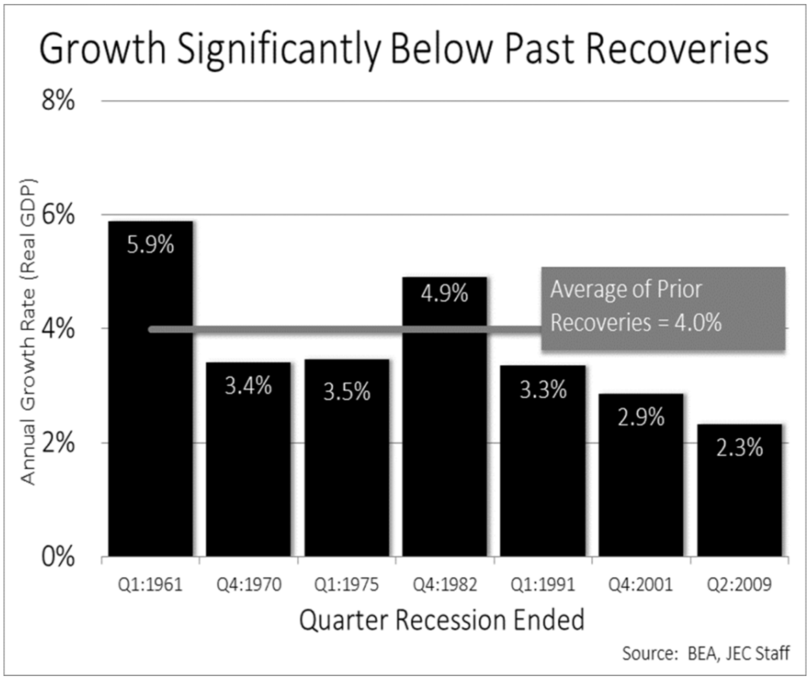
The start of 2015 appears sluggish as well compared to the second and third quarters of 2014. In its February 2015 *Monthly Outlook*, Wells Fargo's Economics Group expects real GDP growth to rise just 1.5 percent in the first quarter of 2015.[6] As mentioned earlier, to the extent that there has been any acceleration in the recovery, it has been modest (see Figure 3 on the following page). The recovery has been lackluster since the beginning and has yet to exceed a cumulative growth rate of 2.7 percent, which occurred early in the recovery.[7]

Figure 3



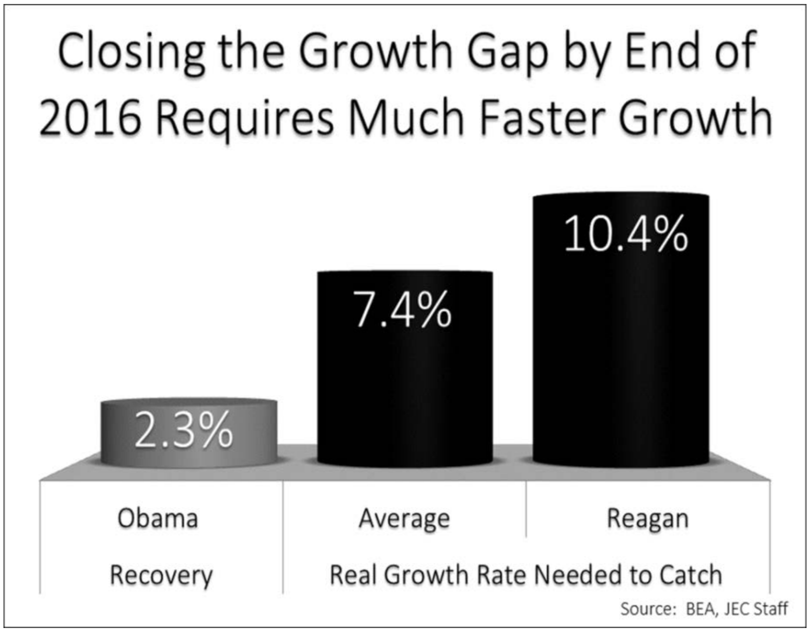
The current recovery continues to rank last among post-1960 recoveries in terms of real economic growth. Since the recession ended in the second quarter of 2009, real GDP has grown at an average annual rate of 2.3 percent. In other post-1960 recoveries, real GDP expanded at an average annual rate of 4.0 percent during the comparable five-and-one-half year period (see Figure 4).

Figure 4



It is essential that America pursues policies that will help narrow this growth gap. However, catching up to an average recovery, much less the Reagan recovery, will not be easy. For example, eliminating the growth gap compared with an average recovery would require annual real GDP growth of 7.4 percent over the next two years and annual real GDP growth of 10.4 percent to eliminate the growth gap with the Reagan recovery (see Figure 5).

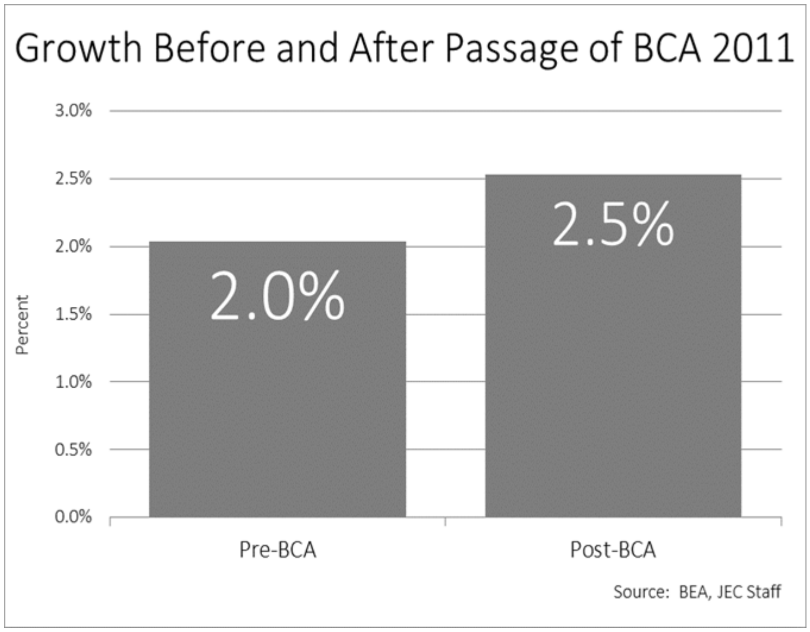
Figure 5



However, the Congressional Budget Office (CBO) projected in the January 2015 release of its *Budget and Economic Outlook* that real GDP will grow at a much slower rate—an average of 2.2 percent annually—than it did during 1980s and 1990s, close to matching its projected real potential over the 2020 to 2025 period.[8]

Regarding previous claims that sequestration, contained in the *Budget Control Act of 2011* (BCA), damaged the economy,[9] real GDP growth has been higher since its passage in the third quarter of 2011 than before passage. Prior to passage of the BCA, real GDP had expanded at an annual rate of 2.0 percent since the recession ended. Since passage, real GDP has expanded at an annual rate of 2.5 percent (see Figure 6 on following page), as measured from fourth quarter to fourth quarter.

Figure 6

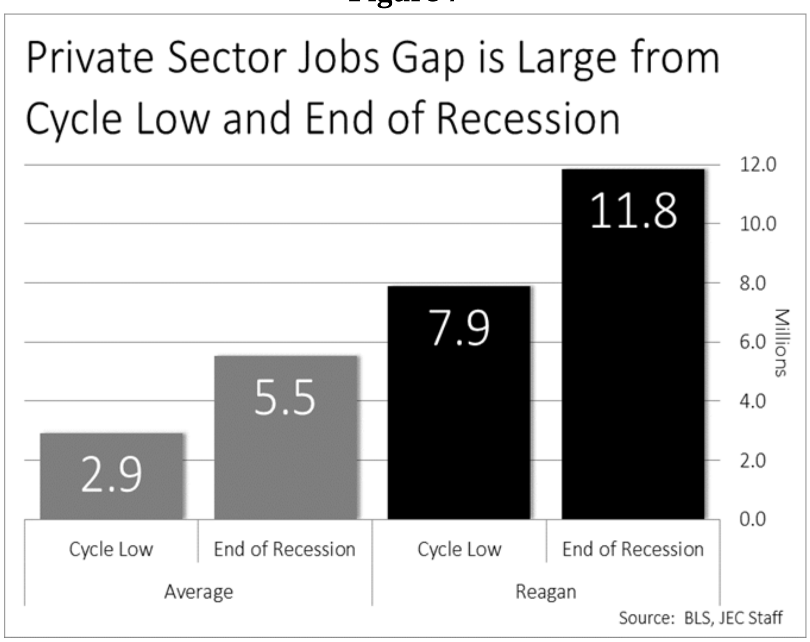


The *Report* suggests that the recovery over the past two years would have been even stronger had government at the federal, state and local levels contributed as much to GDP growth as it had in the first three-and-one-half years of the recovery.[10] While the assertion appears true on its face, context is important. The stimulus packages of both 2008 and 2009 significantly increased federal spending. Measuring against real GDP component levels in the fourth quarter of 2007, when the recent recession began, paints a slightly different picture. Real state and local consumption and investment is 3.5 percent lower than the start of the recession, but federal government consumption and investment is actually 2.0 percent higher. Within the federal government sector, defense spending is 1.4 percent lower, but nondefense is 8.1 percent higher.[11] The fact remains that substandard economic growth leads to substandard job growth and substandard income growth, both of which have typified this recovery.

Labor Market

The *Report* asserts that "[t]he speedup is particularly clear in the U.S. labor market, where the pace of job gains has improved each year since President Obama took office."[12] The CEA accurately notes that "[t]he American private sector has created 11.8 million new jobs over 59 straight months, the longest streak on record."[13] Despite this apparent success, the Obama recovery also suffers from a large and persistent private-sector jobs gap. Exactly how large that gap is depends on what timeframe is used to calculate the gap, and such an analysis would generally make comparisons from the end of the recession. On that basis, the private-sector jobs gap stands at 5.5 million compared with the average of other post-1960 recoveries and at 11.8 million compared with the Reagan recovery (see Figure 7).

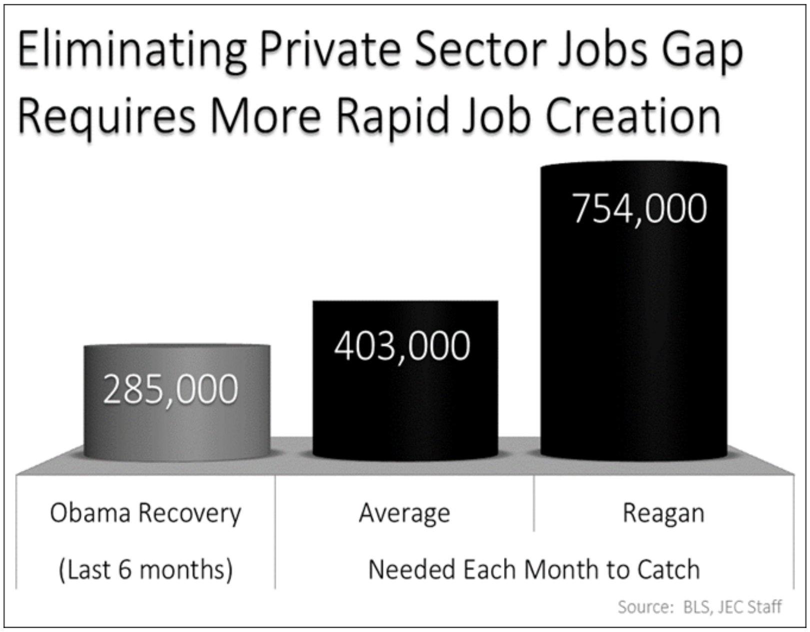
Figure 7



For measuring progress on job gains, the Administration typically focuses on the period since February 2010, when private-sector payroll employment hit bottom. Even on that more favorable basis, the private-sector jobs gap stands at 2.9 million compared to the average of other post-1960 recoveries and 7.9 million compared with the Reagan recovery. Over the last six months, the economy has added an average of 285,000 private-sector jobs per month. Even if that pace were to continue through the end of 2016, the private-sector jobs gap measured from the end of the recession would be 2.6 million compared with the average of other post-1960 recoveries and 10.3 million compared with the Reagan recovery.

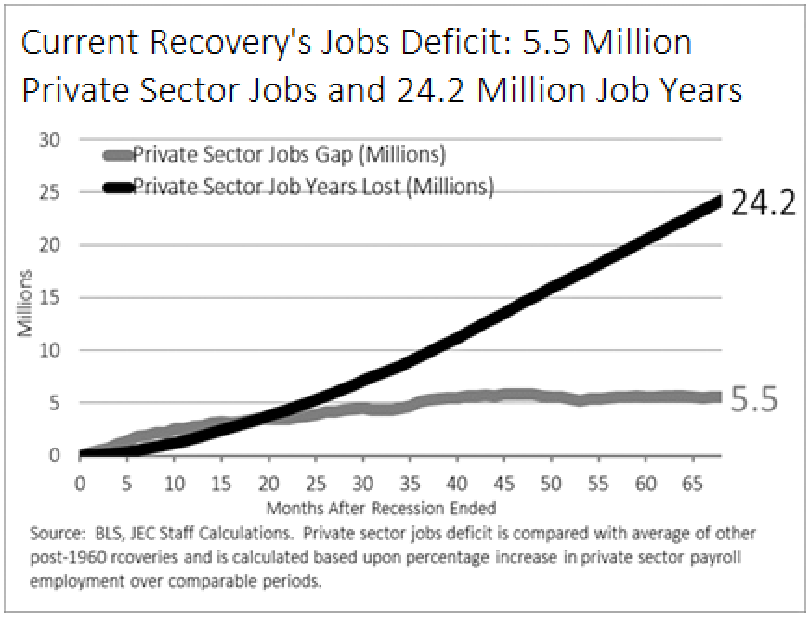
As with the growth gap in real GDP, closing the private-sector jobs gap by the end of 2016 will require much more rapid job growth than the Obama recovery has delivered to date. To eliminate the 5.5 million private-sector jobs gap by the end of 2016, the economy will need to add 403,000 jobs each month over the next 22 months. That mark has only been achieved or surpassed once during the current recovery, in November 2014 when the economy added 414,000 private-sector jobs. Catching up to the Reagan recovery would require 754,000 jobs each month (see Figure 8).

Figure 8



Other than a brief reference to the assertion in the 2014 *Economic Report of the President* that "the Recovery Act added a total of more than 6.0 million job years to the economy (CEA 2014b)," this year's *Report* omits a lengthy discussion of the "job years" created or saved by the Administration's policies. As JEC Republicans have noted in the past, extending this metric to the private-sector jobs gap exposes the recovery's loss of some 24.2 million job years compared to an average recovery measured from the end of the recession (see Figure 9).

Figure 9



Even by the Administration's benchmark of February 2010, the recovery falls 13.4 million jobs years short when compared with an average recovery.

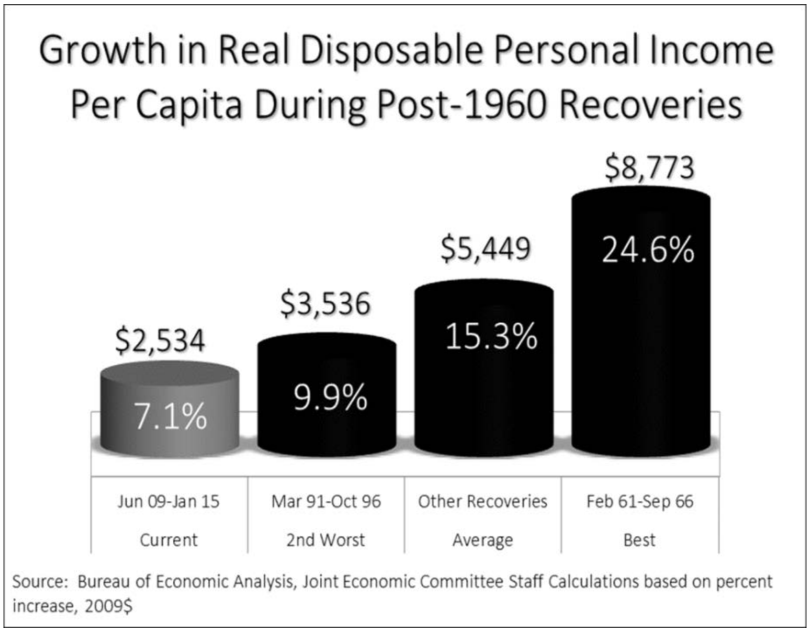
Productivity, Participation and Income

America remains one of the most productive economies in the world. However, much concern remains about whether America will be able to sustain the productivity of which it proved capable over the last half-century. Strong growth in productivity is a key component to output, profit, and wage and income growth. Yet nonfarm business sector productivity growth has not achieved more than one percent annual growth since 2010, and fell at an annual rate of 2.2 percent in the last quarter of 2014. In addition, new business creation, entrepreneurship, and technological innovations are down over the past decade. As recognized in the *Report*, these declines, if they prove to be more than temporary, remain concerning for a number of reasons, including their negative effects on the health of the economy and on Americans' standard of living.

The Administration continues to press inequality as an issue when such concern would be better directed towards policies that improve economic mobility. High and rising income inequality between the top one percent and the 99 percent has been a global phenomenon aided by globalization and skill-biased technological change. However, high and rising income inequality is not considered an issue when all incomes are rising, as Manhattan Institute scholar Scott Winship points to in the U.S. experience during the 1990s,[14] which the *Report* also identifies as "a period that saw rapid wage growth across the distribution."[15]

Nearly six years into the recovery, Americans are only just beginning to see signs of notable income growth, and income growth feeds into upward mobility. Over the last five-and-one-half years, real disposable personal income per capita has increased 7.1 percent, or $2,534 (2009 dollars). In an average post-1960 recovery, the per capita increase would have been 15.3 percent or $5,449 (Figure 10).

Figure 10



Median household income, at $51,939 in 2013, remains well below its recent 2007 peak of $56,436 (in 2013 dollars). It is hoped that growth will continue to strengthen over the coming years, yielding economic mobility both in absolute terms, by which individuals are better off than their parents, and in relative terms, by which individuals are measured against their peers.[16] When mobility is weak, Winship states that the "economic inefficiency that results when much of the population is stuck at the bottom (and the top) means the tide may lift everyone less than it could."[17] However, recent panel data suggests that top percentiles in the income distribution experience high mobility; 11 percent of the population "is found to occupy the top one percentile for one or more years between the ages of 25 and 60."[18] The Administration should broadly support policies that promote economic mobility for all Americans as well as focus on individuals who experience little to no economic mobility, such as those who lack the necessary skills to compete in today's workforce. For example, mobility for young men from the very bottom of the income distribution is an area in which the United States falls behind its international peers.[19]

Participation in the labor force also remains an issue, which the Administration recognizes as a substantial challenge in the *Report*.[20] While demographic trends are indeed affecting the overall labor force participation rate, the participation rate of prime-age workers has witnessed a steady long-term decline, among men and more recently among women, with more rapid deceleration during and in the aftermath of the recession. This is echoed in the *Report*, which notes that the labor force participation rate among prime-age American males is “something of an outlier compared to many other high-income countries,” and, “[t]he story is somewhat similar among prime-age females.”[21]

Despite apparently good intentions, the President continues to pursue policies that impede job growth and real income growth, restraining economic mobility. Improved economic mobility cannot be forcibly legislated, but it can be encumbered by legislation. The economy needs to expand at a stronger rate to support fiscal sustainability, but the *Report* does not address the reforms needed most to make the federal budget sustainable. Although it is hoped that these trends will strengthen, productivity and labor force participation growth alone cannot address the federal spending problems that have been years in the making. Furthermore, it appears that the Administration has not stopped to consider the effects that existing regulations and government policies, such as the *Affordable Care Act's* (ACA) effects on labor force participation and hours worked, have on subduing productivity and the workforce. Rather, the Administration prefers to add more spending programs to the existing structure in an attempt to counterbalance the current disincentives to work. As pointed out by economist Casey Mulligan, since the recession:

> *Major subsidies and regulations intended to help the poor and unemployed were changed in more than a dozen ways—and although these policies were advertised as employment-expanding, the fact is that they reduced incentives for people to work and for businesses to hire.*[22]

Edward P. Lazear, former chairman of the CEA, also notes that the share of the private-sector workforce employed in financial services and hospitals has fallen by five percent between 2010 and 2014, in industries that pay 29 percent and 24 percent, respectively, above the mean wage; one possibility for the decline relates to the passage of two major regulatory laws: *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) and the ACA.[23] Much like the cumulative effects of the ever-increasing burden of regulations, such an approach is open to unintended consequences and misallocation of resources, within and outside of the labor market.

Metrics

As previously mentioned, this year's *Report* purports to view the recovery "through the lens of the typical middle-class American family."[24] However, in order to measure the success of policy goals, it is important to first identify and agree upon the metric by which we measure success. The *Report* itself doesn't seem clear on that metric; its reference to the bottom 90 percent of households and the median household weave throughout the first chapter, suggesting that the "lens" is not quite clear. As it stands, there is no unified, broad definition of income, let alone a clear cut definition of "middle class." Income, even when clearly defined, is only one measure of many in determining the welfare and success of an individual. The "typical" or median household may make sense when referencing a moment in time, but is less useful when comparing the median household over time. The underlying composition of the median household changes over time in terms of persons per household, the aging of the population, the type of household, as well as trends in work, family formation and education.[25] Furthermore, framing goals in the context of "classes" fails to account for the dynamism and economic mobility inherent in passing through different stages in life that individuals and their families experience. As such, the metrics should be carefully considered in order to determine the parameters for which a policy's success is measured.

THE YEAR IN REVIEW & THE OUTLOOK AHEAD

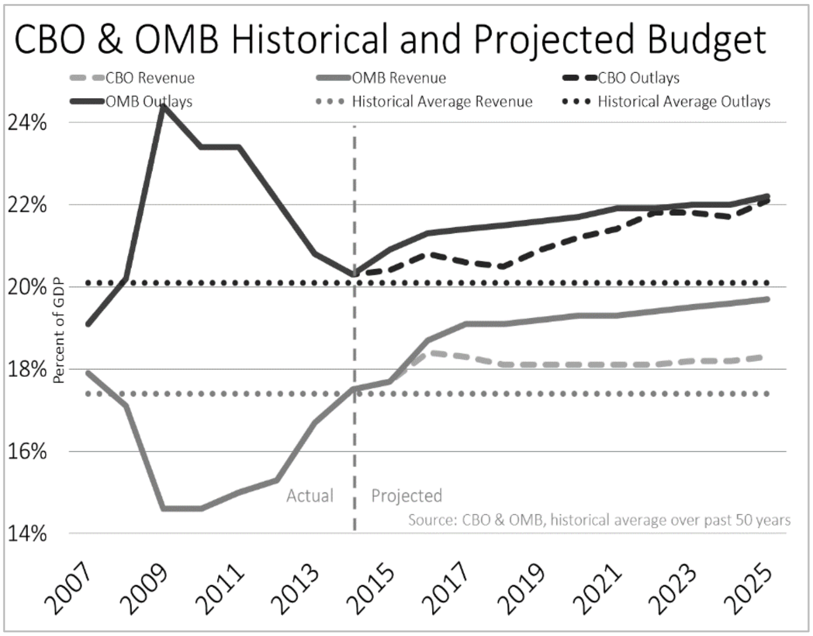
> The *Report* discusses an assortment of economic variables that showed erratic improvement in 2014, producing a growth record envied by other developed countries. Near-term deficits have fallen, but the country has long-term structural deficits that need further policy attention. Yet last year demonstrated that the federal government is *not* the source of economic growth. Rather, the biggest boost to American budgets was falling gas prices, well beyond what experts predicted. When the government gets out of the way of private markets, the economy will benefit. Washington should pursue pro-growth policies that leave the business of growth to private markets.

The *Report* highlights the rapid decline in the deficit as a percent of GDP since fiscal year 2009, noting that the decrease is the "largest since the demobilization at the end of World War II."[26] While deficit reduction is an important step towards fiscal sustainability, it is merely a symptom of the underlying issue: growth in federal spending. It would therefore seem misleading to emphasize deficit reduction without also acknowledging that the Administration has doubled publicly-held debt and increased gross debt by more than half since the President first took office. However, there is little discussion in the *Report* of the significant increase in debt levels resulting from the high deficits incurred in recent years, and the dangers this increased debt holds for future economic prosperity.

The *Budget Control Act of 2011* managed to blunt the growth of federal spending, beginning a few months into 2013, with defense discretionary spending set slightly above its fiscal year 2007 level, and non-defense discretionary spending set to revert to its fiscal year 2002 level (in real dollars). In all, the caps were expected to save an estimated $900 billion through 2021 compared to the pre-BCA baseline, and an additional $109 billion per year evenly split between defense and nondefense discretionary spending as a backup enforcement mechanism to the deadlocked Super Committee plan for $1.2 trillion in savings.[27] As previously mentioned, during that time, a look at fourth-quarter to fourth-quarter real GDP growth, the measure which the Federal Reserve uses to monitor and project changes in annual real GDP growth, showed an increase of 3.1 percent in 2013, up from 1.6 percent in 2012.[28] Annual real GDP growth for 2014 came in at a lower rate of 2.4 percent. It would appear then by this measure of growth that the sequestration which occurred during much of 2013 did not dull economic growth as the *Report* suggests relative to the more stable, "less restrictive" fiscal environment in both fiscal year and calendar year 2014.[29] As Congress continues to deliberate a budget that falls within the spending caps in place for fiscal year 2016 and beyond, it is encouraging to see that GDP growth has been resilient in other components, more than compensating for the decline in government's contribution to GDP in recent years.

The President's Budget for fiscal year 2016, however, seeks to remove the caps in favor of additional spending, offset by increased taxes. In 2016 alone, the President's budget would grow federal spending seven percent beyond budget caps. Figure 11 shows a comparison of the President's budget and the CBO's budget based on current law.

Figure 11



Treasury Secretary Jacob Lew points to the Administration's budget as a sign that the federal budget is returning to "primary balance."[30] The *Report* echoes the President's budget with regard to deficit reduction: "The Administration's FY 2016 Budget proposal includes $1.6 trillion in primary deficit reduction relative to the Administration's plausible baseline, enough to stabilize and begin to reduce the National debt-to-GDP ratio."[31] However, according to analysis of the accounting methods used by the Office of Management and Budget (OMB), the Committee for a Responsible Federal Budget finds that the deficit reduction would otherwise amount to a smaller $930 billion.[32]

Wealth inequality, a frequent theme of this Administration, is also discussed in the *Report*. In Box 2-4, the *Report* observes, "[t]he value of stock market wealth generally increases more than housing wealth as one moves up the income distribution," and the appreciation of equities "is likely to have benefitted higher-income households disproportionately."[33] This contributes to wealth inequality, which the Administration laments: "Broadly speaking, the [Survey of Consumer Finances] shows that the recovery in net worth has been uneven for households across the income distribution, as the top 10 percent of income earners have regained much more of their wealth through 2013, on average, than the bottom 90 percent of earners."[34] Furthermore, it is notable that the Administration chose to compare the recovery of net worth by income, as the same households may not have remained in the same income quintile or decile over that period of time. As Winship reiterates, "[w]ealth and income are not the same thing; the former is the accumulation of annual accruals of the latter."[35] Even ignoring the mobility argument, the Administration's presentation of the data ignores the importance of household type. Many retirees, for example, may have high net worth, but relatively low income while households in the middle and upper quintiles may have relatively less net worth despite ranking higher in the income distribution. Nonetheless, the growth in wealth inequality over the course of this Administration begs the question as to what caused the equity boom. Its origin, in part, can be attributed to the monetary policy of the Federal Reserve.

The *Report* attributes the pace of economic recovery in America—that is, relative to other countries—to reasons including "an accommodative monetary policy," and claims that since "structural reform tends to work slowly, monetary policy must bear the immediate burden of resisting deflation and supporting demand."[36] This is a troubling "off-label" use of monetary policy, which is a fairly blunt instrument, and expecting it to perform the job of a scalpel. Monetary policy is not capable of doing what the Administration desires in any sustainable way. Lessons from the "go-stop" monetary policy of the 1970s Federal Reserve under Chairman Burns reveal unpredictable swings from loose to tight monetary policy can result in stagflation.[37] In the present case, monetary policy has contributed to a great disparity in growth between Wall Street and Main Street. That is a result that is applauded by neither the Administration nor the JEC. Yet in this case, the Administration is championing a monetary policy that worsens wealth inequality. Simultaneously, the *Report* gives no credit to the Federal Reserve's actions which inadvertently reduce current federal deficits by repressing the interest rate paid on burgeoning Treasury debt balances; by omitting credit for lower current deficits, it avoids the question of how deficits will rise when the accommodative monetary policy is ended.

The *Report* is silent on the greatest gain to Americans in 2014: falling gasoline prices. This extraordinary boost to American budgets was achieved without any executive order, regulatory action, or federal government policy change. Consumers benefit when Washington puts more focus on the importance of vibrant private markets instead of introducing ever more intrusive federal policy to impede market activity.

Near-Term Outlook

As previously mentioned, after a rough start in the first quarter of 2014, GDP demonstrated strong growth in the second and third quarters and a deceleration in growth for the final quarter. The CBO and others have revised GDP growth projections downward to account for demographic trends and for slower workforce growth in the years ahead, a dramatic reversal from the exceptional growth witnessed over the last half century.[38] Growth of real private nonresidential fixed investment has picked up over the past year, but tax increases enacted in 2013 continue to elevate the after-tax cost of new investment in addition to policy uncertainty relating to the ACA and the Administration's continued barrage of regulations.

The *Report* expresses some concern over the sluggish pace in household formation, noting that household formation has been particularly "depressed" for millennials "in part due to high unemployment and the rapid increase in cost of rental housing."[39] However, there is no mention of the part that rising student loan debt burdens may have played in delaying not only household formation, but also homeownership, and more broadly, family formation and careers.[40] Overall, homeownership among 30-year-olds both with and without a history of student loan debt has declined significantly since 2008.[41]

Although labor productivity in the nonfarm business sector fell an annualized 2.2 percent in the fourth quarter and increased just 0.7 percent in 2014 overall, the *Report* remains optimistic about the future trend in labor productivity: "In the absence of a structural change in the process generating productivity outcomes, the best way to forecast labor productivity is to draw on long-term data."[42] According to the *Report*, long-term annual growth is expected to average 2.1 percent in labor productivity, in line with the long-term average determined from the periods between business cycle peaks from 1953 to 2007. The CBO's economic projections similarly put labor productivity at 2.2 percent annual average growth over the 1950 to 2014 period, and project a slightly lower annual average growth rate of 2.0 percent over the 2015 to 2025 period.[43] However, it is unclear if history should be the expected guide in this case. The Federal Reserve Bank of San Francisco noted that worker productivity growth has been slowing since 2003, likely due to dwindling benefits from technological innovations; its research expects growth going forward to be a much slower 1.5 percent annually, which would be more in line with the early 1970s to 1995 pace.[44]

Over the past year, some indicators appeared to be in better shape than others, as the *Report* acknowledges. While jobless claims generally trended downward, nonfarm payroll growth for 2014 averaged 275,000 and private-sector job payrolls averaged 267,000. The total recovery average is 150,000 for total nonfarm payrolls and 160,000 for private-sector job payrolls. The unemployment rate continued to decline over the course of 2014 since its October 2009 peak of 10 percent, but long-term jobless workers comprise nearly one-third of the unemployed.

Currently, the labor force participation rate is well below the CBO's estimate of the potential rate, unemployment remains higher than the current natural rate, and share of part-time workers looking for full-time work is "unusually high."[45] The overall rate ticked down slightly over the course of 2014, as well as for prime-age workers (ages 25-54). The long-term trend shows a steady decline overall and among prime-age workers, which slightly accelerated during the recession and through the recovery. Overall labor force participation is down 2.7 percentage points since the recovery's start, and is down 3.2 percentage points from its pre-recession level; the *Report* predicts that it will not return to 2008 levels. Prime-age labor force participation is down 1.8 percent since the recovery's start, and is down 1.9 percent from its pre-recession level. The CBO estimates that if the unemployment rate returned to its December 2007 level and the labor force participation rate equaled its potential, there would have been 2.75 million more workers in the fourth quarter of 2014.[46]

The employment-to-population ratio ticked up over the course of 2014. However, the drop in employed persons during the recession has left a deep trough from which to recover. The overall employment-to-population ratio is equal to ratio at the recovery's start, but it is still 3.6 percentage points below its pre-recession level. For prime-age workers, the employment-to-population ratio is up 1.5 percentage points since the recovery's start, but remains 2.4 percentage points below its pre-recession level.

Federal deficits incurred during the recent recession have left the United States with an imposing debt burden that will limit its fiscal flexibility to address future economic upheavals. As the following Table 1 shows, of the seven countries with the highest 2014 gross federal debt-to-GDP ratio, only smaller developed countries like Greece and Portugal have increased their debt burden at a rate equal to or above the U.S. rate over the past decade[47]:

Table 1. Debt-to-GDP Ratio, 10-Year Trend

Country	**2004**	**2014**	**Rate of Increase**
Japan	165.5%	227.2%	37.3%
Greece	98.6%	175.1%	77.6%
Italy	103.9%	132.6%	27.6%
Portugal	57.6%	129.0%	124.0%
Singapore	98.0%	105.5%	7.7%
United States	62.7%	101.5%	61.9%
Belgium	94.2%	101.5%	7.7%

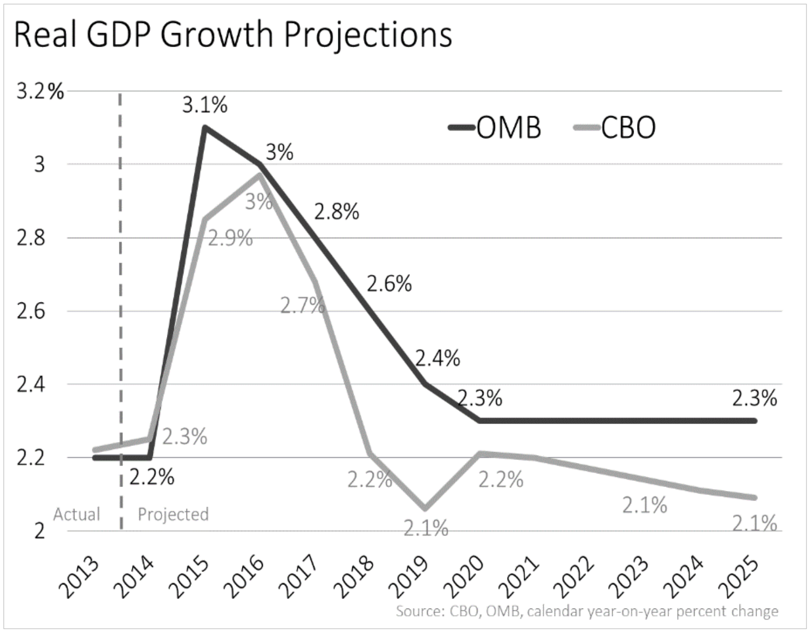
Source: Forbes.

Actions taken by the Federal Reserve have lent to a favorable environment for government borrowing. Over the past six years, the Federal Reserve has engaged in its own form of "stimulus" by use of Quantitative Easing (QE) and yield curve "Twist." QE began in March 2009, followed by QE2, Operation Twist, QE3, and a final, gradual tapering that was completed in October 2014. These programs were intended to drive interest rates down in order to encourage private-sector spending by reducing the borrowing costs of mortgage interest payments for consumers and lowering capital costs for businesses. This collection of extraordinary measures in order to speed recovery from the recession did not come without costs, and it remains to be seen how and if the Federal Reserve can manage the wind-down of assets that rapidly accumulated in its portfolio. Concerns include the rate at which interest rates and core inflation could rise, potential asset bubbles, greater financial risk to near-retirees, depleted retirement savings, impaired financial markets, and the effect that doubling publicly-held debt has had while federal interest costs were low.[48]

Long-Term Outlook

The Administration's budget assumes in its economic forecast 2.8 percent annual average real GDP growth over the next four years, easing to an average of 2.3 percent by 2019.[49] In contrast, the CBO expects a slightly more conservative annual average rate of 2.7 percent over the next four years and 2.1 percent from 2019 through 2025. Even these small differences in growth projections can have significant effects on tax collections, deficit spending, and debt accumulation. According to the CBO, under current law, if GDP growth was 0.1 percentage point lower per year, tax revenues would be lower by an estimated $2 billion in 2015 and $59 billion less in 2025. Altogether, annual deficits would be $69 billion larger by 2025, with a cumulative increase in the deficit of $326 billion from 2016 to 2025.[50] A smaller economy over the next decade means less revenue than the Administration expects to meet ever-growing spending obligations (see Figure 12).

Figure 12

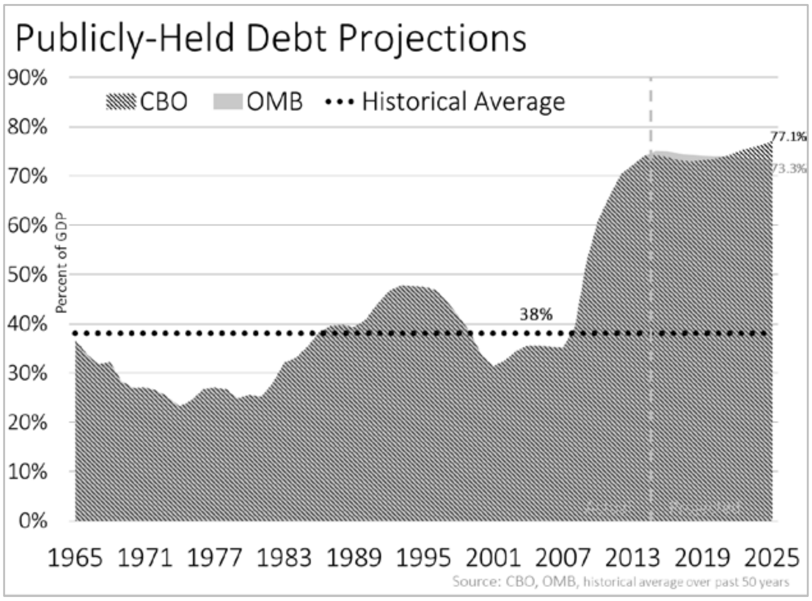


This comparison is limited by the fact that the CBO's economic assumptions are based on current law, and the President's budget is based on a variety of changes to current law and economic assumptions that differ from the CBO's analysis. According to the CBO's analysis of the President's 2016 budget, the CBO estimates that the cumulative deficit under the President's budget for the 2016 to 2025 period is $303 billion higher than the Administration's estimate. Over the same period, the CBO also estimates that revenues would be $1.1 trillion less than the Administration's estimates, while outlays would be $834 billion less than the Administration's estimates. However, the CBO's analysis does not include macroeconomic effects and subsequent feedback from those effects on the budget. In the coming months, the CBO will complete a separate analysis of the economic and indirect budgetary effects of the President's budget and how it differs from current law.[51]

According to the CBO, growth of the potential labor force is expected to remain sluggish, held down by ongoing retirement of Baby Boomers, stable participation among working-age women, and by federal tax and spending policies set by current law; the current economy has less slack, and therefore less potential, than the CBO previously estimated. In addition, the CBO projects nonfarm payroll employment to rise by an average of 180,000 jobs per month in 2015. Going forward, the projected average increase is roughly 130,000 per month in 2016 and 2017, consistent with expected "moderation" in output growth.[52]

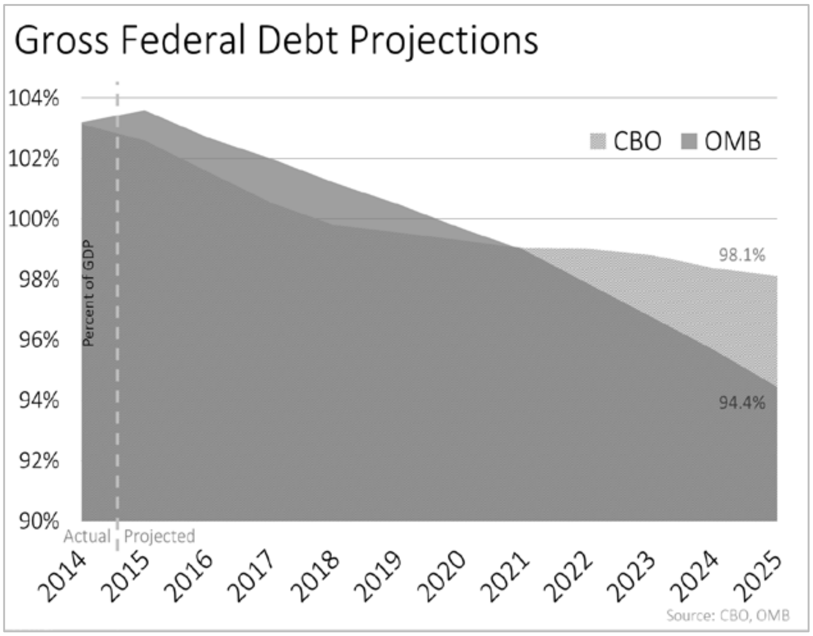
Due to the Administration's rosy economic outlook, combined with its proposed tax hikes, the OMB expects publicly-held debt to slowly decrease over the next decade, while the CBO expects it to rise rapidly in the last half of the decade under current law, as shown in Figure 13.[53] It must be noted that the *Report* sees higher productivity, achieved partially through tax reform and new trade agreements, as essential to reducing the structural long-term deficits that threaten the economic well-being of younger workers as well as future generations. If the White House achieves neither passage of tax reform nor trade agreements, despite Republican support, it is unclear what will be the new source of productivity gains needed to help tame future deficits.

Figure 13



Furthermore, the CBO's long-term budget outlook shows this figure rising further, reaching over 100 percent of GDP beyond 2035.[54] The Administration expects gross debt to fall over next decade, while the CBO sees a slower decline, as shown in Figure 14.[55] However, the *Report* does very little to address imminent spending obligations including Social Security, and the President's proposal for almost $300 billion in health savings is dwarfed by Medicaid and Medicare growth cost projections, which will increase 75 percent over the next decade alone.[56]

Figure 14



However, the CBO's long-term budget outlook of publicly-held debt would, in effect, also cause gross federal debt to rise over the same period, sending gross federal debt back above 100 percent of GDP much sooner than 2035.

Fiscal sustainability must be a priority. Though the current, albeit sluggish, economic recovery is expected to rank third by length of expansions, based on the CBO's forecast of economic growth,[57] the debt that has rapidly accumulated since the recession leaves little to no room for policymakers to act upon the next crisis. Economic forecasts at the beginning of the millennium did not include the terrorist attacks on 9/11, the war on terrorism, nor the financial crisis that led to the recent recession, yet such events dramatically changed the trajectories of economic growth and budget projections from previous estimates that had at one point predicted that national debt would fall to a net zero percent by

2013.[58] As discussed in previous JEC Republican staff analysis, overspending is undermining fiscal sustainability:

> *A more comprehensive understanding of the relationship between government spending and debt and the effect on the broader economy is imperative for all policymakers. Spending and debt can stunt economic growth, which in turn leads to a vicious cycle of further deficit spending and debt…*
>
> *Massive stimulus spending and an expansion of entitlement programs since 2008 have failed to deliver the promised jump that our economy needs. Now, left with an even larger base of federal spending ahead of demographic changes that will place an excessive strain on existing entitlement programs, the growth of the federal government is squelching private enterprise and innovation with spending increases; crushing debt with higher interest payments; burdensome and byzantine regulations; maligned incentives; and an ever-broadening scope of government functions.*[59]

Federal spending and revenue as a percent of GDP returned to their respective historical averages of 20.1 percent (20.3 percent for 2014) and 17.4 percent of GDP in 2014, respectively, after years of above-average spending and below-average revenue in the aftermath of the recent recession, resulting in massive debt accumulation. However, both the CBO's and the President's budget projections show above-average spending over the next decade, averaging 1.0 to 1.7 percentage points, respectively, above the fifty-year historical average.[60]

The CBO reiterates in its recent release of the *Budget and Economic Outlook* that high and rising debt, which is already high by historical standards, will have serious and negative consequences for both the economy and the federal budget. Spending on federal debt interest payments is expected to rise with interest rates over the next several years. Net interest spending on the debt is set to comprise a large majority of deficit spending over the next decade. In the long term, continued federal debt accumulation may cause investors to doubt the ability of the United States to pay on obligations, thus further raising interest rates on federal borrowing. As the federal government borrows more, the cost of borrowing rises for businesses, which reduces capital stock and lowers income and output activity below what would otherwise occur. As such, faced with historically high debt, policymakers will likely be limited in their ability to meet the fiscal challenges that unexpected negative blows to the economy, such as another financial crisis, could bring.[61] This is something that the *Report* discusses in the context of Eurozone countries, but the *Report* fails to acknowledge the obvious parallel with the U.S. federal government's own fiscal situation:

> *A country's ability to tackle demand shortfalls through higher public spending or tax cuts may be limited if fiscal space is insufficient—either because government debt is already high or because markets doubt the government's ability to manage its budget sustainably over the longer term.*[62]

The Administration should cease relying on exceptionally rosy economic projections to make its budget look less unreasonable. The President's proposed tax increases will not achieve the desired effect of raising revenues to a sustained fifth of GDP. In fact, many of the President's tax proposals hurt economic growth, jobs, and revenues by making the after-tax cost of capital even more expensive. The Tax Foundation finds that the President's capital gains tax alone would shrink GDP by 0.8 percent over ten years.[63] Furthermore, if the projected long-term trends in demographics and participation in the labor force serve to frame the future labor market, then countries such as the United States would be wise to ensure their fiscal sustainability to avoid potentially slower future economic growth.

A LOOK AT THE U.S. LABOR MARKET

The Administration delved into a deep discussion of the U.S. labor market, noting that it has come far in its recovery from the recession, but the gains have not been evenly shared by workers with less education. Labor force participation is falling and will not return to pre-recession levels because of retiring Baby Boomers (Americans born from 1946 to 1964). The Administration sees the greatest policy need in helping unemployed and underemployed workers, promoting wage growth through increasing the minimum wage, providing federal support for education and employer training programs. These initiatives are also intended to help the economy absorb the workers who join the labor force after immigration reform.

However, the recession accelerated the transformation of the U.S. labor market that began with the technology revolution in the second half of the 20th century. As the unemployed and new jobseekers understand well, the old rules no longer apply and the old solutions no longer work in today's labor market. Many graduating millennials (though no chronological end point is defined, this generation of Americans is generally between the ages of 18 to 34 in 2015)[64] who have incurred tens of thousands of dollars in student debt are not finding jobs in their related field of study; instead, they are learning that they would have been better off finding jobs instead of extra class work. The connection between education and jobs is fractured, and its repair requires partnership with employers who know what skills their workers need. Students considering additional education must have a clear understanding of its cost, including lost income for more time without a full-time job, compared to the benefit they will see in higher lifetime earnings.

The *Report* highlights the strong job growth over the past year as an indicator that the Administration's economic policies are working, but made the caveat that "…work remains to both complete the cyclical recovery and address underlying structural issues that predate the recession…"[65] The *Report* reiterates that productivity growth, income distribution and labor force participation are three key issues that affect the economic situation of the middle class.[66] Yet those factors have implications beyond the middle class; the trends in productivity, labor force participation, and more importantly, income mobility over distribution, will shape the economy and its growth path going forward. The Administration notes that the current demographic and labor force trends will present challenges to America's workforce in the coming decades, highlighting five long-term issues in need of address:

> *…i) a long-standing decline in the participation rate that has been compounded by the recession and the retirement boom; ii) a rapidly recovering long-term unemployment rate that nonetheless remains elevated; iii) a similar pattern of rapid decline but continued elevation in the rate of people working part time but who are seeking full-time employment; iv) cyclical improvements in labor market fluidity that are set against a back-drop of a long-term decline in a variety of metrics of labor market fluidity, or labor market "churn"; and v) real wage growth that is beginning to pick up but is still insufficient.*[67]

All five points are indeed remaining areas of concern. A sixth could be the rise in the proportion of prime-age individuals out of the workforce; some reasons for this increase may relate to discouragement and scarring left from the recession. Paired with increasing levels of student debt, government debt, and rising obligations for healthcare and retirees, this complicates the capability to create a highly-skilled and educated workforce that meets the needs of America's future.

Unemployment

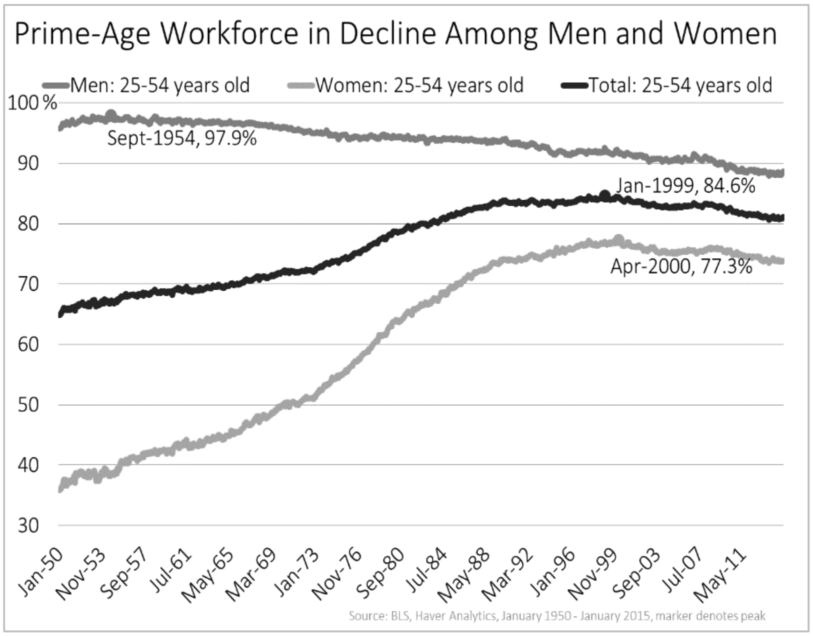
The *Report* emphasizes the rapid rate at which the unemployment rate has declined over the past year, achieving a decrease to 5.5 percent in the latest estimate for February 2015, "roughly five years ahead of consensus forecasts made as recently as 2013."[68] Much of the decline in the unemployment rate was due to a drop in long-term unemployment, yet the *Report* recognizes that long-term unemployment, at roughly one-third of the unemployed, still remains well above its pre-recession level. The *Report* cites research suggesting that "long-term unemployed are going back to work at higher rates,"[69] which may be true to some extent, but analysis from the Federal Reserve Board suggests that the long-term unemployed are "frequently moving between unemployment and nonparticipation, possibly due to a lower search intensity which does not always qualify them as unemployed from the viewpoint of the [Bureau of Labor Statistics]."[70]

The *Report* also highlights recent research suggesting that becoming long-term unemployed "makes it harder to escape from unemployment."[71] In addition, research from the Federal Reserve of Boston finds that the "hangover" from any length of unemployment can have effects on wages that can last for almost 20 years, with a more pronounced effect on long-term unemployed; after a decade, individuals who were jobless less than six months made 9 percent less than continuously employed workers, but those who were jobless more than six months earned nearly one-third less.[72] This finding corroborates previous work that long-term unemployment can have deleterious effects on skills loss and personal well-being. Furthermore, this effect, along with demographic trends like a large cohort of the workforce retiring, will likely dampen household income growth for years to come.

Labor Force Participation and Employment-to-Population Ratio

Participation in the labor market has continued to steadily decline since its peak mid-2000 at 67.3 percent, down to 62.8 percent in February 2015. The *Report* states that much of the decline in the overall participation rate has been largely due to demographic changes, such as the retirement of Baby Boomers, but the decline in the labor force participation rate among the prime-age workforce has also continued its long-term trend since the September 1954 peak for prime-age men, and the more recent April 2000 peak for prime-age women (see Figure 15). These participation rates are not expected to return to their peak levels any time soon, as the *Report* acknowledges.[73]

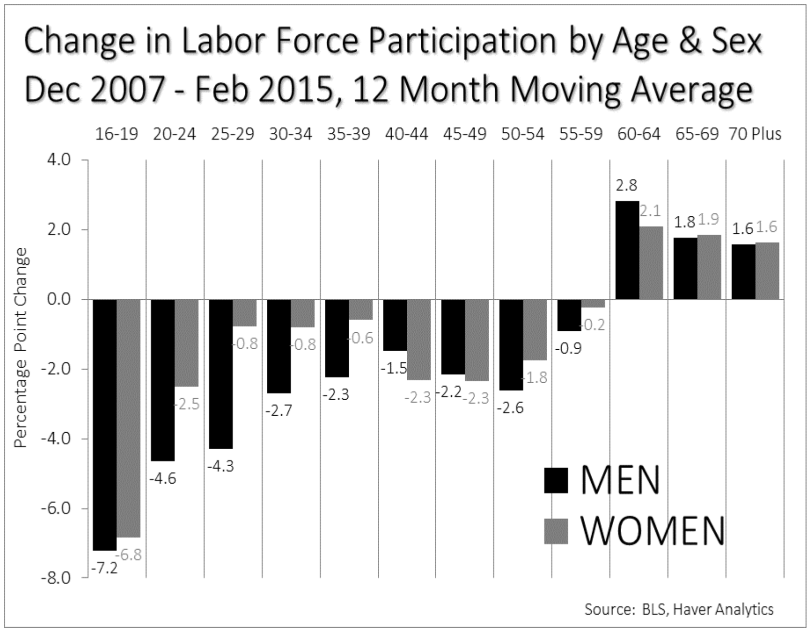
Figure 15



The *Report* deals with the labor force participation rate in great detail, noting "…research finds that long-term trends such as aging account for between 25 and 82 percent of the participation decline over the recession."[74] Notably, the time periods of the studies do not exactly match up. Another portion is attributed to cyclical factors remaining in the recovery due to the recession. The *Report* also finds that nearly an entire percentage point (0.9) in the decline since its emergence in 2012 as shown in the *Report's* Figure 3-6 "is not fully understood," but suggests the severity of the recession may have contributed to further decline than would be anticipated in typical recessions.[75]

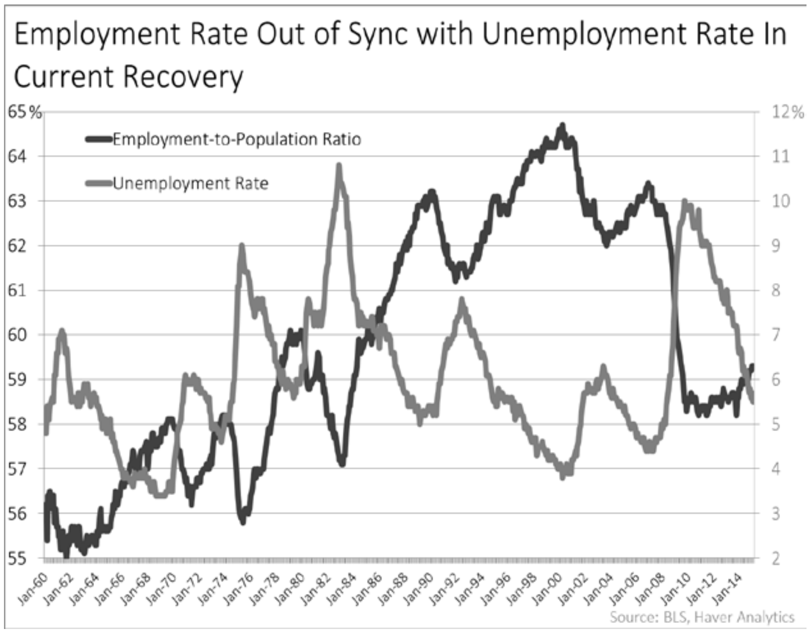
Demographics, such as the aging of Baby Boomers, are not the sole reason for the overall decline in labor force participation, and by some studies' estimates, do not account for even half the decline since the beginning of the recession. Though they are still more likely to be out of the labor force than any other age group, older Americans are in fact retiring at a slower rate in the recovery than they had been prior to the recession.[76] During the recession and recovery, the labor market for young employees has been hit especially hard, but it appears that older workers have fared much better. The *Report* characterizes the labor market recovery as "shared across the full spectrum of American workers," but later notes the annual average declines in the labor force participation rate for ages 16-24 and 25-54 over the 2007-2014 period, in contrast to the increase in participation among those age 55 and older.[77] Broken down into more detail by five-year age cohorts, the 12-month moving average of changes in labor force participation rates since 2007 demonstrate that virtually all increases within the participation rates are specifically from older workers, aged 60 and over, for both genders (see Figure 16). While some of this may be preference and ability to work even after becoming eligible for retirement, financial repression related to the Federal Reserve's decision to hold interest rates near zero for such a prolonged period of time may have pushed near-retirees to work longer to make up for the minimal yields in their retirement portfolios.[78]

Figure 16



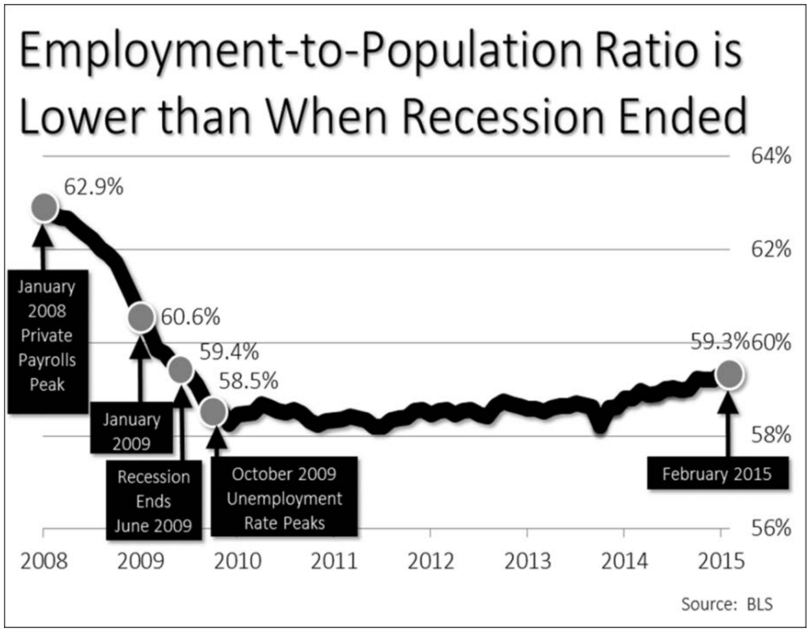
The *Report* claims that many labor market indicators are well on the way to their pre-recession levels; for example, the *Report* states that the overall unemployment rate is 93 percent recovered from its recession peak. However, it does not necessarily follow that most of that recovery was translated into employment. As shown in the Figure 17, unlike past recessions and subsequent recoveries, the inverse relationship between the unemployment rate and the employment-to-population ratio was virtually flawless until this recovery, which shows a dramatic fall in the unemployment rate, but very little increase in the employment-to-population ratio.

Figure 17



Though the employment-to-population ratio has shown an upward trend, particularly over the last year, the February 2015 rate of 59.3 percent still remains well below the pre-recession peak of 62.9 percent (see Figure 18). Despite recent gains in the ratio, it would appear that the return to the pre-recession peak in the employment-to-population ratio will not happen in the near-term either.

Figure 18

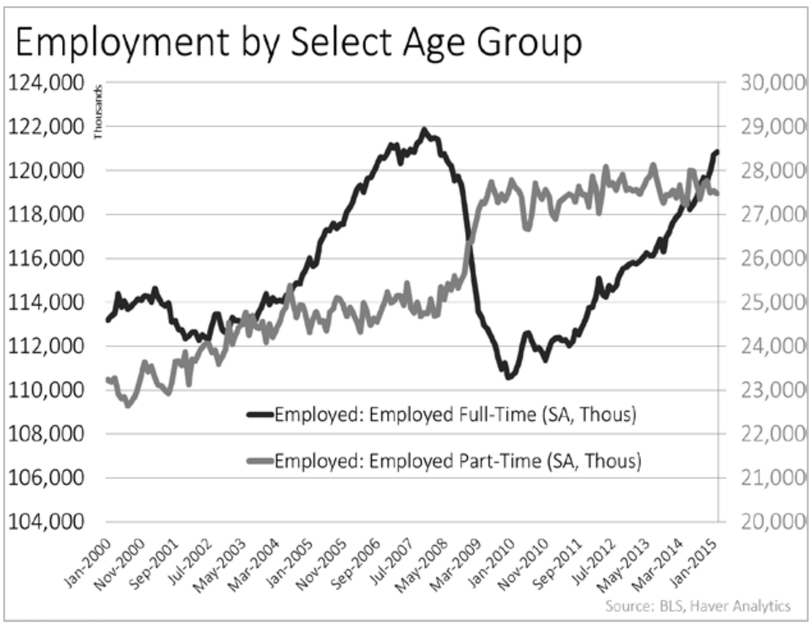


There are other metrics that indicate a shift in the relationship that young individuals have with the labor market. The *Report* notes that "[t]he share of young adults aged 16 to 24 enrolled in school between January 2008 and December 2012 rose well above its trend, enough to account for the entire decline in the labor force participation rate for this age group over this period."[79] Other trends among young adults are more concerning; the percent of all young adults in America between ages 20 and 24 that are neither enrolled in school nor working has risen within the last quarter of a century. As of 2013, 31 percent of high school graduates between ages 20 and 24 were not in school or working, up from 21 percent in 1990; nearly 1 in 10 with a bachelor's degree or more in the same age group neither in school or working in 2013 is also up from 1 in 20 young adults in 1990.[80]

Full-time and Part-time Employment

Although both part-time employment and full-time employment have made significant gains over the course of the recovery, full-time employment has still not returned to its pre-recession level. Part-time employment witnessed a sharp increase during the recession, and remains at a higher level in the recovery (see Figure 19).

Figure 19



In a positive sign, the share of those working part-time for economic reasons has fallen considerably over the past year, yet still remains elevated above its pre-recession average, as noted in the *Report*, and the persistence of residual elevation will remain dependent upon the underlying reasons and whether they suggest additional slack in the labor market.[81]

Job Churn

Job churn has slowed in recent decades, and expanding firms are adding fewer jobs on average than they have in the past. This slower worker mobility, identified in several studies, is something that the *Report* highlights as a concern. The *Report* offers some salient points on the effects of slower job churn:

> *Lower fluidity may reduce workers' abilities to raise their wages by changing jobs, and consequently also their bargaining power with their incumbent employer. In this way, reduced fluidity may contribute to slower wage growth… the slower recoveries in the shares of part-time for economic reasons and in long-term unemployment in recent recessions could in fact be related to the long-run decline in fluidity.*[82]

Many business formation statistics demonstrate the trend of slower job churn. Further research finds that the number of new businesses created is in decline, down from the approximate 6 million jobs created per year prior to the recession, and well below the job creation pace of 7 million to 7.5 million seen in the 1990s. Firm exit rates have exceeded firm entry rates in recent years, with firm entry on a steady decline since the late 1970s. Similarly, older firms (age 16 and older) have steadily risen as a proportion of total firms since the early 1990s.[83] In addition, the number of people under 30 years of age who own a private business has fallen to a 24-year low, down to 3.6 percent from over 10 percent in 1989; raising money to start a business was suggested as an important factor, which may be exacerbated by the college debt that many graduates have accumulated in recent years.[84] Overall entrepreneurship has also fallen at all ages over the past quarter century. Though the full effects are not yet fully understood, such trends will likely lend to slower economic growth and lower standard of living compared to what would have otherwise occurred with greater rates of job churn, business dynamism and entrepreneurship.[85]

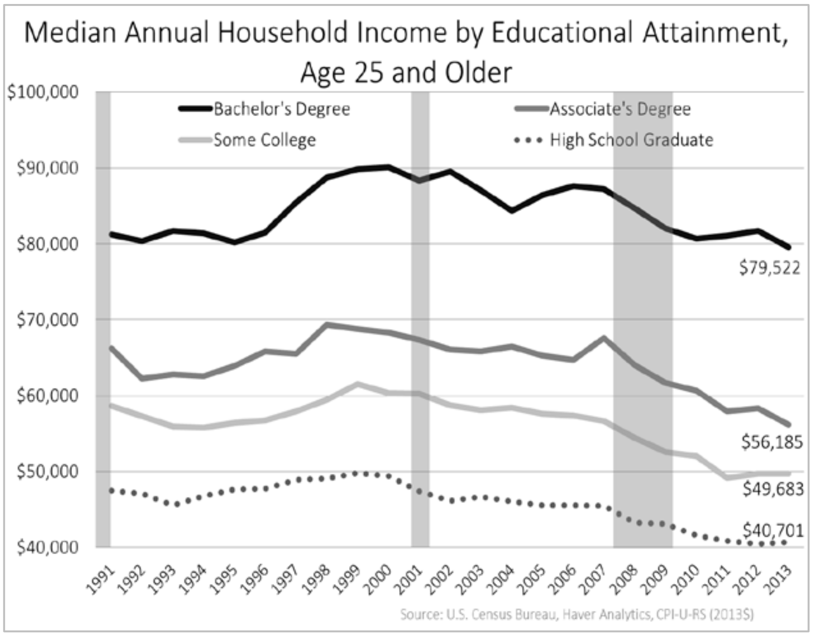
Other trends point to a continued decline in workforce growth and population growth, many of which are observed in recent research that the *Report* highlights. Further studies find similar trends in labor dynamism, population and productivity. The National Center for Health Statistics reports that annual births have declined for six consecutive years and are 9 percent below their 2007 high, and the general fertility rate in the United States dropped to a record low in 2013 to an average 1.86 babies born to women ages 15 to 44 over their lifetimes, well below the 2.1 needed to stabilize the population.[86] According to McKinsey Global Institute research, without a sustainable increase in worker productivity, America and the rest of the world face a slow-growth future. This research finds that global employment growth will slow to 0.3 percent annually over the next 50 years, down from 1.7 percent. Even if the 1.8 percent annual productivity growth of the 1964-2014 period continues, overall global productivity growth is expected to shrink by 40 percent to 2.1 percent per year, thus slowing the growth rate in GDP per capita by roughly 20 percent. For the United States specifically, the report finds that labor force growth will fall to 0.5 percent annually between 2020 and 2030. This will likely be exacerbated by the demographic changes relating to age; the percent of Americans age 65 and older is expected to more than double, from 15 percent in 1964 to 38 percent in the next 50 years. The research further projects that annual GDP growth through 2064 will average 1.9 percent per year and per capita growth will average 1.3 percent annually.[87]

Education, Wage Growth and Job Quality

Education remains an area ripe for reform, and unlike the Administration's focus on making community college "as free and universal in America as high school is today,"[88] reform must take place at the primary and secondary levels to adapt to the human capital needs of the 21st century. Despite the growing amount of funds per student spent on education at K-12 public schools, the quality of education across America varies considerably. Yet in the *State of the Union*, and echoed again in the *Report*, the Administration has preferred to promote the idea of making community college free, rather than focus on the existing education deficits experienced by multitudes of students across the country.

Making community college free does not ensure that students who graduate from said programs will actually have the skills they need to obtain a good paying job. Today, many of the classes offered at community colleges are remedial, compensating for deficits in education received at the high school level. Financially, community college is not perceived as a chokepoint for many students, as most low-income individuals are already able to receive a community college education for free if they are eligible for Pell Grants.[89] Furthermore, of the nearly 40 percent that are able to graduate,[90] their incomes remain scant above that of workers with only a high school diploma if they do not go on to complete a college degree. The graduation rate for first-time, full-time students completing a bachelor's degree is 39 percent, a rate that rises to just a 59 percent completion rate within six years.[91] As shown in Figure 20, in 2013, those who manage to attain at least some college still see a roughly $30,000 gap in median annual income compared to earners with a bachelor's degree.

Figure 20



Broadly, the University of Pennsylvania's Alliance for Higher Education and Democracy and the Pell Institute for the Study of Opportunity in Higher Education found that the gap in graduation rates between high- and low-income students remains wide; in 2013, nearly eight in ten students from families in the top income quartile earned at least a bachelor's degree by the time they turned 24 years old; in contrast, only 9 percent of students from families in the lowest income quartile did the same.[92]

Though not covered in much detail in this year's *Report*, the President has pursued policies that attempt to ensure post-secondary education remains affordable to students, but it fails to acknowledge that some of those steps can have unintended consequences that can fuel the problem of rising tuition costs. Furthermore, high and rising student debt burdens have reportedly led to postponing the acquisition of homes, vehicles, and other major purchases that young workers in decades past were already accumulating at this age. As noted by former Indiana governor Mitchell E. Daniels, the percent of young workers that report owning a part of a new business has fallen from 6.1 percent to 3.6 percent, roughly 70 percent of recent graduates are now borrowers, and the class of 2014 carried an average debt load of $33,000.[93] A study from the Federal Reserve Bank of New York found that young millennials are even more likely to live with their parents in recent years (nearly 50 percent for 25 year-olds in 2013, up from 35 percent in 2003) than to own their own home (less than 15 percent for 25 year-olds in 2013, down from nearly a quarter in 2003), and that every $10,000 increase in student debt per graduate is correlated with an additional 2.9 percentage point increase in the rate of living with their parents.[94] Similarly, research from Dartmouth College notes that the composition of debt young workers accumulate has changed over the past several decades. Millennials have taken on far more student and credit card debt in place of mortgage debt that Baby Boomers took on at the same age. Only one-fifth of young Americans have mortgage debt, which is far below the near-third of young Americans in the 1980s and 43 percent in the mid-1970s.[95]

There is also an issue with the variability in the quality of education that students receive across America. Many students find themselves unprepared for even the most basic post-secondary courses at the community college and university levels, let alone for skilled jobs that offer good pay. Preparing the American workforce with the skills demanded in this economy requires more than simply making college cheaper or community college free. Many recent graduates took shelter from the recession by pursuing an advanced degree to improve their odds of obtaining a higher paying job in a stronger future economy, only to find themselves burdened with additional student loans with an unclear payoff; recent research finds that graduate student debt has been driving the increase in student loan debt in recent years, accounting for one in six student-loan recipients.[96] Of current, young job holders, the Federal Reserve Board's Survey of Young Workers reveals that only 42 percent of those surveyed reported having a job that is closely related their field of study, and 28 percent responded that they were overqualified for their current job, with bachelor's and associate's degree holders most likely to respond this way.[97] Students' time and resources should be better invested so that they can enter the workforce truly equipped and without needless delay and countless dollars spent on a degree that leaves them underemployed or jobless. The better equipped that students are to make the best decisions for themselves with the best information available to obtain the education they need for the careers they seek, the less likely they will find themselves steeped in debt and with little to no paycheck to pay off their investment in skills for a bright career.

Overall wage growth has recently started to pick up in pace, as the *Report* points out, but it notes that "the middle class has seen little improvement in real incomes since 1997 despite productivity growth."[98] However, Pew Research Center notes that America's "middle" has held its ground in 2013 relative to 2010 after years of continued decline since 2000, finding that the middle income (though Pew reiterates there is no universal definition, it defines the middle as twice the median income or as low as two-thirds the median, adjusting for family size, at $40,667 for the lower-bound and $122,000 for the upper-bound in 2013) remained steady.[99]

The wage gains for millennials, however, appear to be delayed, though data on median weekly earnings shows a notable increase for this age group in the last quarter of 2014.[100] Since the beginning of the recession, starting wages of recent college graduates (defined by the Federal Reserve Board as ages 21-25 with a college degree) have remained little changed, and a growing gap between overall median weekly earnings has appeared during and beyond the recession.[101] A Georgetown University study supports this finding, noting that young workers in 2012 did not earn the median wage until age 30, up from age 26 in 1980.[102] Considering that overall wage growth has been slow, the contrast is even more distressing for young workers.

The *Report* also goes into some detail about the research on skill-biased technological change, which has increased the wage premium that workers receive for a college education and higher degrees; this has placed greater emphasis on higher education as a key to economic mobility than in the past. The *Report* states: "At the same time that wages and employment have been growing among high-skill workers, employment in middle-skill jobs has declined, especially relative to higher-and lower-skill jobs."[103] Indeed, the information technology revolution has also benefitted lower-skilled jobs in the service industry, such as customer service, that despite being repetitive, still require a significant cognitive component, and jobs that are manual but require creativity, such as emergency responders or athletes.[104] Past JEC analyses have also dealt with this subject, noting that the experience of job polarization and the effects of skill-biased technological change are not unique to America, as evidenced by cross-country studies of European countries and across broad occupation groups.[105]

Minimum Wage

The *Report* echoes the President's address to the *State of the Union* in offering a minimum wage raise as a solution to increasing worker wages: "…a step that would help tens of millions of workers and help ensure that no full-time worker raises a family in poverty."[106] However, raising the minimum wage can have deleterious effects on young workers, who typically have the least skills and are among the greatest beneficiaries from low-skill and entry-level jobs to build up critical skills and work experience. It would follow that such an increase, likely at a rate that is quite steep relative to past minimum wage increases, would only be marginally helpful for the small percentage of families struggling to support themselves on the minimum wage. The minimum wage increase is a poorly targeted tool relative to the effectiveness of the Earned Income Tax Credit (EITC), which reaches a much larger proportion of the working poor.

As reported by the Bureau of Labor Statistics (BLS), while workers under age 25 represent only one-fifth of workers, they make up just over half of those paid the Federal minimum wage or less. As such, most minimum wage workers are typically not the primary earners in their household; even excluding the half of minimum wage workers age 16 to 24, the median family wage is $42,462 for minimum-wage workers age 25 and older as of 2013.[107]

Research suggests that the initial pay at an entry-level job matters less for advancement than the fact that it is available as an opportunity to advance in the first place; Heritage Foundation senior policy analyst James Sherk points out that two-thirds of minimum-wage workers earn more than the minimum wage a year later.[108] More broadly, according to a study by Ron Haskins of the Brookings Institution, employment is one of several key factors of upward mobility into the middle class. Those that did not have any of the criteria were 77 percent likely to live in poverty and had a 4 percent chance of mobility into the middle class.[109] The Federal Reserve Board's Survey on Young Workers reported that young workers who had a job in high school were more likely to be employed full-time after graduating college.[110] Raising the minimum wage reduces the number of opportunities available to low-skill and entry-level workers to build their skills. The CBO estimates that raising the minimum wage to $10.10, as previously supported by the Administration,[111] could result in the loss of up to one million American jobs.[112] Furthermore, a vast number of studies over the span of the last five decades and beyond have provided evidence that minimum wage workers are significantly hurt in other ways even if not by reduced employment.[113]

The employer insurance mandates associated with the ACA are expected to compound the problem businesses face in the increasing cost of employing low-skill workers. According to a 2013 analysis by Sherk and Patrick Tyrell of the Heritage Foundation, the costs of both a minimum wage increase and the insurance mandates together are expected to add at least $4.38 per hour in the minimum cost to employ a worker, a 53 percent increase, provided employers pay the penalty instead of providing coverage. If an employer opts to pay for coverage, then the combined cost could amount to as much as $5 more per hour, a nearly 60 percent increase.[114]

Given that the ACA may incentivize some workers to “choose”[115] to work less, then the Administration should recognize that policies like the ACA are making labor participation less attractive than time out of the workforce. This is in addition to the ACA’s effects on the cost to hire workers, which increases the difficulty of finding work. As aforementioned, the inability to find work or to bridge wage lapses due to remaining underemployed during one’s prime working years will have long lasting effects including lower wages, reduced lifetime earnings and preventing or delaying many Americans from gaining ground and advancing their well-being. Given that the labor market today looks very little like the labor market of decades past, it is time to renew the American Dream for workers today, especially young workers, whose choices and obstacles will resonate in the rate of economic growth.

Among the suggestions the *Report* offers, a few hold great potential to improving access to and participation in the labor market: expansion of apprenticeships and improving best practices for occupational licensing at the state level. The *Report* states,

> *…[the President] has proposed expanding apprenticeships and improving our workforce training systems by expanding career counseling and training in high-growth fields…the President has also proposed working with states to spread best practices for occupational licensing systems and to reduce unnecessary training or high fees that keep people from doing jobs that best utilize their talents.*[116]

Similarly, employers could consider expansion and improvement of cooperative education, which helps students connect what they are learning in college and universities with on-the-job application and experience that can lead to well-paying, quality jobs upon graduation. Many colleges have seen successful outcomes for their students, who receive a starting salary that can be nearly one-fifth higher than the national average for a new graduate.[117] In addition, recent JEC analysis maintains that states should reexamine occupational licensing laws to ensure they help the consumers they are meant to protect rather than serve the interests of incumbent groups, as "[o]ccupational licensing can often be a clumsy solution to ensure consumer health and safety; there are other ways, such as voluntary certification, to prioritize consumer health and safety without hurting entrepreneurship and job creation."[118] These suggestions, if implemented, would help to remove barriers between willing participants in the labor market and their potential employers or self-owned businesses.

The Effects of the Affordable Care Act on Labor

Notably, no chapter in this year's *Report* was reserved solely for the topic of health care; this has occurred only one other year since this President first took office. The ACA contains numerous provisions that penalize those who work and subsidize those who do not. The net result is some people will work less and others not at all. According to the CBO, the ACA will reduce employment by up to 2.5 million full-time-equivalent workers by 2024.[119] According to the *Report*, the labor force participation rate declined by 3.2 percentage points between 2007 and 2014. This decline is attributed to an aging population (1.7); the most recent recession (0.5); and an "unexplained" residual (0.9).[120] CBO's long-term projection exceeds the CEA's estimated residual because many of the ACA provisions have been modified or delayed. Therefore, their final impact is not yet apparent. Ultimately, even CBO's projection understates the long-term employment effects because it does not include every relevant provision.[121] There are four main categories of provisions in the law most likely to reduce the supply of labor: (1) insurance mandates, (2) Medicaid expansion, (3) marketplace exchange subsidies, (4) employer taxes.[122]

The ACA requires insurance plans covering dependent children to extend coverage until age 26. By allowing young adults to remain on their parents' policy, the ACA would reduce their incentive to work in order to obtain health insurance.[123] This provision took effect for plan years beginning on or after September 23, 2010. Further, the ACA mandates employers with 50 or more full-time-equivalent workers pay a $2,000 tax (per full-time worker) if they do not offer minimum essential coverage to at least 95 percent of full-time workers and at least one full-time worker receives a premium subsidy; or pay a $3,000 tax (per full-time worker with a subsidy) if they do offer minimum essential coverage and at least one full-time worker receives a premium subsidy.[124] These taxes will encourage employers to shift workers from full-time to part-time employment. These taxes were waived for all employers in 2014, and only apply to employers with 100 or more full-time-equivalent workers in 2015, so the full impact of this mandate will likely be seen in the coming years.[125]

With regard to Medicaid, the ACA provides additional federal funding to States that expand Medicaid eligibility to non-disabled, non-elderly adults with incomes up to 138 percent of the federal poverty level.[126] Thus, able-bodied, working-aged adults would no longer need to work or have dependent children in order to obtain health insurance. Many low-wage, full-time workers would have an incentive to reduce their hours of employment in order to obtain Medicaid coverage.[127] The Medicaid expansion took effect on January 1, 2014. As of January 2015, twenty-eight states (and DC) had expanded their Medicaid program to include adults without children.[128] States had the option to provide such coverage under prior law, but most chose not to do so. Under previous law, states were required to pay 100 percent of adult coverage, but under the ACA, the federal government pays 100 percent of the cost for three years, phasing down to 90 percent after that. The Government Accountability Office's simulations expect state spending on Medicaid to be the driver of increasing long-term fiscal pressures on state budgets over the next fifty years: "Specifically, state and local Medicaid expenditures and the cost of health care compensations for state and local government employees and retirees generally grow at a rate that exceeds GDP."[129]

In addition, the ACA provides subsidies that reduce insurance premiums and out-of-pocket expenses to persons with incomes up to 400 percent of the federal poverty level on the marketplace exchanges.[130] These subsidies are reduced and eventually eliminated as income goes up, thereby providing an incentive to work less in order to maximize these subsidies. The ACA requires individuals to obtain health insurance coverage or pay a tax equal to the greater of – $95 or 1 percent of income in 2014; $325 or 2 percent of income in 2015; or $695 or 2.5 percent of income in 2016 and beyond.[131] Some individuals may choose to pay the tax rather than purchase subsidized coverage, but this result becomes less likely as the taxes continue to rise in the future.

The effects of ACA-related taxes do not end with employers. The ACA imposes a series of new taxes on individual income and health care services. Individual income taxes include an additional 0.9 percent tax on wages and self-employment income over $200,000 (single) or $250,000 (married), and an additional 3.8 percent tax on investment income such as rent, interest, dividends and capital gains over $200,000 (single) or $250,000 (married). These taxes will directly reduce the incentive to work, save and invest, thereby reducing employment. According to one study, these taxes would reduce the number of full-time-equivalent jobs by 0.3 percent.[132]

Taxes on health care services include a 2.3 percent tax on medical device manufacturers and importers; a lump-sum tax on brand name pharmaceutical manufacturers and importers; and a lump-sum tax on health insurance premiums.[133] One recent study finds that the device tax has already reduced industry employment by 14,000, and reduced hiring by another 19,000; the study further suggests that as many as 132,000 more jobs would either be lost or not created as a result of the device tax.[134] Some companies abandoned new U.S. facilities altogether due to the device tax.[135] These taxes will most likely be passed along to consumers in the form of higher prices.[136] Higher prices for health care will reduce income and output in other sectors of the economy, thereby reducing employment.

The taxes and subsidies contained in the ACA will discourage full-time employment and encourage part-time employment and non-employment. As a result, U.S. national income and economic output will be reduced relative to the levels that would otherwise exist. These effects will only become more apparent over time as the ACA provisions are fully phased-in. There is insufficient data at this point in time to determine the effect of the ACA on full-time compared to part-time employment,[137] in part due to the delays of many components of the ACA, and it therefore seems too early for the Administration to claim that the Act is "not playing a meaningful role in recent trends in part-time work."[138] More broadly, economist Casey Mulligan estimates that, if fully implemented, by 2017, the ACA's long-term effect will translate to roughly three percent less in weekly employment, three percent fewer total hours worked, and two percent less in labor income.[139]

ENSURING OPPORTUNITIES ARE AVAILABLE FOR WORKING FAMILIES

In the *Report*, the Administration suggests that the lack of paid family leave, financial support for child care, and flexible work arrangements are lending to the problem of lower labor force participation. Many companies that have voluntarily adopted these policies tend to attract the best workers, thus benefiting society, increasing women's workforce participation, and yielding happier and more productive workers. Yet in a society where the median age for a woman to have her first child is a year younger than the median age for her first marriage,[140] family-friendly policies are about more than paid leave and child and elderly care. Federal policies that make it more complicated and more expensive to keep employees will not improve the labor market.

Working parents and caregivers are an essential part of our national economy. The entrance of women into the workforce has been extremely beneficial to the American economy and to the global economy at large. According to the latest BLS statistics, 73.0 million of America's 128.2 million, or 57.0 percent, of working-age women are working outside the home in 2014.[141]

Increasingly, women are contributing a larger share of earnings towards household incomes. Nearly 40 percent of married women earn more than their husbands.[142] Employers are taking note by increasing options and services to parents including flextime, shift flexibility, job sharing, on-site lactation rooms, childcare referral services, and adoption assistance. Telecommuting on an ad-hoc basis is now offered by 57 percent of employers.[143] From 2009 to

2014, the percentage of American organizations offering ad-hoc telecommuting rose from 45 percent to 54 percent.[144]

To blame family pressures for lower labor force participation is to turn family into a side issue. A young person strives to leave home and establish an independent life, seeks work that will fill much of the next forty years, and for some, meets a partner and raises children, expanding a single income into a family income, potentially offering more stability.

The recent recession delayed many young workers' launch into their adult journey. Almost 40 percent of recent college graduates are "underemployed," working in jobs that do not require a college degree,[145] and as previously mentioned, only 42 percent have jobs related to their field of undergraduate study.[146] Lacking career-oriented income and promotion prospects, paired with increasing student debt burdens, more millennials are delaying marriage, increasing the average age of marriage to a record 29 years old for men and 27 for women. Marriage may happen later for some millennials, but childbearing has not been delayed at the same rate. With the exception of college-educated women, the phenomenon known as the "Great Crossover" has witnessed the median age of 25.7 at first birth fall below the median age of 26.5 at first marriage.[147] Due in part to the weak economy, another symbol of adult achievement, homeownership, also lags. The trend in lower homeownership is closely tied to delayed marriage and parenthood, accounting for virtually all of the recent declines in homeownership, according to chief economist Jed Kolko at Trulia, Inc.[148] Nonetheless, a recent Federal Reserve Bank of New York survey indicated that most millennials very much want to be homeowners, but reasons cited for the delay included: inadequate savings or too much debt (56 percent), insufficient income (53 percent), and lack of good credit (41 percent).[149]

Meanwhile, millennials' parents (most commonly Baby Boomers) are approaching or have already entered their retirement years, counting on the payroll taxes that their working children will contribute to Social Security and Medicare, just as the previous generation had counted on young Baby Boomers' payroll taxes to sustain their retirements. They worry that they have saved too little to live comfortably and independently as they age, while the young workers wonder how they will take care of their immediate family's living and education requirements as well as what assistance their aging parents may need. Family matters, immensely. It provides the structure and sense of purpose that enhances lifetime success. Strong families thrive in an economy that provides opportunity to get ahead.

Unemployment, Regulations, and Opportunity

Before parents and caregivers can receive flexibility and benefits from their employers, they must be employed. With more than eight million workers unemployed and over seven million more out the labor force since the start of the recession, increasing employment opportunities should be a top priority. By February 2015, the number of people specifically between the ages of 16 and 64 who are not in the labor force increased by 7.4 million since the start of the recent recession; nearly six million (80 percent) of the net decline occurred since the start of the recovery.[150]

According to an April 2014 survey by the National Federation of Independent Business, half of small and independent businesses responded that it is a bad time to expand facilities, while only eight percent said it is a good time. When asked to cite their single biggest problem, taxes were the most frequently cited concern, followed by government requirements and red tape.[151]

As previously mentioned, the ACA is one policy that has contributed in part to higher taxes and regulations. While it has increased access to health insurance for many Americans, it has done so at the expense of employment opportunities. The Federal Reserve Bank of Philadelphia conducted a study in August 2014 examining the effects of the ACA. Their study found that over 18 percent of firms indicated that the number of workers they employ was lower because of the law; three percent indicated higher levels of workers. Similarly, 18 percent indicated that the proportion of part-time workers had increased. The ACA has also affected both the cost and the coverage of health care for many employees. With regards to health insurance benefit coverage, 41 percent of respondents said their coverage was unchanged, but 52 percent indicated changes to their offerings. The changes included higher deductibles (91 percent), higher worker-contributed premiums (88 percent), and higher out-of-pocket maximums (77 percent).[152]

Options for Flexibility in the Workplace

Congress and the White House should work together to develop policies that, rather than impose mandates, enable employees and employers to have the flexibility they need to find the best arrangement for all. As the home page of the White House Council on Women and Girls states, "[f]lexible workplace arrangements can mean flexibility in terms of when one works, where one works, or how much one works. Flexibility can play a key role in creating effective workplaces and in providing important benefits to employers, employees and the greater community."[153]

Bills have been introduced in the House and Senate that offer flexibility for workers that have earned compensatory time which can be used for sick leave and to care for personal matters. Workers should have the ability to choose options that work best for them. A strong economy is the best forum for family-friendly policies. Families are vital to our economy, and flexible, family-friendly employers will excel in recruiting and retaining talent.

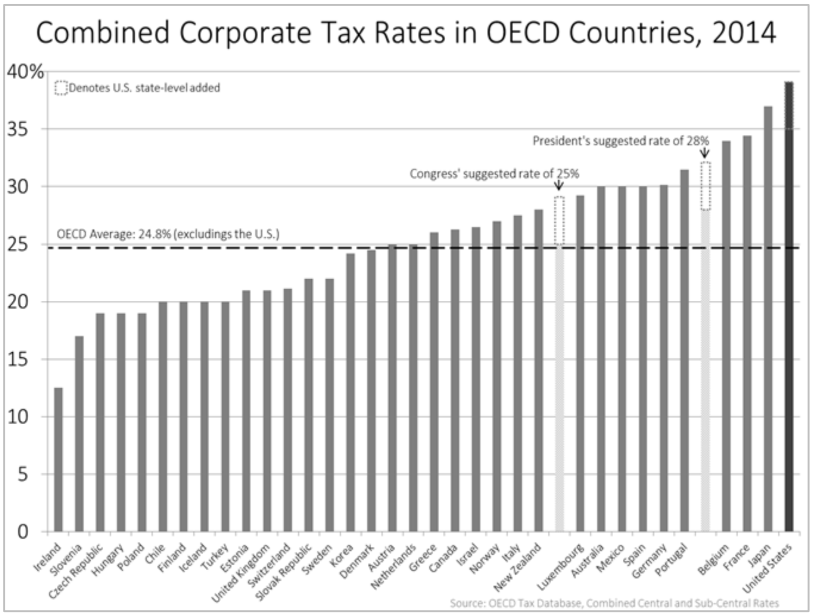
IDENTIFYING PRO-GROWTH TAX REFORM

The *Report* finds that the current loophole-ridden tax system needs reform for both individuals and businesses but focuses largely on business tax reform. On the individual side, the Administration's stated goals are rewarding work, increasing human capital, sharing economic gains widely, more simplicity and efficiency, and deficit reduction. The Administration's business tax reform objectives include increasing productivity, output, and living standards, as well as using certain revenues to finance infrastructure spending.

The Administration and Members of Congress in both parties agree that the U.S. tax system is broken, and that the U.S. corporate tax rate, which is the highest in the developed world, must be lowered in order for American businesses to compete in the global marketplace. There is also broad agreement that tax reform done well can increase economic growth. However, elements of the President's framework may not lead to the desired goals of productivity and other economic gains.

The Administration acknowledges that among the 34 advanced economies in the Organization for Economic Development and Cooperation (OECD), the U.S. corporate rate is the highest at 39.1 percent, including the 35 percent federal rate and state taxes.[154] However, the *Report* presents the data in such a way that justifies the Administration's proposed federal rate of 28 percent instead of the 25 percent rate supported by many in Congress. A corporate income tax rate of 25 percent (not including state taxes) would be closer to the average of other developed countries, while a 28 percent rate would still place the U.S. rate among the highest.

Figure 21



The *Report* abruptly shifts focus to a comparison involving only the G-7 countries, which tend to have higher tax rates than many other countries in the OECD. The CEA arrives at an average effective tax rate of 29.2 percent among the other G-7 economies, using a weighted average of rates from 2006 to 2009, and claims the U.S. effective rate is below that average at 27.7 percent.[155] First, using this timeframe ignores the statutory rate reductions that have occurred among these countries since 2006 and even since 2009, as Table 2 illustrates.

Table 2. Statutory Rate Reductions

G-7 Countries	2006 Rates	2009 Rates	2015 Rates
United States	39.3%	39.1%	39.1%
Japan	39.5%	39.5%	37.0%
Germany	38.9%	30.2%	30.2%
France	34.4%	34.4%	34.4%
United Kingdom	30.0%	28.0%	20.0%
Italy	33.0%	27.5%	27.5%
Canada	33.9%	31.0%	26.3%

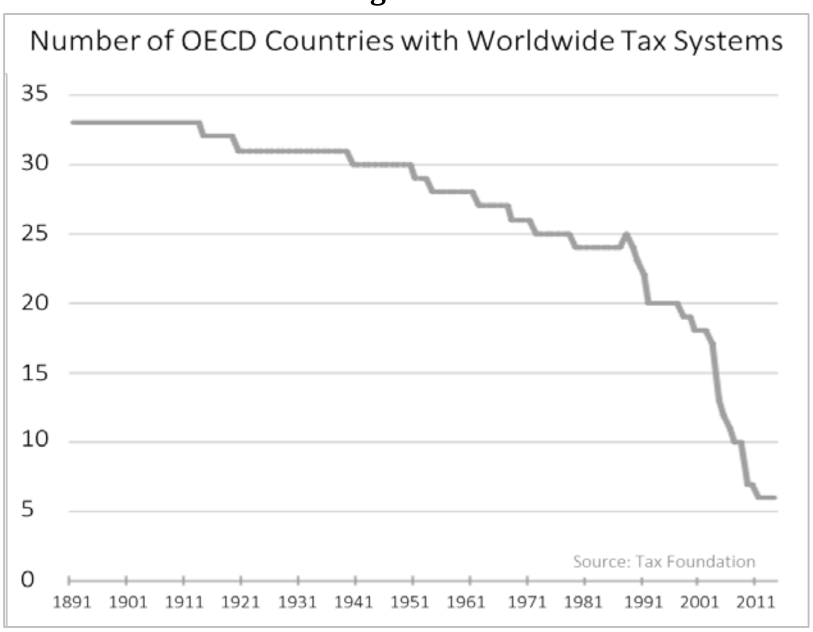
Source: OECD

Using a different timeframe, the *Report* also claims that the United States has a marginal effective corporate tax rate of 23.9 percent, only slightly above the CEA's calculated weighted average of 20.6 percent among other G-7 countries.[156] However, other studies show a very different picture of the competitiveness of U.S. effective tax rates and marginal effective tax rates. For example, research published by the American Enterprise Institute found that both the effective and marginal effective tax rates in the United States are far above those of the United States' OECD competitors.[157] A recent Tax Foundation study found that the United States has the second highest marginal effective tax rate of 95 different countries.[158] Additional research by the Tax Foundation examined nine different studies and concluded that effective tax rates in the United States are in the highest quarter of countries in the world.[159] Regardless of effective and marginal effective tax rates, the United States' stiffest competition for corporate headquarters and business opportunities around the world is from countries with significantly lower statutory tax rates, as well as territorial tax systems.

Territorial versus Worldwide Tax Systems

In its discussion comparing taxes among the G-7 countries, the *Report* fails to mention that the United States is the only country in the G-7 without a territorial tax system. In addition, 28 of the other 33 countries in the OECD have territorial tax systems. Territorial systems allow active income earned overseas to be brought back to the home country with little or no tax. In contrast, the United States is an outlier (see Figure 22 below) with a worldwide system, which subjects all income of companies to U.S. tax, regardless of where in the world it is earned. Because the tax is triggered when the profits are brought back to the United States, companies have a strong incentive to leave earnings overseas, which ends up reducing the levels of investment by these companies in the United States.

Figure 22



In recent testimony before the Senate Finance Committee that echoed past testimony before the JEC, Dr. Laura D'Andrea Tyson, former Chair of the CEA under President Clinton, argued that the United States should move to a territorial system, allowing U.S. multinationals to compete more effectively in foreign markets that comprise roughly 80 percent of the worldwide purchasing power:

> *As part of comprehensive corporate tax reform, the United States should adopt a territorial approach to taxing the foreign earnings of U.S. multinational companies. Such a system would provide a level playing field that supports U.S. companies' global competitiveness. It would also eliminate the rising costs associated with locked out earnings and boost their repatriation, with significant benefits for U.S. output and employment.*[160]

However, the Administration instead chose international tax reform that it describes as "hybrid," in which a 19 percent minimum tax would be imposed on all foreign earnings of U.S. companies.[161]

In her recent testimony, Dr. Tyson argued forcefully against such an approach, which she pointed out would amount to an effective rate of at least 22.4 percent for American companies competing in foreign markets due to the minimum tax that applies until 85 percent of the foreign effective tax rate exceeds 19 percent:

> *… Adoption of a minimum tax of this magnitude and structured in this manner would harm the global competitiveness of American companies that earn a large share of their income in global markets. A significant share of corporate income earned by U.S. multinationals in Europe would likely be subject to the minimum tax. Sixteen of the*

> *28 EU countries had statutory tax rates below 22.4 percent in 2014, and effective tax rates are likely to be still lower. Further, while the competitors of American companies could fully avail themselves of the benefits of the current and planned patent boxes in 12 EU countries with tax rates in the 5 to 15 percent range, American companies would pay a non-competitive rate as high as 22.4 percent on such income.*
>
> *In such situations, U.S. companies would be at a competitive disadvantage in acquiring foreign companies with desirable intellectual property. Instead, as a result of their significant global tax disadvantage, existing U.S. companies with such property would become attractive targets for foreign acquirers and would have even stronger incentives to move their headquarters, their R&D and their future intellectual property to lower-tax foreign locations with territorial systems. And start-up companies based on innovations and intellectual property developed in the US would have an incentive to incorporate in such locations.*[162]

As Dr. Tyson demonstrated, the minimum tax would do little to improve the competitive position of American companies and could drive more corporate headquarters outside the United States.

Corporate Inversions

The *Report* discussed the troubling trend of U.S. companies merging with foreign companies and moving their headquarters to the lower-taxed jurisdiction, known as "corporate inversions."[163] However, the Administration's proposed legislative solution to corporate inversions is deeply flawed. Under current law, an "inverted" company is taxed as a U.S. corporation if 80 percent or more of the shareholder ownership does not change after the inversion, unless there are "substantial business activities" in the foreign jurisdiction.[164]

The Administration's proposal would also lower the 80 percent threshold of shareholder ownership to 50 percent. Requiring the American share of the business to be smaller than the foreign share would create several unintended consequences. This would encourage larger U.S. companies to splinter into smaller spin-offs that would then be acquired by more dominant foreign competitors. The President's framework would give a larger advantage to foreign competitors than already exists. While foreign competitors could be nimble with their investments, U.S. companies would be at a greater competitive disadvantage and become takeover targets for larger foreign companies. In addition to the 50 percent of shareholder ownership threshold, the Administration would also tax companies as U.S. corporations if the "management and control" of the company is primarily in the United States. This test would chase high-quality management jobs outside the United States, as domestic and foreign companies would respond by moving jobs. This concern was echoed by Senator Charles Schumer when he spoke at a Senate Finance Committee hearing last year about a bill introduced by Senator Carl Levin that would implement the Administration's proposal:

> *I do have concerns about the 'management and control' part of the Levin proposal because we want to keep jobs here at home, and the management and control proposal may encourage jobs to grow abroad.*[165]

In addition, while the Administration's plan is aimed at trapping American-headquartered companies in the U.S. tax system, the proposal is likely to discourage new companies from choosing American headquarters. Every day, entrepreneurs launch new companies and decide where to place the headquarters. It would be illogical to select a location that attempts to trap its businesses in an uncompetitive tax system indefinitely.

Like the United States, Great Britain was also losing major companies, but responded by lowering its corporate tax rate and moving to a competitive international tax system. As a result, companies are returning to Great Britain and new companies are incorporating there.[166]

Using Tax Increases for Spending Programs

The President's proposed framework would impose a 14 percent tax on existing earnings of American companies invested overseas, known as "deemed repatriation." However, rather than using this revenue to transition to a more competitive international tax system, the Administration would use these revenues solely to pay for infrastructure spending. While the tax reform plan proposed by then-Ways and Means Chairman, Representative Dave Camp, in the last Congress would have used deemed repatriation for the Highway Trust Fund as well, these revenues were also intended to transition to a more competitive international tax system. The President's proposed tax is substantially higher and does not contribute to American companies' competitiveness in the world marketplace.

Pass-Through Businesses

While the Administration has proposed lower tax rates for C corporations, no similar rate reduction is offered to the 95 percent[167] of businesses that pay taxes at the individual level rather than corporate level, known as pass-through businesses. The vast majority of small businesses are organized as pass-throughs, and as such, a lower corporate rate will be of little help. When President Obama took office, the top federal tax rate paid by small businesses was identical to the top rate paid by large corporations, 35 percent. However, because of ACA taxes and the President's insistence on raising the top individual rate and imposing other penalties, the top rate paid by small businesses is now 44.6 percent.[168]

The President's framework would put small businesses in an even worse position. If certain business tax preferences are eliminated, and the proceeds used only to lower the corporate rate, then many small businesses will face even higher effective tax rates. The *Report* attempts to explain that part of this disparity occurs because C corporations face a double tax, at both the corporate and shareholder level, while pass-throughs generally pay only a single layer of tax. However, as the *Report* discusses, the CBO has determined that even with only a single level of tax, pass-through businesses only enjoy a four percent lower effective tax rate than C corporations.[169]

Under the President's framework, C corporations would experience a rate reduction from 35 percent to 28 percent, while small businesses would be taxed at a top rate of 44.6 percent and lose many of the tax discounts that would lower their effective rate. The *Report* glosses over this disparate treatment by offering small businesses a change in accounting rules and permanent expensing for equipment purchases.[170] While permanent expensing would be a welcome development, it would not help small businesses that are not planning to make equipment purchases, or businesses that do not qualify for this relief because they had to make very large equipment purchases well above and beyond the cap for expensing.

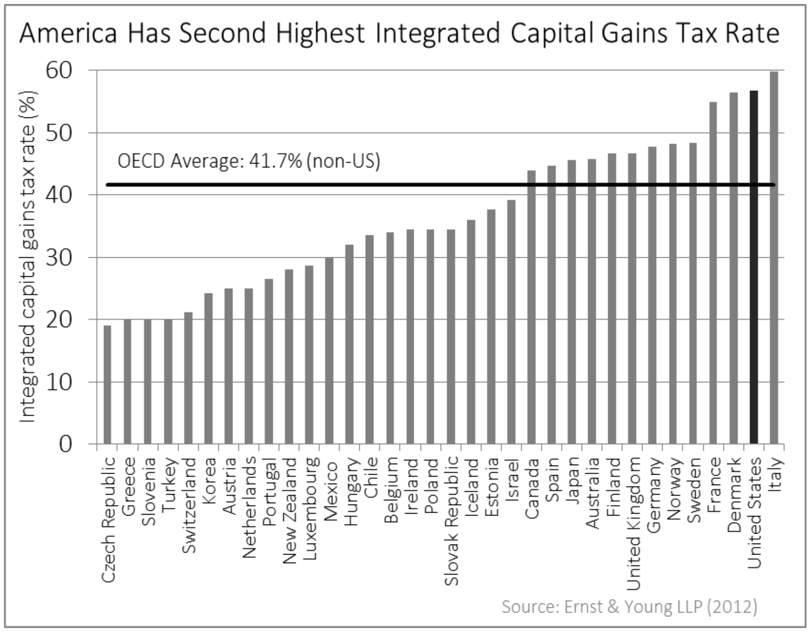
Damage to Capital Stock

The *Report* focuses heavily on the potential of tax reform to boost labor productivity, a component of which is “the amount of capital workers have at their disposal…”[171] Even the total factor productivity that the *Report* claims has been missing during periods of lower productivity has a capital component.[172] As the *Report* explains, “Improvements in the quantity and quality of investment increase productivity and, in doing so, increase American living standards.”[173] It is puzzling, therefore, that the Administration’s tax plan proposes to increase the capital gains tax rate and impose a new tax on capital when an owner passes away.

The Administration proposes to raise the top tax rate on capital gains to 28 percent. Under President Obama, the top rate on capital gains has already risen by almost 60 percent, from 15 percent to 23.8 percent when ACA taxes are included. Yet even this dramatic increase understates the full effect because capital income is often taxed at the corporate level as well.

When both corporate and individual taxes are included, the Administration’s tax increases that have already taken place have given America the second highest integrated capital gains rate in the OECD at 56.7 percent (Figure 23).[174] Without other reforms, an additional hike of 4.2 percentage points to 28 percent would give the United States the dubious distinction of taxing capital gains at the highest rate in the developed world.

Figure 23



As discussed above, capital gains are already subject to multiple layers of taxation. In addition, a lower rate on capital gains at the individual level mitigates the effects of inflation which can erode the actual economic gain from selling an asset.

America has experimented with high capital gains rates before, and it was a failure. After the capital gains tax rose to 28 percent in 1987, sales of capital assets sank and remained depressed until Congress lowered the capital gains rate to 20 percent in 1997.[175] Following this cut, capital gains revenues ballooned and helped balance the budget.[176] In addition, the Tax Foundation analyzed the economic effects of the Administration's proposed capital gains tax hike and found that it would have a damaging effect on the goals the Administration hopes to achieve through tax reform. In exchange for a static revenue increase of $19.9 billion, a total of $141.8 billion would be lost from GDP, wages would decline, almost 135,000 full-time equivalent jobs would be destroyed, and the capital stock would decline by 2.29 percent. Additionally, due to the damage to the economy, revenues would actually decline on a dynamic basis by $11.8 billion.[177]

The Administration's other attack on capital comes in the form of a new inheritance tax. In addition to increasing the traditional estate tax, the President aims to create a new death tax by eliminating the "step up in basis" that occurs with capital assets when an owner passes away. Stepped-up basis allows heirs to inherit assets with a basis equal to its fair market value at the time of their loved one's death. This treatment has eliminated a great deal of complexity, as it prevents heirs from having to track the basis in a variety of assets, some of which may have been purchased generations ago.

The Administration proposes to apply "carryover basis" to these assets so that heirs are immediately taxed on any capital gain that occurred while their loved one was living. This is unlike the standard treatment of capital gains, in which taxpayers pay a tax only when the asset is sold. Instead, the owner's death itself would become the taxable event, even if the heirs do not plan to sell the assets. In addition, the capital gains tax would be the Administration's higher proposed rate of 28 percent. The Administration's proposal applies to assets with capital gains of over $100,000 for single taxpayers and $200,000 for married couples. And while the Administration proposes to exempt certain kinds of tangible personal property, no similar exemptions are allowed for business property, including plants, equipment, and land. The Administration claims to provide protection for small businesses with assets worth less than $1 million, but this would only be a delay of the tax, not protection from the tax.

The Administration derides the stepped-up basis treatment of assets at death as the "trust fund loophole," but this ignores the damage the proposal would do to business assets, which include the capital stock that is essential for labor productivity and economic growth. According to data published by the nonpartisan Joint Committee on Taxation, a very large number of businesses own assets within the range targeted by the Administration's tax increase. Almost 793,000 C corporations have assets valued at greater than $100,000, as do over 1,446,000 S corporations, over 1,700,000 partnerships, and over 2,136,000 sole proprietorships. Regarding the million-dollar threshold under which small businesses could qualify for a delay in the tax, hundreds of thousands of businesses exceed this threshold. This includes almost 239,000 C corporations, over 330,000 S corporations, over 773,000 partnerships, and almost 116,000 sole proprietorships.[178] The proposal is also likely to hit a large number of family farms. According to the U.S. Department of Agriculture, the average size of household assets of family farmers is $1,046,283.[179] Much of this is made up of illiquid assets such as land and equipment, not cash. As a result, an immediate 28 percent tax would force farm families to sell land, farm machinery, and livestock in order to pay the tax.

Taken together, the President's two tax increases on capital will have a damaging effect on the capital stock that is a necessary component of labor productivity and economic growth.

ENERGY PRODUCTION & OPPORTUNITIES IN AMERICA

The *Report* states that the United States is experiencing an energy revolution affecting consumption, energy independence, and trade, placing our nation in the position of global leader in climate change. The *Report* acknowledges the importance of domestic oil and gas supply, and in its discussion of energy the *Report* more fully acknowledges the game-changing advancement in drilling technology that reversed declines in the domestic production of natural gas and crude oil. The *Report* also acknowledges America's lessened oil import dependency and improved national energy security, the oil and gas industry's job creation, and the stimulative effect it has had on the economy.

However, the *Report* fails to mention the statutory prohibition against crude oil exports that is preventing export of light, sweet shale oil that domestic refineries cannot fully utilize at present. The *Report* also fails to mention that the United States has been running a trade surplus in refined petroleum products. Exports of crude oil and refined petroleum products can garner some of the same benefits, including geopolitical ones that the *Report* enumerates for natural gas exports. Acknowledgment of the positive contributions that shale oil and gas are making is not enough; North American energy independence is a realistic objective, but the Administration must let the energy revolution in America proceed unimpeded to make energy independence possible.

Energy independence for North America, in the sense that it can supply its own needs if the international price gets too high, has become an achievable objective, and government policy should facilitate reaching that objective. The *Report* fails to recognize the historic opportunity in oil and gas and the implications it should have for American energy policy. The *Report* describes the benefits of energy security,[180] but discussion beyond railroad expansion is lacking; there is no mention of Mexico opening its oil fields to foreign investment, neither of Canadian oil sands, nor of the Keystone pipeline or any other pipeline investment.

The *Report* touts the overall increase in oil and gas production, but fails to mention that this ongoing energy revolution has occurred mainly on private lands and not on federal lands. In fact, oil production on federal lands actually fell by 6 percent between 2009 and 2013.[181] During that same period, production on state and private lands jumped by 61 percent, or 2.1 million barrels of oil per day. In 2010, around 64 percent of total U.S. crude oil production occurred on private land. Today, that number is closer to 80 to 85 percent.[182]

Oil and gas development on federal land has lagged due to heavy regulation and the Administration's refusal to open federal acreage for oil and gas development. State agencies handle permitting on state and private lands and process applications in a fraction of the time that it takes at the federal level. In 2011, it took an average of 307 days to process an Application of Permit to Drill on federal land.[183] In contrast, some state agencies can process a permit as quickly as 10 business days.[184] As for access to new development, the Administration has made only about 12 percent available of the total 1.7 billion acres of the Outer Continental Shelf under the current five-year lease plan[185] and cordoned off upwards of 166 million acres of onshore federal lands.

These offshore and onshore federal lands hold the potential for greatly increased production if only the Administration would allow it. The Arctic National Wildlife Refuge, for example, is believed to contain about 10.4 billion barrels of technically recoverable oil. Rather than developing these resources in an environmentally sound manner, the Administration recently announced its intention to lock up the land by designating it as wilderness.[186] As a result, millions of acres of land and billions of barrels of recoverable oil will become off-limits to legitimate, environmentally-safe development.

Renewable Energy

The majority of renewable energy technologies are still not competitive despite the *Report's* emphasis on the role of renewables; the energy revolution is not yet "encompassing renewables,"[187] as it claims. Alternative energy is not sufficient to replace traditional energy sources, and the *Report* acknowledges more research and development is needed. Current clean technology is still not competitive and consumes large subsidies—the *Report* itself cites federal construction subsidies of 30 percent of the project's cost for wind and solar facilities.[188] The renewable supply has failed to realize significant economies of scale, and has created negative externalities, such as dead birds at wind and solar farms. The *Report* tries to equate job creation in the renewable sector with that of the oil and gas industry,[189] but the concept of "green" jobs has been derided for its overly expansive definition,[190] and jobs created with transfers from the productive sector of the economy do not "similarly" contribute to economic growth.

The market share of alternative energy and the significance of mandated conservation measures in lowering oil consumption are also overstated. The *Report* focuses on percentage increases from a small base and avoids stating the share of total energy that wind (4.13 percent) and solar (0.23 percent) actually comprise.[191] In the *Report*, Figure 6-6 shows biofuel consumption in billions of gallons per year, whereas Figure 6-2a shows oil consumption in millions of barrels per day.[192] If Figure 6-6 were converted from billions of gallons per year to millions of barrels per day with biofuel measured alongside crude oil, biofuel's contribution would not be visible.

The *Report* attributes only 35 percent of the U.S. oil import reduction to increased domestic supply based on an Energy Information Administration (EIA) forecast from 2006.[193] However, leaving aside the methodology, the *Report* omits data from 2014 when the rate of domestic production averaged 8.5 million barrels per day based on EIA data through November 2014, and exceeded 9 million barrels per day in October and November of 2014.[194] With respect to reductions in U.S. oil consumption, the *Report* does not mention the "rebound" effect that the Corporate Average Fuel Economy (CAFE) standards and subsidized conservation measures have on consumption. Improved gas mileage, for example, reduces the cost of travel, inducing people to drive more and buy larger, heavier vehicles.

Climate Change

The *Report* lists a broad range of initiatives to reduce greenhouse gas (GHG) emissions, but lacks economic analysis in its description of the Administration's *Climate Action Plan*. With regard to the Administration's 2009 pledge in Copenhagen to cut GHG emissions by 17 percent below the 2005 level by 2020, the *Report* states, "the United States is expected to meet this target," and states that in November 2014, "the United States announced a new goal to reduce emissions 26 to 28 percent below 2005 levels by 2025."[195] The *Report* extensively discusses the damage from delaying actions to mitigate climate change, but if America meets the 17 percent target as the *Report* expects, then the country appears to be on schedule. If America achieves a 26 percent reduction by 2025, it is unclear how the Administration would characterize meeting that goal.

Furthermore, the *Report* does not discuss what actions reduce global warming and how much such actions cost. A recent study conducted by IHS Energy and the U.S. Chamber of Commerce estimates that, between now and 2030, the Environmental Protection Agency's (EPA) carbon regulations will exact an annual cost to the U.S. economy of $51 billion in GDP and an average of 224,000 fewer jobs.[196] These regulations will force U.S. consumers to pay $289 billion more for electricity and will lower household disposable income by $586 billion through 2030.[197] Incredibly, according to the Chamber study, such high costs will yield only a paltry 1.8 percent reduction in overall carbon emissions.[198] Meanwhile, U.S. household incomes have not kept pace with the rising cost of energy. Another recent study found that household energy costs increased by nine percent from 2001 to 2012.[199] The Administration's carbon regulations serve as yet another harmful regressive tax on poor and middle-income families. The JEC Report on the *2013 Economic Report of the President* also made this observation, stating:

> *The Council treats Administration policies as self-justified by their professed intent to counteract global warming and says as much in the conclusion of chapter 6. It provides no basis for determining what polices are more or less effective among those adopted or for deciding what other polices may be better. The chapter promoting the massive undertaking of managing the global climate does not address the impact on the economy of doing so.*[200]

It would appear that the mere intent to reduce climate change is sufficient justification for action upon it, however little it may accomplish. For example, the President has refused to approve the Keystone XL pipeline for years in part because of the project's alleged effect on GHG emissions. Yet the Administration has failed to provide any demonstration of the extent of such emissions, and the U.S. State Department has found that the alternatives to Keystone would cause much larger increases in GHGs than the Keystone XL pipeline. Yet despite bipartisan support, the President vetoed legislation to begin construction of the Keystone XL pipeline, further delaying this important energy project.

The desire for cleaner energy does not have to make the government averse to better ways of supplying conventional forms of energy. The *Report* states that "the President will continue his aggressive All-of-the-Above strategy for a cleaner energy future."[201] The strategy's three elements are, in order: (1) economic growth and job creation, (2) energy security, and (3) addressing the challenges of global climate change. The *Report* states further:

> *A central challenge of energy and environmental policy is to find a responsible path that balances the economic benefits of low-cost energy with the social and environmental costs to future generations associated with conventional energy production. Addressing these challenges is a central part of the President's All-of-the-Above Energy Strategy, which several recent policy achievements demonstrate.*[202]

Yet the *Report* goes on to describe U.S. pledges specific to the reduction in CO_2 emissions in 2009 at the Copenhagen Conference on Climate Change and in November 2014 with China. The *Report* uses the term "All-of-the-Above" several times, but the Administration's supposed "All-of-the-Above" strategy is overwhelmingly hostile to America's single largest energy source: coal.[203]

Regulatory Issues

The Administration has launched an aggressive assault on coal and the low-cost electricity it provides. In addition to the EPA's harmful carbon regulations, the Administration has unleashed more than a dozen rules aimed at eliminating coal-fired power plants in the United States. Beginning this year, coal plants will need to comply with the Mercury and Air Toxics Standards (MATS), which EPA estimates will cost $9.6 billion;[204] the Cross-State Air Pollution rule (CSAPR) that will cost $2.4 billion per year[205]; and the 316(b) Cooling Water Intake Standards that will cost $297 million per year.[206] Not least, the EPA's proposed ground-level ozone standard threatens to become the most expensive regulation ever imposed on the U.S. manufacturing industry.[207]

Taken individually, each burdensome regulation increases costs and slows economic growth. Taken collectively, these regulations hang as a giant albatross around the necks of working people and American businesses large and small. This "War on Coal" that the Administration seems intent on pursuing has led and will continue to lead to more plant closures and lost jobs. A recent study prepared by NERA Economic Consulting estimated that implementation of the MATS and CSAPR rules would result in a loss of over 200,000 jobs, while the EPA's ozone rule could potentially cost over 600,000 jobs.[208] Increased electricity bills drive up costs for businesses – particularly manufacturers, whose first or second largest input cost is often electricity. Higher costs mean fewer sales and a reduced capacity to hire new workers.

An historic opportunity has opened up for America to become independent of overseas crude oil and to be a major supplier of oil, natural gas, and petroleum products to nations that remain concerned for their supplies from unreliable sources.

AMERICA'S PLACE IN THE GLOBAL ECONOMY

In the international theatre, the *Report* discusses the history and benefits of multilateral trade liberalization. The *Report* discusses the benefits of free trade at length, but it remains imperative that the President work with Congress in a bipartisan manner to secure Trade Promotion Authority to negotiate the TPP, T-TIP, and other FTAs successfully to completion.

The *Report* discusses the success of the multilateral system in lowering the average tariff in advanced countries from 40 percent in 1947 to three percent in 2012 and the progress in reducing non-tariff barriers.[209] In the last two decades, developing and least-developed countries have joined advanced countries in liberalizing trade.[210] As a result, global real exports of goods have grown at nearly triple the pace of global real output since 1960,[211] and trade in services is growing rapidly as well. In 2014, U.S. services exports were about $710 billion, or 30 percent of total U.S. exports.[212]

Free-Trade Agreements

Currently, free-trade agreements (FTAs) cover 40 percent of total U.S. trade in goods.[213] FTAs expand trade with FTA-partners, but do not have significant trade-diversion effects with non-FTA partners as some critics allege. Looking at GDP-weighted averages of trade across all FTA partners and non-partners suggests that, on average, trade in both country groups was growing around three percent per year before the enactment of the agreements. After these FTAs went into force, trade grew at about 10 percent per year with FTA partners, and also grew at about six percent per year with non-partners.[214]

Currently, the United States is negotiating two major FTAs—the Trans-Pacific Partnership (TPP), which would encompass 12 countries around the Asia-Pacific, and the Trans-Atlantic Trade and Investment Partnership (T-TIP) between the United States and 28 Member-States of the European Union (EU). If these FTAs come to fruition, the percentage of U.S. exports in goods covered by FTAs would expand to 66 percent.[215] The *Report* emphasizes these new FTAs would be "values-driven" by including core environmental and labor standards that would be enforceable through trade sanctions.[216]

The TPP would add five countries—Brunei Darussalam, Japan, Malaysia, New Zealand, and Vietnam—to the existing six Pacific countries with which the United States currently has FTAs—Australia, Canada, Chile, Mexico, Peru, and Singapore. TPP partners account for 37 percent of world GDP, 11 percent of the world population, and 23 percent of world exports of goods and services.[217] The United States and EU already have the world's largest bilateral trading partnership, accounting for nearly one-half of world GDP and 42 percent of world exports of goods and services. The T-TIP would focus on removing non-tariff barriers and harmonizing regulations.[218]

In his 2010 *State of the Union* address, President Obama introduced a National Export Initiative (NEI) with the goal of doubling U.S. exports by the end of 2014. Indeed, the 2013 *Economic Report of the President* emphasized this initiative as a central strategy for stimulating economic growth in the wake of the global financial crises. Unfortunately, the failure to date to secure TPA is at least partially responsible for the delay in concluding the new trade agreements that would increase trade and help meet the NEI goal of doubling exports. Any mention of the President's NEI is noticeably absent from the 2015 ERP.

It is imperative that the President obtain TPA to negotiate the TPP, T-TIP, and other FTAs successfully to conclusion. The Constitution stipulates a strong role for Congress in approving trade agreements. TPA will provide the Administration with negotiating parameters to ensure that any new trade agreement can engender congressional support and ultimate approval. Both the President and Republicans have voiced strong support for approving TPA to facilitate these important trade negotiations. However, the President must do his part to generate congressional support to enact TPA quickly.

The TPP, in particular, has a strong potential to provide benefits for the U.S. economy. In 2013, upwards of 44 percent of U.S. exports went to TPP countries, for a total of $698 billion. A recent study conducted by the Business Roundtable estimated that trade with TPP countries supports 15.3 million American jobs, and over 17,000 TPP companies have investments in the United States.[219] The TPP would open new markets for U.S. exporters in several countries that do not currently share an FTA with the United States. The TPP would reduce tariffs and other trade barriers in these markets and increase U.S. exports.

Skill-Bias and Income Inequality

The *Report* responds to critics of free trade by citing economic research that technological change has played a more important role than trade liberalization in increasing wage inequality in both the United States and abroad. Information technology has changed relative demand for workers with different skill levels: "…the education skill premium increased in a wide range of countries during this time, including many relative poor countries."[220] The *Report* actually understates the findings of most economists. In 2007, the JEC documented the phenomenon of skill-biased technological change (SBTC) and its effects on the education skill premium and income inequality:

> *As the real cost of acquiring and using information technology (IT) assets plummeted, U.S. firms substituted computers and computer-driven machinery for workers performing routine tasks. Simultaneously, computerization improved the availability, accuracy and timeliness of information, increasing the marginal productivity of highly skilled, college-educated workers performing cognitive non-routine tasks. Because SBTC concurrently dampened the demand for routine labor and stimulated the demand for cognitive non-routine labor, SBTC increased the real earnings of college graduates relative to less educated workers.*[221]

The JEC report found that SBTC alone explained a majority of the increase in income inequality among U.S. households over three decades, and additionally, found that SBTC is also driving the increase in income inequality abroad. In fact, income inequality is increasing more rapidly in large developing countries such as China and India than in advanced countries such as the United States.[222] In contrast with SBTC, trade liberalization and changes in labor market institutions (such as reduced unionization) have played, at most, a very minor role in the increase in income inequality in the United States. In addition, the best way to reduce pollution, especially in developing and least-developed countries, is to increase their real income per capita. Globalization and trade liberalization are, in fact, indispensable tools in improving environmental quality.

The Global Financial Crisis and Monetary Policy

The *Report* points out financial flows have increased even faster than trade flows since 1985, and expansion of financial flows have coincided with increased financialization within countries and the expansion of banking services across countries.[223] The *Report* discusses different types of financial flows—foreign direct investment, foreign portfolio investment, and bank lending. The *Report* asserts that the international financial system is biased toward debt for several reasons: (1) deposit insurance and implicit bailout guarantees; (2) tax laws that favor debt over equity financing; (3) underdeveloped equity markets in some developing and least-developed countries; and (4) national policies to promote home ownership that effectively subsidize mortgage lending.[224]

The *Report* claims that: (1) global bias toward debt, (2) excessive leverage of banks and other financial institutions, (3) increased importance of financial activity outside the regulated banking sector ("shadow banks"), (4) lack of transparency, and (5) lax financial regulations were key contributors to the severity of the recent financial crisis.[225] Furthermore, the *Report* cites the enactment of Dodd-Frank in 2010 and increased cooperation among global bank regulators through implementation of Basel III as good steps to prevent future financial crises.

The *Report* focuses entirely on microeconomic causes of the financial crisis of 2008, while ignoring its macroeconomic causes. Regulatory lapses alone cannot inflate large asset bubbles; that requires an excessively loose monetary policy. During the 1980s and 1990s, the Federal Reserve moved from discretionary monetary policy to an implicitly rules-based approach that became known as the Taylor Rule (named after economist John Taylor). Moving toward this increasingly rules-based approach brought price inflation under control and supported two long and strong output expansions during the "Great Moderation." Following the brief recession, the Federal Reserve maintained an overly accommodative monetary policy between 2002 and the middle of 2006 that kept the target rate for federal funds too low for too long (as compared with the Taylor rule). Taylor compared the actual federal funds rate during this period with a counterfactual federal funds rate based on Taylor-rule calculations. He found that "a higher federal funds rate path (consistent with the Taylor rule) would have avoided much of the housing boom."[226]

Moreover, because the U.S. dollar remains the world's reserve currency and most commodities and international transactions are priced in U.S. dollars, an excessively accommodative monetary policy by the Federal Reserve creates unpleasant choices for other central banks—to either (1) maintain an excessively easy monetary policy to keep their currency from appreciating against the U.S. dollar, while risking price inflation, an unsustainable asset bubble, financial instability, and subsequent recession; or (2) pursue the right monetary policy for long-term growth, price stability, and financial stability, while allowing their currency to appreciate against the U.S. dollar. The latter choice is often opposed by export-oriented domestic industries that claim an appreciating currency hurts exports.

The *Report* also fails to acknowledge monetary policy errors can lead to wildly fluctuating exchange rates that undermine political support for free trade both here and abroad. There are several elements missing from the *Report's* discussion on monetary policy: (1) the need for the Federal Reserve to extract itself from its current highly accommodative monetary policy stance and normalize monetary policy in an orderly and predictable way; (2) the importance of a return to a rules-based monetary policy to prevent such destructive asset bubbles in the future; and (3) the role of the Federal Reserve, other federal regulatory agencies, and government-sponsored housing finance enterprises (Fannie Mae and Freddie Mac) had in undermining sound underwriting standards for home mortgage loans and directing the bubble into housing.

In brief, the *Community Reinvestment Act* (CRA) was enacted in 1977. The CRA requires banks and other depository institutions to make loans in the entire area in which they took deposits. Banks and other depository institutions that did not receive a sufficiently high CRA-rating by their primary federal regulator could see their federal regulatory applications denied. The *Home Mortgage Disclosure Act* (HMDA) was enacted in 1975 and amended in 1989. HMDA requires residential mortgage lenders to disclose detailed information about mortgage applicants and borrowers to identify possible discriminatory practices and enforce antidiscrimination laws.

In 1992, economists at the Federal Reserve Bank of Boston used a statistical analysis of the HMDA data to allege discrimination in housing finance against minorities in the Boston area. Many economists subsequently found problems with both the data and analytical techniques used in the Boston Fed study and questioned its conclusion of discrimination. Whether the Boston Fed study was valid or not, it had a significant political effect. Congress directed the Secretary of Housing and Urban Development to impose "affordable housing standards" on Fannie Mae and Freddie Mac through the *Federal Housing Enterprises Financial Safety and Soundness Act* (FHEFSSA). FHEFSSA set quotes for the purchase of residential mortgage loans to moderate- and low-income borrowers by Fannie Mae and Freddie Mac. These quotas were increased in 2000 and again in 2004.

As a result of these policies, there was a steady weakening of residential mortgage loan underwriting standards from the middle 1990s until the onset of the financial crisis of 2008. A report written in 2002 for the Fannie Mae Foundation frankly describes how these policies encouraged banks and other mortgage lenders to offer risky "innovative products" to moderate- and low-income home buyers, knowing that Fannie Mae and Freddie Mac would take these loans off their books and place them into mortgage-backed securities:

> *The result has been a wider variety of innovative mortgage products. The GSEs have introduced a new generation of affordable, flexible, and targeted mortgages, thereby fundamentally altering the terms upon which mortgage credit was offered in the United States from the 1960s through the 1980s. Moreover, these secondary market innovations have proceeded in tandem with shifts in the primary markets: depository institutions, spurred by the threat of CRA challenges and the lure of significant profit potential in underserved markets, have pioneered flexible mortgage products. For years, depositories held these products in portfolios when their underwriting guidelines exceeded benchmarks set by the GSEs. Current shifts in government policy, GSE acquisition criteria, and the primary market have fostered greater integration of capital and lending markets.*[227]

Comparatively, in the analysis of financial services regulation, the *Report* extols the benefit of Dodd-Frank. With only 60 percent of the law's regulations being enforced four-and-one-half years after enactment,[228] claiming that this law has solved the root cause of financial crisis implies that implementation of the remaining regulations is superfluous. Dodd-Frank imposes a costly regulatory burden, and the economic benefit of the 395 new rules required in the law must be examined.

The *Report* goes on to commend the importance of Basel III implementation, hardly noting that these regulations will not be fully phased in until 2019.[229] The effects of these new rules are not well understood, either across the globe or within the U.S. banking system. Particularly for community and independent banks, it is unclear that the cost of additional regulations produces equivalent financial benefit to the economy; a November 2014 GAO study found that community banks with less than $175 million in assets will see their annual compliance costs rise by $43,000.[230] "One-Size-Fits-All" regulation imposes unnecessary burden on institutions that played no role in the global financial crisis.

Final Comments

The *Report* addresses the sluggish economic recovery nearly six years in the making, with in-depth discussion about the labor market scars that remain and the challenges to invigorate a more productive and participatory workforce. It recognizes the importance of working families' contributions to the economy, and the effects that businesses' workplace policies can have on worker productivity and participation. It attempts to convey a more competitive business environment through tax reform proposals. It covers America's rise to the top in energy production, even as Americans are consuming less energy over time. It highlights the benefits of increased trade, while noting that other countries' economic performances will continue to affect the United States.

Despite the rosy picture the Administration tries to paint, the *Report* ignores several important realities. It is clear that the growth gap between this recovery and recoveries of previous decades will likely persist in the near future. The Administration must keep in mind that much of the subsidies and regulations that have been put in place or extended since the recent recession will continue to affect the participation of Americans in the labor force. Piling on more incentives whether by tax credits or workplace mandates on to the existing structure could potentially undermine such policies' intended effects of greater productivity and increased participation.

Part of making participation in the labor force more attractive involves strengthening the connection between workers and employers, empowering workers with the skills they need to fill the jobs that employers offer. Government can encourage thriving worker and employer relationships through smart regulatory reform that reduces the cost to hire workers and redirects business resources otherwise spent on compliance. A second important policy caveat is that increased participation, productivity and income gains alone will not grow the United States out of the dire fiscal circumstances that currently exist in the aftermath of the recent recession, and these fiscal challenges will only increase in the coming years as spending obligations on health care and retirees increasingly engulf the federal budget. As a result, actions to address the unsustainable growth of mandatory spending programs and to ensure the continued vitality of these programs for current and future generations, are critical. Becoming energy independent is more attainable than ever before, if only the Administration would take the initiative to unleash additional energy production opportunities. Finally, opportunities to improve GDP growth are available now pending the Administration's efforts to secure Trade Promotion Authority to finalize new trade agreements, improving the well-being of Americans and of citizens in trade partner countries.

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VIEWS OF RANKING MEMBER CAROLYN B. MALONEY

INTRODUCTION

The Joint Economic Committee (JEC) is required by statute to submit findings and recommendations in response to the *Economic Report of the President* (ERP, or *Report*), which was released by the Council of Economic Advisers (CEA) on February 19, 2015.

The *Report* is a comprehensive, data-driven, fact-based assessment of the economy written by leading economists in accordance with widely accepted standards in the field. It analyzes data collected by nonpartisan government agencies and cites peer-reviewed work by numerous academic economists. It provides important information on the status of the current economic recovery, as well as thoughtful recommendations for steps to further improve the economy.

Any discussion of the economic recovery must be put in proper context. As the *Report* points out, the recovery is taking place in the wake of the worst economic disaster since the Great Depression of the 1930s. When President Obama took office in January 2009, the economy was losing about 800,000 jobs per month, home prices were collapsing, lending was at a virtual standstill and the U.S. banking system was in peril. In the final three months of 2008, the economy shrank at a staggering 8.2 percent annual rate.

The data presented in the *Report* show that, beyond question, substantial progress has been made since that time. Real (inflation adjusted) gross domestic product (GDP) has grown in 20 of the past 22 quarters; the unemployment rate has fallen 4.5 percentage points from its peak of 10.0 percent; 12.0 million private-sector jobs have been added in the past five years; corporate earnings have hit record highs and the Dow Jones industrial average has nearly tripled from its post-crash low.

The *Report* includes extensive economic data demonstrating that the economy continued to improve in 2014 and is poised to make further progress in the future.

However, the *Report* makes clear that there is more work that can and should be done. It discusses remaining challenges and outlines further steps to ensure that future economic gains are more broadly shared. It identifies three goals: higher productivity growth, expanded labor force participation and greater income equality—all issues that have received bipartisan attention.

The *Report* also provides policy suggestions on how to achieve those aims. For example, the report suggests:

- Improving workforce training programs to enhance workers' skills and better connect them to existing employment opportunities

- Making work more family friendly through policies such as paid parental leave and workplace flexibility

- Expanding tax policies that support low- and middle-income workers and their families

- Funding investments in infrastructure that would boost productivity growth and create job opportunities

This Democratic response to the 2015 *Report* has three sections:

- An overview of the state of the economy and an analysis confirming that the recovery has continued in recent months

- A discussion of select policy recommendations outlined in the *Report*

- An examination of frequently repeated misconceptions about economic policy

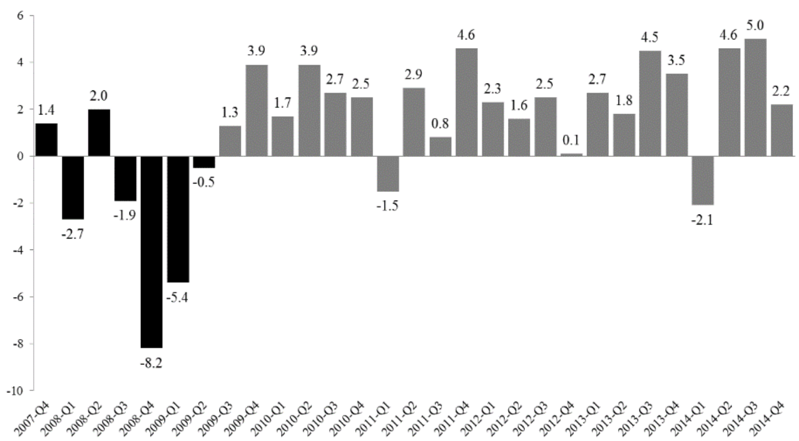
THE STATUS OF THE ECONOMIC RECOVERY

The U.S. economy is currently performing better than the economies of many other advanced nations, and the near-term outlook is bright. Recent data show the economy has continued to recover since late last year when the economic assumptions in the *Report* were finalized. The labor market has continued to strengthen while consumer prices have declined, in large part due to falling energy prices. As the economy moves closer to full employment, wage growth is expected to pick up. This section provides an overview and analysis of recent economic trends, including overall economic growth, employment, inflation and interest rates.

Overall Economic Growth. The U.S. economic recovery accelerated in 2013 and 2014, with real GDP growing at a 2.7 percent annual rate over the past two years. This pace of expansion exceeded the 2.1 percent annual growth rate recorded during the prior 3½ years. Growth in the second half of 2014 was unexpectedly strong, with GDP growing at an average annual rate of 3.6 percent over the last six months of the year (see **Figure 1**).[1] GDP has now grown in 20 of the past 22 quarters.

The CEA projects that U.S. economic activity will accelerate this year. The Federal Reserve Board, the Congressional Budget Office (CBO) and leading private-sector forecasters offer similar projections.

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

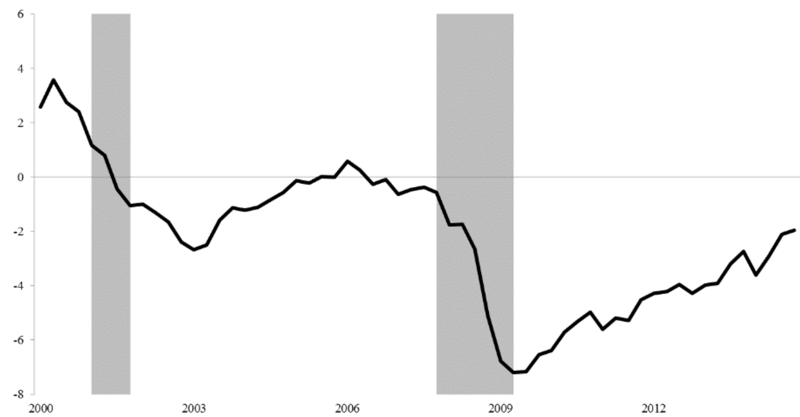


Note: Black bars denote the most recent recession period as determined by the National Bureau of Economic Research.
Source: JEC Democratic staff based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

The economy is now operating much closer to its "potential" level (that is, the level consistent with full employment and stable, low rates of inflation).[2] While the gap between actual and potential GDP reached more than 7 percent during the recession, it has since narrowed to 2 percent (see **Figure 2**).

However, the fact that the economy is still performing below potential means that some labor and capital resources remain 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-Q4



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: 2015 to 2025* (January 2015).

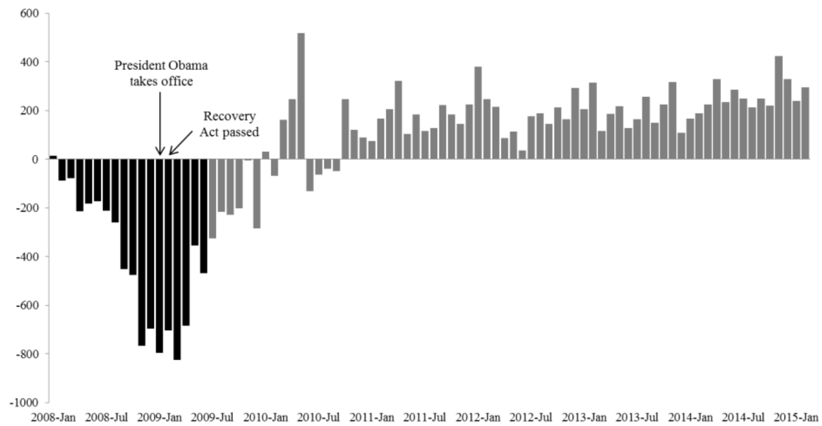
The remaining slack in the economy also means that there is still a need for expansionary fiscal policies to boost aggregate demand. Such policies would raise GDP and further narrow the output gap without diverting resources from other productive uses.

In sharp contrast, austerity policies, such as sequestration, would constrain economic activity and widen the output gap.[3] Fiscal austerity also would work to offset the positive impacts of current monetary policy and would make it more difficult to achieve full employment in coming years.

Employment. Job growth increased in 2014 and has remained strong in the first months of 2015 (see **Figure 3**). More than 3.1 million nonfarm jobs were added in 2014 (260,000 jobs per month), the strongest yearly gain since 1999. The average pace of job creation increased to 293,000 jobs per month over the six months through February 2015.[4]

The private sector continues to drive the economic expansion. Private-sector job growth last year reached its highest level since 1997. Businesses have added jobs for 60 consecutive months, creating more than 12.0 million jobs over that period. Those gains have been widespread across industries.

Figure 3. Nonfarm Payroll Employment
Change in thousands, monthly through February 2015

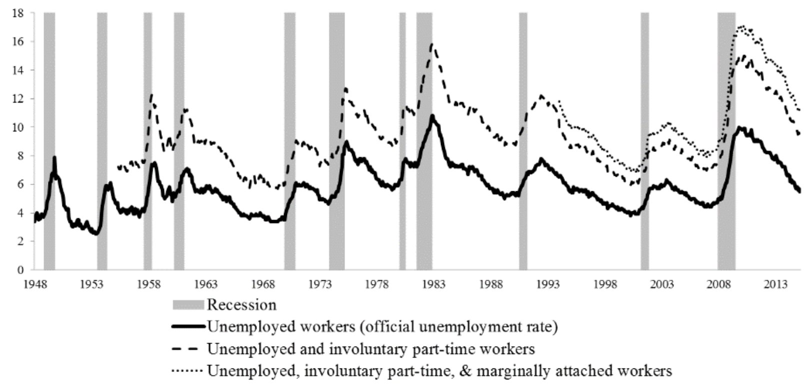


Note: Black bars denote the most recent recession period as determined by the National Bureau of Economic Research.
Source: JEC Democratic staff based on data from the Bureau of Labor Statistics, U.S. Department of Labor.

Unemployment. Strong job growth has led to a decline in the unemployment rate. Since peaking at 10.0 percent of the civilian labor force in October 2009, the unemployment rate has fallen by 4.5 percentage points to 5.5 percent in February 2015 (see **Figure 4**). Over the last 18 months alone, the unemployment rate has declined by 1.7 percentage points on the strength of rising employment.

At its peak, there were nearly eight unemployed workers for every private-sector job opening in the country. As of February 2015, that number has fallen to fewer than two, which is essentially the level that prevailed before the recession. Over the 12 months through January 2015, the number of job openings reported by private businesses increased by 28.6 percent, more than five times the pace at which openings grew over the year ending in January 2014.[5]

Figure 4. Measures of Underemployment
Percent of official or augmented labor force, monthly through February 2015



Notes: 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.

The short-term unemployment rate has already fully recovered and is now below its average during the years before the recession. While the long-term unemployment rate has decreased more slowly than the short-term rate, its decline has accounted for most of the drop in overall unemployment over the last 1½ years. The long-term unemployment rate rose to a record high of 4.4 percent due to the recession (see **Figure 5**). As of February 2015, it had fallen to 1.7 percent.

Even with those improvements, long-term unemployment remains elevated and continues to be a concern for policymakers. Before the Great Recession, the duration of unemployment spells had been trending up, with the share of unemployed workers who had been looking for work longer than 27 weeks increasing steadily over many decades. In fact, the past several recessions led to sharper increases in long-term unemployment than had occurred in earlier recessions, culminating with the Great Recession, which led to an unprecedented increase in long-term unemployment.

Considerable research has shown that long periods of joblessness erode the skills of the unemployed, making it harder for these workers to find the kinds of jobs they had previously. Long-term unemployment has also been linked to declines in the health and welfare of unemployed workers and their families.[6]

The decline in the unemployment rate over the course of the recovery largely reflects improving labor market conditions, though some factors unrelated to the recent business cycle have also played a role. For example, some of the decline in the unemployment rate reflects a long-term downward trend in labor force participation due to demographic shifts that predate the recession (see **Figure 6**). The largest impact results from the retirement of the baby boom generation. Additionally, labor force participation had begun to decline well before the recession due to the inevitable flattening of the strong growth of women's labor force participation achieved in the 1970s and 1980s.

Figure 6. Employment and Labor Force
Percent of civilian noninstitutional population, 16 years and older, monthly through February 2015

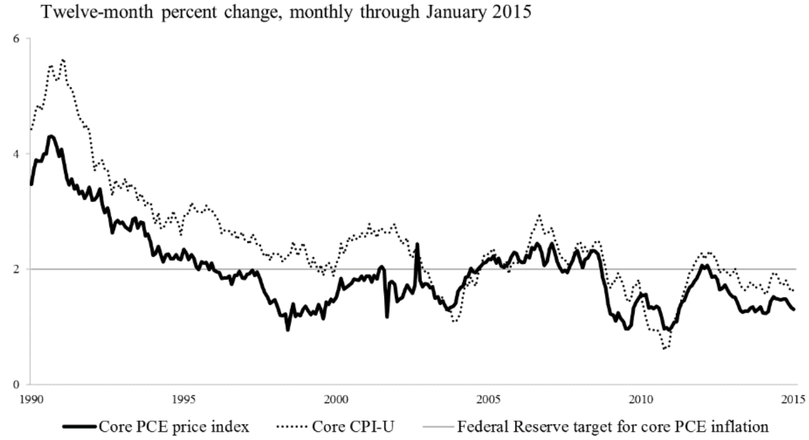
Sources: JEC Democratic staff based on data from the Bureau of Labor Statistics and the National Bureau of Economic Research.

Similarly, the relatively slower rebound in the employment-to-population ratio (the fraction of the population with a job) may partly reflect long-term trends such as the shift from manufacturing to service industries, or the effects of technological advances on business hiring and retention practices. Because of such longer-run factors, most analysts agree that neither the labor force participation rate nor the employment-to-population ratio is likely to return to pre-recession levels anytime soon.

Inflation. On average, consumer prices declined during the three months ending in January, primarily due to falling energy prices. Fuel prices have been dropping since mid-2014 and plunged around the turn of the year. Those declines largely reflect expanded domestic fuel production and weakening global demand. Lower global commodity prices (oil and other goods) along with persistent increases in the exchange value of the dollar are expected to subdue U.S. consumer prices for a time.

Underlying inflationary pressures also remain low. Over the 12 months through January 2015, the "core" rate of consumer price inflation, as measured by the consumer price index excluding food and energy, rose 1.6 percent (see **Figure 7**).[7] Another, more accurate measure of underlying inflation in consumer prices, the price index for personal consumption expenditures excluding food and energy, rose by only 1.3 percent over the 12 months through January. Recent inflation readings remain well below the 2 percent rate of core inflation that the Federal Reserve considers sustainable over the longer term.[8]

Figure 7. Core Inflation in Consumer Prices
Twelve-month percent change, monthly through January 2015

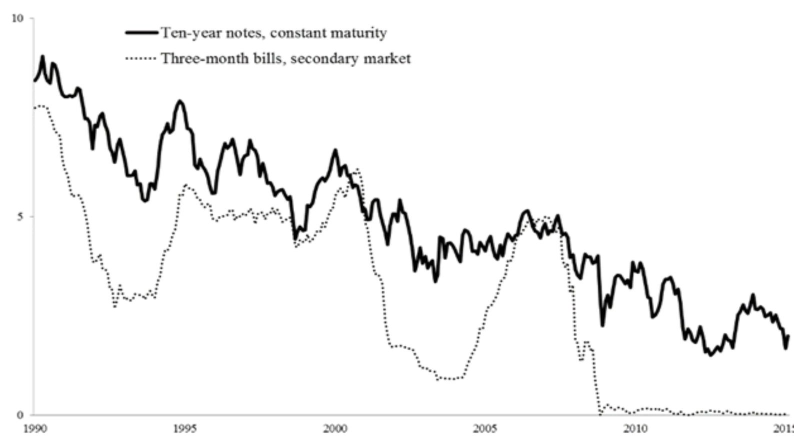


Notes: Core price indexes of consumer prices exclude the volatile indexes for food and energy prices. The PCE price index is the price index for personal consumption expenditures in the national income and product accounts. The CPI-U is the consumer price index for all urban consumers.
Source: JEC Democratic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

Inflationary pressures are likely to remain low over the near term because GDP remains somewhat below its potential level. The economy continuing to operate below its full capacity diminishes pricing power for suppliers of labor, capital and materials. For example, while growth in labor earnings appears to have picked up recently, earnings growth through the recovery has been meager. Labor productivity in nonfarm businesses has increased at an average annual rate of 1.3 percent since the overall recovery began in mid-2009; however, real hourly labor compensation (including wages, salaries and benefits) has barely changed at all. Faster growth in labor income would further boost personal income and support increased consumer spending.

Interest Rates. The combination of a gradual recovery from a severe global recession, relatively low inflation expectations and 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.

Figure 8. Yields on U.S. Treasury Debt
Percent, end of month value through February 2015



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

In recent years, large-scale asset purchases (LSAPs) by the Federal Reserve have helped keep longer-term interest rates relatively low. While the central bank stopped those purchases late last year, it has not yet begun to shrink its holdings of longer-dated Treasury and agency securities and it expects to do so only gradually in the coming years. Longer-term interest rates have risen slowly over the last two years, primarily reflecting stronger credit demand 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.

POLICY APPROACHES TO BOOSTING U.S. LIVING STANDARDS

While the *Report* is largely an analytical document, it also provides policy prescriptions. These include a number of specific proposals that, by boosting productivity and labor force participation, would lift incomes for middle-class families.

The central aim of U.S. economic policy is to raise the living standards of all Americans. As the economy continues to grow, policymakers should focus on ensuring that the benefits of that growth are widely shared. Policies that raise the well-being of the middle class and those working to enter the middle class have proven to be far more effective at raising living standards across the board than "trickle-down" policies targeted at the wealthiest Americans and businesses.

The *Report* describes what President Obama has called "middle-class economics." Its premise is that the economy performs best when the middle class is thriving and when everyone shares in the benefits of economic growth. Policies designed to increase productivity, foster labor force participation and reduce inequality would support middle-class families, boost economic growth over the longer term and lead to lasting increases in U.S. living standards.

Congress should give careful consideration to these select recommendations from the 2015 *Report*:

Strengthening Labor Markets. The *Report* points out that, although labor markets have improved considerably in recent years, more progress is needed. The report recommends policies that reflect lessons learned from past severe recessions.

Excellent examples include proposals to provide free attendance for two years at community colleges as well as to expand apprenticeship programs, career counseling and training in high-growth fields.[9] Those policies would help individuals and also build a better-educated, more highly skilled workforce, raising overall productivity and ultimately boosting economic growth.

The *Report* also recommends providing universal access to preschool for 4-year-olds. Research shows there is a high return on investments in early childhood education and that children's early learning experiences directly affect their long-term academic prospects and earning potential. Making those investments today would bolster future productivity and enhance living standards for generations of Americans to come.[10]

Additionally, the *Report* recommends modernizing the unemployment insurance system to increase the share of workers covered by the program and to improve job search assistance. This would help raise productivity and labor force participation by increasing the efficiency of job matching and by shortening the duration of unemployment spells. Lower- and middle-income Americans, who often disproportionately bear the brunt of economic downturns, would directly benefit from such actions, helping to reduce income inequality.[11]

Programs such as unemployment insurance serve an important purpose—they act as "automatic stabilizers." Because unemployment insurance and many other federal tax and transfer programs automatically adjust to changes in economic conditions, they mitigate the impacts on households and businesses of cyclical swings in the economy.

<u>Reducing Poverty</u>. The *Report* recommends increasing the federal minimum wage to $10.10 an hour, up from the current $7.25.

Taking this important step would help keep individuals in the labor force and work to ensure that no full-time worker lives in poverty. Additionally, a higher minimum wage would have the broader benefit of increasing consumer spending and further lifting the economy.[12]

Making Work More Family Friendly. The *Report* proposes reforms that would make the workplace more family friendly and raise living standards among middle- and lower-income Americans. In general, family-friendly policies make it easier for workers, especially women, to find and stay in positions that fit their skills. Those policies, in turn, increase labor force participation and productivity, ultimately boosting living standards.

Family-friendly policies not only benefit employees; they also benefit employers.[13] Many large corporations have already learned that family-friendly policies help increase worker retention and long-term productivity. A 2010 report by the Democratic staff of the Joint Economic Committee found that roughly three-quarters of Fortune 100 companies at the time had paid maternity leave policies.[14]

Paid family leave: Economic studies have shown that access to paid family leave significantly increases the likelihood that workers will return to their jobs instead of dropping out of the labor force.[15] Workers are more likely to maintain their pre-leave wage level if they stay with the same employer than if they are forced find a new job. This can raise their long-term earnings.[16]

In particular, women with access to paid leave are significantly more likely to return to their pre-leave employer and to maintain their pre-leave wages. They are able to build more tenure and experience in their jobs and maintain good job matches. This can increase their earnings and help close the gap between what men and women earn for the same work.[17] There is also evidence that mothers' access to leave can have a positive impact on their children's health and development, and it can even affect long-term educational and earnings outcomes for their children.[18]

As the *Report* notes, the United States is one of only a handful of countries in the world—and the only developed country—that does not have a paid maternity leave policy. Many countries also provide paid parental leave to new fathers.[19]

Paid sick leave: Employees who go to work sick are less productive. There is also a risk they may infect other employees and customers, potentially lowering productivity and profits. Paid sick leave gives employees time to recover without having to worry about losing wages or their jobs.[20] In addition, employees with access to paid sick leave are more likely to receive preventive care, which is proven to reduce long-term health care costs. Paid leave is particularly important to lower-wage workers who cannot afford to take unpaid leave, even if they have access to it.[21]

Workplace flexibility: The *Report* also recommends providing workplace flexibility through telecommuting and alternative work schedules. Those policies can complement paid leave and further help workers to balance the demands of work and family.[22]

<u>Providing Tax Credits to Support Workers and Families</u>. The *Report* presents a number of tax initiatives to support low- and middle-income families and raise their standard of living. Specifically, it recommends expanding the Earned Income Tax Credit (EITC) for workers without children, tripling the child care tax credit and cutting taxes for families where both spouses work.

The EITC supports the earnings of low-income workers, and it has proven to be an important progressive element of the U.S. tax system.[23] In 2013, it lifted 6.2 million people out of poverty.[24] The *Report* recommends doubling the EITC for workers without children to $1,000—the current maximum credit is $500. Presently, the average credit for a family with children is about 10 times the benefit for a family without children.[25] Doubling the credit would encourage and reward work as well as reduce tax burdens on low-income workers.

The *Report* also calls for making the Child and Dependent Care Tax Credit available in full for families with incomes up to $120,000, and it expands the credit to $3,000 for families with children under the age of five. Those proposals would help families better afford the rapidly growing cost of child care, supporting children's development at the critical early stages of their lives and increasing their future productivity.

Finally, the *Report* recommends a $500 second-earner tax credit targeted to families where both spouses work. That tax benefit would help 24 million two-earner families offset the costs of commuting, child care and other expenses.

<u>Promoting Business Investment</u>. Corporate tax reform can boost productivity by increasing the quantity and quality of private investment in the United States.

Under current law, the federal tax a business pays can vary depending on its location, its industry, the composition of its asset base, the particular means it uses to finance investment and its organizational form. Such differences can distort economic decisions, since they can lead businesses to invest in ways that minimize their tax exposure without necessarily maximizing the productive return on their investments. The use of tax planning strategies to avoid paying U.S. taxes may cost the government revenue equal to 30 percent of corporate tax receipts.[26] That strains the federal budget and, if not addressed, could lead to higher taxes on domestic businesses and families.

By reducing marginal tax rates on corporations while broadening the tax base on which those rates are applied, corporate tax reform could reduce inefficiencies in the current system and spur productive investment. There is broad bipartisan support for reforming and simplifying the corporate tax code to bolster U.S. competitiveness.

One way to reduce distortions and make the corporate tax system fairer to all businesses would be to address the "repatriation" issue. Currently, U.S. corporations approximately $2 trillion in profits offshore—by law, they can avoid paying federal taxes on those profits until they are brought back to the United States. A significant portion of those profits were earned in this country, but were "moved" offshore using various accounting methods. Some corporations—for example, those that derive profits from intellectual property—can more easily take advantage of tax loopholes to avoid paying their fair share in federal taxes. That gives them an unfair advantage over other businesses, and it shifts the burden of taxation from these corporations to other businesses and to American families.

The Obama administration has proposed a comprehensive plan for corporate tax reform that would decrease inequities and inefficiencies in the current system. One important element of that plan is a one-time 14-percent tax on the roughly $2 trillion in accumulated profits held offshore.[27] After paying this one-time tax, corporations could "repatriate" their foreign profits without incurring additional federal taxes, allowing them to put that capital to productive use in the United States. The one-time tax would also generate needed revenue for a six-year infrastructure investment program.

Federal spending to repair the nation's crumbling roads and bridges would benefit millions of Americans who count on the transportation system to commute to work. Quality infrastructure also is essential to American businesses—it enables them to transport goods more efficiently and at less cost, resulting in higher productivity, lower prices and stronger U.S. long-term competitiveness.

Prudent government spending on critical transportation projects also creates jobs in construction and other industries. The spending leads directly to hiring, generating additional consumer spending and further increasing demand.

Energy Policies. The goal of U.S. energy policy should be to boost living standards by ensuring the availability of low-cost energy to American households and businesses. Policies should also aim to minimize the substantial long-term economic and environmental costs of using conventional, carbon-based energy.

Reducing energy costs will increase the purchasing power of consumers, particularly of lower- and middle-income families for whom energy expenses comprise a relatively large share of household budgets. When consumers spend less on energy, they can spend more on other goods and services, creating additional positive economic effects.

The price of gasoline has fallen more than a dollar per gallon over the past year, due to increased energy efficiency, more domestic production of oil and gas, and decisions by Organization of the Petroleum Exporting Countries (OPEC) to increase global supply.

While declining gas prices are welcome news for consumers, they likely will not last and prices have ticked up some in recent weeks. Therefore, efforts to reduce reliance on oil and gas should continue. Policies should include accelerated construction of high speed rail, increased access to mass transit and expanded incentives for the development of emerging cleaner, more efficient technologies.

Clean energy technologies yield additional economic benefits because they decrease the adverse effects on public health caused by carbon dioxide emissions. This lowers health care costs and enables Americans to be healthier, more productive workers.

Global Financial Regulatory Coordination. The recent financial crisis demonstrated the devastating impact that excessive risk-taking in the financial sector can have on middle-class families. The United States and other countries have paid an extremely high price because financial regulations in place at the time were inadequate. The economic challenges we face today are still due in large part to these failures.

The Wall Street Reform and Consumer Protection Act (referred to as “Dodd-Frank”) established important mechanisms designed to decrease the chances that the United States will suffer a similar severe recession. Dodd-Frank, along with other consumer protection laws like the Credit Cardholders’ Bill of Rights, is critical for protecting the economic security of all Americans. In effect, prudent financial regulation and consumer protections are essential for a thriving economy.

The global financial system is highly interconnected and therefore international regulatory collaboration is necessary. Cross-border financial flows can help to diversify risk and ensure that investments are made where they are most productive. But those international flows can also transmit adverse economic shocks across regions as well as lead to exploitation of differences in national regulatory and tax systems. As outlined in the *Report*, continued collaboration across countries, including through the Basel process and the Financial Stability Board, is needed to maximize the benefits and minimize the risks of international financial interconnectedness.

ADDRESSING SOME MISLEADING CLAIMS ABOUT THE ECONOMIC RECOVERY

Frequently repeated misconceptions about measuring economic performance have been used as a basis for claims that the economic recovery is substantially weaker than the data in the *Report* and other sources suggest. It is important to refute these myths in order to establish a solid footing for evaluating the economy and discussing economic policy options.

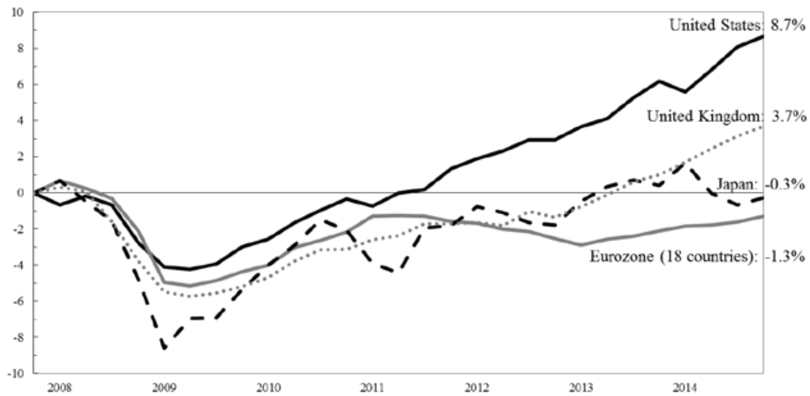
Myth #1: The economic recovery has been unusually slow

Some have claimed that the current U.S. economic recovery has been unusually slow. To back this claim, they compare the current recovery to recoveries from other economic downturns since the 1960s.

However, it is misleading to compare the recovery from the Great Recession to an "average" recovery. The Great Recession was not by any means "average"—it resulted from a severe global financial crisis and was the most protracted economic decline since the Great Depression of the 1930s. A recent study by economists Carmen Reinhart and Kenneth Rogoff looked at recoveries from 100 systemic banking crises spanning three centuries and concluded that: "postwar business cycles are not the right comparator for the severe crises that have swept advanced economies in recent years."[28]

A more appropriate assessment compares the current U.S. recovery with the recoveries of other advanced economies from the same financial crisis. Such a comparison shows that in fact the U.S. recovery has significantly outpaced the recoveries of many of those other economies (see **Figure 9**).

Figure 9. U.S. Economic Growth Compared to Other Advanced Economies
Percentage change in real gross domestic product from Q4-2007, through Q4-2014



Source: JEC Democratic staff based on data from the Bureau of Economic Analysis, U.S. Department of Labor; Statistical Office of the European Communities, European Commission; Cabinet Office of Japan; and the Office for National Statistics of the United Kingdom.

Another way to assess the current recovery is to compare it to recoveries from other severe financial crises that have occurred during the past several centuries. This reveals that the current U.S. recovery has been stronger than recoveries from most financial crises during this period.[29]

Myth #2: The unemployment rate is a "big lie"

Some have asserted that the official unemployment rate is a "big lie"—an inaccurate portrayal of the true employment picture. They claim that the 12 million private-sector jobs added in the past five years and the decline in the unemployment rate from 10.0 percent in October 2009 to 5.5 percent in February 2015 is not really as good of news as it would seem.

This claim is based on the fact that the official unemployment rate does not include people who have stopped looking for work and dropped out of the labor force. However, the unemployment rate has been calculated the same way for decades and it has been used as a core economic indicator under both Democratic and Republican administrations. The official unemployment rate has never included people who have stopped looking for work. And even though it does not fully capture the slack in the labor market, economists find this indicator valuable because it provides a consistent measure over time of labor underutilization.

To get an accurate sense of the employment picture, it is important to look at a broad range of economic indicators. And these clearly suggest that the labor market has made significant progress during the recovery. For example, the private sector has added jobs for 60 consecutive months. Full-time workers account for all of the increase in employment over that period. Long-term unemployment has dropped significantly, and real wage growth has begun to pick up. The most recent jobs report showed that the private sector added another 288,000 jobs in February 2015. That means that there have been 12 straight months of private-sector job gains above 200,000—the first time that has happened since 1977.

The *Report* shows that, although labor force participation has declined since the start of the recession, most of that decline stems from ongoing shifts in demographics that predate the recession, such as the retirement of the baby boom generation. These changes and their impact on labor force participation are well-known and have been studied by leading economists.[30]

Moreover, over the past 1½ years, labor force participation has been relatively stable while the unemployment rate has continued to decline.

Myth #3: The health care law is causing job losses

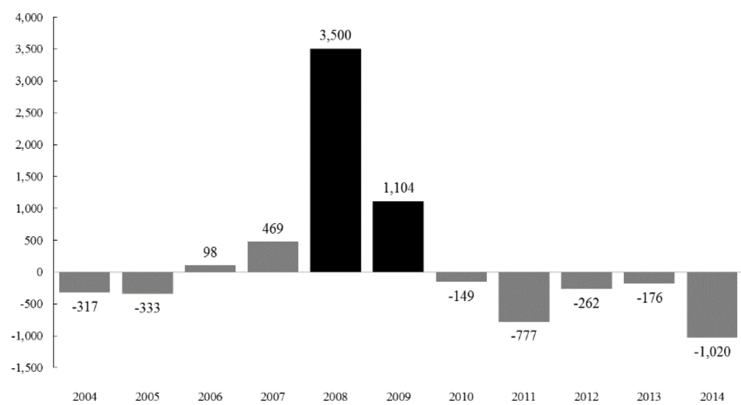
Some claim that the Affordable Care Act (ACA) imposes regulatory burdens that have caused businesses to shed jobs. This argument largely is based on a misinterpretation of a CBO report that shows that likely reductions in hours worked would be small (1.5 to 2 percent between 2017 and 2024) and would almost entirely reflect the decisions of workers voluntarily choosing to work less.[31]

The bulk of job losses from the recession occurred well before the ACA was passed by Congress and signed into law. And while there is no evidence that health policy is causing job losses, there is considerable evidence that labor demand is strengthening. Private-sector job growth has increased in the years since the ACA was enacted. Over the course of 2014, private-sector employment grew at its fastest rate (2.6 percent) since 1997.

Moreover, CBO recently lowered its estimate of the cost of the ACA due mainly to the fact that health insurance premiums are expected to increase at a much slower rate than had been anticipated. In addition to contributing to the slowdown in health care costs, the ACA is also helping improve financial security for lower-income Americans and boosting productivity by making it easier for individuals to access preventive care and stay healthy.[32]

Some claim that, because the ACA requires medium and large businesses to provide health coverage for their full-time employees, it creates incentives for employers to hire part-time instead of full-time workers. However, data show that involuntary part-time employment has actually dropped every year since the passage of the ACA. In 2014 alone, the number of workers employed part time for economic reasons declined by more than 1 million (see **Figure 10**). The greatest increase in involuntary part-time work occurred over the course of 2008, before President Obama took office and well before the ACA became law.

Figure 10. Work Part Time for Economic Reasons
Twelve-month change (December to December) in thousands, not seasonally adjusted



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

In any case, the number of part-time workers who would be affected by the ACA provision is quite small.[33] Moreover, rising full-time employment accounts for nearly all of the employment gains since the beginning of the recovery.

The current trend in part-time work for economic reasons during the recent recession and recovery is broadly in line with the trends seen in other recent business cycles. As businesses seek to cut costs during downturns, involuntary part-time employment tends to spike; it then decreases more slowly than the unemployment rate over the course of the ensuing economic expansion.

Myth #4: America Can't Afford Family-Friendly Workplace Policies

The United States is one of the only advanced economies in the world that does not provide family-friendly workplace policies such as paid family leave.

Critics of family-friendly workplace policies, such as paid sick leave, paid parental leave and flexible work schedules, contend that those policies are too costly for American businesses and would stifle economic growth. However, a growing body of research shows that family-friendly policies are in fact beneficial to workers and businesses alike, and can actually boost economic growth.

Providing workers with paid family and medical leave ensures that they can afford to take extended leave to care for a new child, recover from a serious illness or care for an ill family member without losing their job or putting their family's economic security in jeopardy. Economic studies have shown that access to paid family leave significantly increases the likelihood that workers return to their jobs instead of dropping out of the labor force or spending time out of work to search for a new job.[34]

Businesses reap economic gains from retaining workers with valuable firm-specific knowledge and skills, and from not having to bear the sizable costs of recruiting and training new employees. They also benefit from increased productivity and higher levels of employee satisfaction.[35]

Increasing access to paid leave can boost economic growth by helping workers stay in jobs that are a good match for them and where they have developed skills, which increases overall productivity.[36] Paid leave has been shown to increase labor force participation and employment-to-population ratios, especially for women.[37] The combination of increased productivity and labor force participation bolsters economic growth.

Providing paid sick leave also benefits businesses by boosting productivity, making workplaces more attractive for potential employees and increasing retention. Paid sick leave can even reduce employers' overall costs by limiting the spread of illnesses and allowing workers to recover faster and return to work more productive.[38] In addition, employees with access to paid sick leave are more likely to receive preventive care, which is proven to reduce long-term health care costs, boost the overall health of the workforce and improve long-term productivity.[39]

CONCLUSION

The *Economic Report of the President* convincingly demonstrates that the American economy has made tremendous progress toward recovering from the most crippling economic downturn since the Great Depression. A broad range of key economic indicators have continued to show strong improvement, including private-sector job creation, the unemployment rate, GDP growth and stock market performance. Notably, the U.S. economy is outperforming most advanced economies that experienced similar shocks. The most recent economic data suggest that prospects for future growth are bright.

Yet, work remains to be done. As the economy continues to grow, policymakers must do everything possible to ensure that the gains from future growth are more broadly shared. The *Report* seeks to achieve this through "middle-class economics"— policies designed to raise the well-being of millions of American families. This is a welcome change from the failed policy of "trickle-down economics."

The *Report* includes specific recommendations that would further improve the economy, including policies to strengthen labor markets, reduce poverty, make workplaces more family friendly, provide tax credits to families and workers, promote business investment and improve the nation's infrastructure. These policies would boost productivity and raise living standards. Congress should seriously consider these recommendations.

Economic policy will be hotly debated in the 114th Congress. It is critical that such discussions are grounded in facts. The *Report* provides a strong, data-driven foundation for serious debate. This JEC Democratic response supplements that work by addressing some misleading claims and frequently repeated misconceptions about the economy. This should help policymakers when assessing the strength of the U.S. economy, recent progress on unemployment, the effect of the Affordable Care Act on economic growth and other issues.

The economy is in much stronger shape than it has been in years—there should be little argument about that. Now, policymakers must build on that progress and ensure that all Americans benefit from the robust economic recovery.

ENDNOTES

[1] This report reflects economic data available through early March 2015. In particular, the latest national income and product accounts data available correspond to the second estimate for 2014-Q4 as released by the Bureau of Economic Analysis on February 27, 2015, http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm. Because the CEA's economic assumptions, outlined in the *2015 Economic Report of the President* (ERP), are used as the basis for the Administration's budget estimates, those assumptions must be finalized months ahead of the ERP's release. The economic assumptions in the 2015 ERP were based on data available through early November 2014.

[2] 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 was stable at a low level. The Congressional Budget Office (CBO) currently estimates that potential output is growing between 1½ and 2 percent a year; see "The Economic and Budget Outlook: 2015-2025," Congressional Budget Office, January 2015, http://www.cbo.gov/sites/default/files/cbofiles/attachments/49892-Outlook2015.pdf. 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.

[3] According to the *2014 Economic Report of the President*, CBO estimated that sequestration slowed real GDP growth over the four quarters in 2013 by 0.6 percentage point, and reduced employment by the equivalent of roughly 750,000 full-time jobs; see 2014 *Economic Report of the President*, March 2014, https://www.whitehouse.gov/sites/default/files/docs/full_2014_economic_report_of_the_president.pdf

[4] JEC Democratic staff calculations based on data available through February 2015, as released by the Bureau of Labor Statistics, March 6, 2015, http://www.bls.gov/news.release/archives/empsit_03062015.pdf

[5] JEC Democratic staff calculations based on data available through January 2015, as released by the Bureau of Labor Statistics, March 10, 2015, http://www.bls.gov/news.release/archives/jolts_03102015.pdf

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