I. Presidential Address

Digging Out from the Great Recession: Prospects for Jobs and Economic Growth

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Abstract

The recession that began in December 2007 and ended officially 19 months later in June 2009 was the worst recession in more than 60 years. The economy has begun expanding again. But for workers, the pain is not yet over. Unemployment remains above 9%, where it has been for the last 20 months. In my remarks, I examine how things could have gone so wrong for the U.S. economy. I discuss the dimensions of the crisis confronting the job market, the extent of the decline in private sector demand, and the inadequacy of the policy response. I consider the sources of the federal budget deficit in the short term and long term. Finally, I conclude with a menu of policy initiatives for digging out from the Great Recession.

Introduction

The recession that began in December 2007 ended officially 19 months later in June 2009. It was the worst recession in more than 60 years. Not only was it longer than earlier recessions but, compared to previous post-war recessions, output (GDP) fell further, down more than 5% from peak to trough; capacity utilization declined more, reaching 65.1% at its lowest point; employment fell further, with payrolls down 6% from the beginning of the recession to their lowest point and 8.5 million payroll jobs lost; and unemployment increased the most, up 5.5 percentage points to 10% at its peak in October 2008. The economy is expanding again. But for workers, the pain is not yet over. Eighteen months after the official end of the recession, the unemployment rate still stands at 9.4%, and 25 million workers are unemployed or underemployed. In a front page story this morning (January 8), the *Wall Street Journal* estimated that, at the current rate of job creation, the number of payroll jobs will not reach its pre-recession level until December 2016.

In my remarks today, I will address several issues. I will begin by examining how things could have gone so wrong for the U.S. economy. I will focus on America's grand experiment with laissez-faire capitalism, the collapse of the housing bubble, and the meltdown in financial markets, exploring how the crisis evolved. We need to be clear on the source of the problem in order to propose policies that can address it. Next, I will lay out the dimensions of the crisis confronting the job market, the extent of the decline in private sector demand, and the inadequacy of the policy response to this challenge. The federal government deficit has increased during the recession and its aftermath, leading to calls to rein in spending and raising the possibility that premature efforts to bring government spending in line with tax receipts may threaten the weak recovery. I will discuss the sources of the short-term, recession-induced increase in the deficit as well as the long-term structural increase after 2020. Finally, I will present a menu of options for addressing America's stubbornly high unemployment rate that do not increase the deficit. In light of the size of the job market crisis and the slow recovery in private sector demand, however, it will not be possible to create the millions of jobs the

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country needs without the public sector stepping in to temporarily increase its spending (and, hence, the federal deficit) in order to fill the gap in demand caused by the pull-back in private sector spending.

How Did Things Go So Wrong?

The U.S. has been engaged in a grand experiment with laissez-faire capitalism that began in the 1970s and continued apace in the decades since. The deregulation of financial markets and lax lending standards set the stage for the housing bubble and the meltdown in financial markets that followed. The emphasis on increased labor market flexibility led to a shift in bargaining power that favored employers. The result was stagnation in median household income over a 30-year period, despite continued increases in productivity. Inequality in household incomes increased dramatically, with the top 1% of households capturing nearly a quarter of all household income on the eve of the Great Recession, a feat last accomplished in the 1920s on the eve of the Great Depression. As a result, economic growth over the past several decades has been debt driven, fueled by the stock market and housing bubbles. This contrasts with the decades following the Second World War, when growth was driven by rising real wages and household incomes. Bubble-driven growth is inherently unstable as bubbles must ultimately burst.

Deregulation of Financial Markets

The deregulation of financial markets began in the United States in the 1970s and continued through 1999. ERISA (the Employee Retirement Income Security Act), passed in 1974 and amended in 1978, permitted pension funds and insurance companies to undertake more risky alternative investments and provided the funding for an earlier round of leveraged buyouts.. The Garn-St. Germain Act, passed in 1982, allowed savings and loan banks (S&Ls) to hold junk bonds and invest in risky activities. The Depository Institutions Deregulatory and Monetary Control Act of 1980 eliminated interest-rate caps and made subprime lending more feasible for lenders. The Gramm-Leach-Billey Act—the Financial Services Modernization Act of 1999—repealed what was left of the Glass-Steagall Act of 1933 and enabled commercial banks to merge with investment banks and insurance companies. This opened up the opportunity for investment brokers to sell risky investment products to commercial banks.

Deregulation was promoted on the grounds that the institutional participants in financial markets—pension funds, insurance companies, investment banks, commercial banks, and so on—were sophisticated players and understood the transactions in which they were engaging. Regulatory oversight became lax; regulators largely took a "hands-off" approach since, according to the prevailing view, markets could be counted on to discipline participants. In case problems did emerge, both economists and the general public were convinced of the power of monetary policy to stabilize the economy.

The result was a proliferation of "innovative" financial products—mortgage-backed securities (MBS), commercial mortgage-backed securities (CMBS), collateralized debt obligations (CDOs—many backed by MBS), credit default swaps (CDS—whose purpose was to insure the owners of CDOs against the risk of default). The ability of banks and mortgage brokers to sell mortgages on to investment banks, where they would be diced and sliced and combined into mortgage-backed securities, led mortgage brokers to relax underwriting standards. The result was a proliferation of subprime, Alt-A, adjustable rate, interest-only, and other mortgage products that were aggressively marketed by mortgage brokers.

A belief in the efficiency of markets led elite economists—including former Federal Reserve Bank chair Alan Greenspan and current Fed chair Ben Bernanke—to ignore the warning signs of developing asset bubbles in the housing and stock markets, especially the surge in house prices relative to equivalent rental units. The catastrophic performance of financial markets in 2008–2009 contradicts the efficient markets hypothesis—that prices in financial markets instantly and accurately reflect all available data.

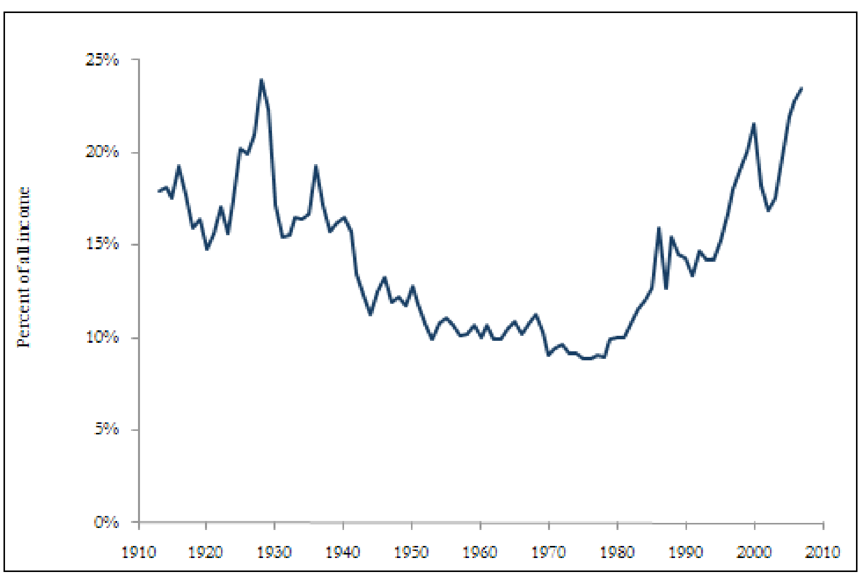
Deregulation of Labor Markets

In the late 1970s and 1980s, U.S. policy makers retreated from a commitment to full employment and rising wages. Following the oil price shocks of the 1970s and the sharp spikes in inflation and interest rates that followed, the commitment to full employment was abandoned as inflationary. Instead, the dominant concern of policy makers shifted to a concern with rising prices. In place of policies to maintain full employment, neo-liberal policies were adopted that focused on the deregulation of industries, the outsourcing of production to low-wage countries, the undermining of unions, and reductions in employment protections for workers. Rising wages for American workers and an expanding middle class were no longer seen as the source of demand for products and the engine of economic growth.

In the push to make labor markets more flexible, the incomes of working- and middle-class families came under attack. Trade agreements threw blue-collar workers in the United States into direct competition with low-paid workers in less developed economies, with deleterious effects on employment and wages. Lax enforcement of labor and employment laws further undermined workers' wages and working conditions. Union membership eroded, leaving ever more workers subject to "employment at will." The value of the real minimum wage was allowed to decline to the point where it no longer functioned as a floor under middle-class wages. The result is that power in wage setting shifted decisively to employers. Private sector wages were redefined as a cost to be controlled, private sector pensions were replaced by employee savings schemes, public sector workers were threatened with pension cuts, and Social Security was repeatedly targeted for austerity measures. The link between growth in aggregated demand, productivity, and wages was broken. The living standards of the majority of working families came under attack. Median wages of men stagnated after the mid-1970s. The labor force participation of married women increased, but from the mid-1980s, inequality in household income increased. Between 1999 and 2008, median real household income fell by $2,284—the first time in the four decades for which we have data that household incomes were lower at the end of a decade than at the beginning.

As Figure 1 shows, the period 1983–2008 exhibited a large increase in the income share of the rich. From 1952 to 1982, while the middle class grew, the richest 1% of households received 10% of national income. In 2007, the richest 1% of households received 24%. The last time the United States experienced this much inequality was in 1929, just before the Great Depression.

FIGURE 1
Share of Total Income Going to Top 1% of Households, 1913 to 2010



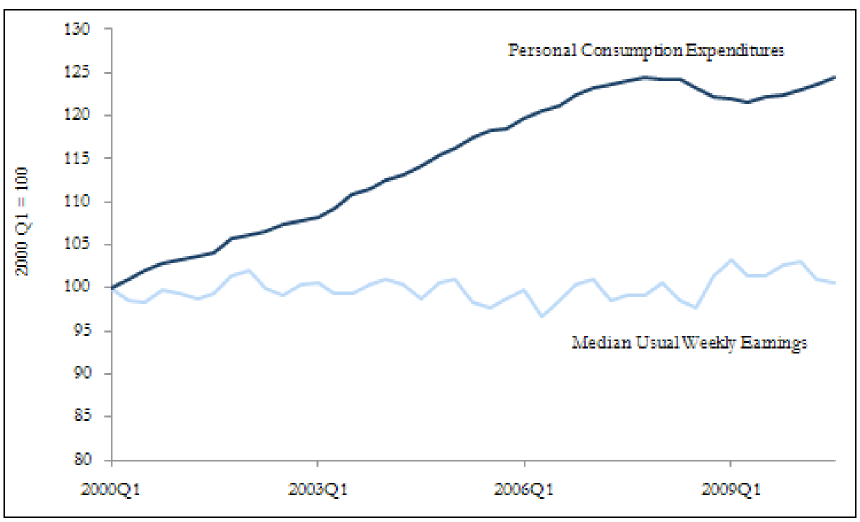
Source: Piketty and Saez (2009), income with capital gains fully included.

Debt-Driven Growth

In recent decades, economic growth has been based on rising debt—not wages—as the source of increases in demand, with the increase in debt made possible by asset price inflation and bubbles. In the dot-com boom and stock market bubble that began in 1995, equity prices tripled, adding nearly $12 billion to household wealth in the United States before the bubble burst in 2000 and the economy went into a recession. Cheap imports have mitigated wage stagnation for low- and middle-income families. These imports have greatly increased the U.S. trade deficit. As a result, policy makers have been unwilling to confront the global imbalances that have flowed from America's over-valued currency. The growth of household debt has been supported by financial deregulation and financial innovation. The debt of the average American household, which was equal to 83% of income in 1990, rose to 92% of income in 2000 and skyrocketed to 130% of income in 2007. In the period from 2005 to 2007, savings out of disposable income fell to less than 1%.

The growth in household debt was made possible by the housing bubble, itself the result of weak regulation of financial market players. The securitization of mortgages created perverse incentives for mortgage originators to relax lending standards; the result was explosive growth in adjustable rate, subprime, alt-A (no documentation), and other risky mortgage products. Subprime mortgages rose from 9% of all mortgages in 2002 to 25% of all mortgages in 2005. Homeowners were encouraged to tap the equity in their homes by refinancing or taking out home equity lines of credit. The assumption, widely promoted by real estate agents and mortgage lenders, was that house prices would never fall. The result, as Figure 2 shows, was that consumption continued to increase through 2007 despite the fact that real median weekly wages were flat.

FIGURE 2
Stagnant Real Wages but Increasing Consumption 2000 to 2007



Source: Bureau of Labor Statistics and Bureau of Economic Analysis.

The Housing Bubble

Inflation-adjusted house prices were flat for a century, from 1895 to 1995. But beginning in 1996, house prices began to rise faster than the rate of inflation. The first phase of the housing bubble, from 1996 to 2002, was driven by developments in the stock market. In the late 1990s, the stock market boom fueled the demand for bigger and better homes. When the stock market bubble collapsed in 2000–2002, real estate was seen as a safe investment. The result was a 30% increase in inflation-adjusted house prices by 2002.

In the second phase of the housing bubble, from 2002 to 2006, the rise in house prices was fueled by low interest rates, lax underwriting, and financial innovation. The rate on 30-year mortgages fell to 5.25% in 2003. House prices rose a further 32% from the fourth quarter of 2002 to the fourth quarter of 2006. The run-up in real house prices over the years from 1996 through 2006 added $8 trillion dollars to household wealth. That is, households had $8 trillion in housing bubble wealth—wealth that they would not have had if inflation-adjusted house prices had followed their historical path and remained flat. This added housing wealth had two effects: via the wealth effect, it added between $400 billion and $500 billion a year to consumption spending by households; and it led to a precipitous drop in the personal savings rate, which had averaged more than 8% of disposable income from 1950 to 1986. The run-up in house prices encouraged builders to ramp up construction of new homes: housing starts peaked at 2.1 million in 2005, 50% above their pre-bubble level.

Prices of houses peaked in 2006 and then fell substantially as the housing bubble collapsed. Between 2006 and 2008, housing wealth declined by $6.4 trillion. The wealth effect went into reverse, and consumption declined dramatically. The decline in house prices and uncertainty about the future value of homes led to a sharp decline in demand for houses. Residential construction collapsed. By December 2007, the economy was in recession. In 2009, housing wealth declined a further $1 trillion. While data for 2010 are not yet available, predictions are for a further sharp drop.

Financial Market Melt Down

The collapse of the housing bubble undermined the financial calculations of highly indebted households. Many homeowners found themselves "underwater"–owing more on their mortgages than their homes were worth. Households that had taken on larger mortgages than they could afford, with the idea of refinancing as house prices rose, were caught short. As a result, the default rate on residential mortgages spiked. Delinquency rates and foreclosures rose sharply. The high rate of defaults on mortgages caused the value of mortgage-backed securities—and complex financial products based on these securities—to decline precipitously. The market for these securities collapsed. Many holders of these securities had insured themselves against a decline in their value by purchasing credit default swaps. But insurers such as AIG had not put away sufficient reserves and could not make good on this insurance. Many institutions were exposed to losses, and investors had little confidence in financial instruments. The result was the credit squeeze that hit financial markets in 2008 with the bankruptcy of Bear Stearns, the liquidation of Lehman Brothers, and the near-death experiences of AIG and Goldman Sachs. Thus, the collapse of the housing bubble had two effects—it led to a sharp decline in private sector demand that led to recession in 2007 and it sparked the financial crisis that took hold in 2008. Turmoil in financial markets led share prices in the stock market to collapse: equity prices fell by half from their peak in late 2007 to their trough in early 2009.

It is important to get causality right. Beginning the story with the financial crisis leads to the view that fixing financial markets will turn on the spending spigot and the economy will quickly recover and create jobs. This, as we know, has not happened. The bailout of the financial sector succeeded in making the banks profitable, but this has not resulted in rapid economic growth and a decline in unemployment. Understanding that it was the steep drop in private sector demand on the heels of the collapse of the housing bubble suggests a very different approach for policy to promote growth and job creation.

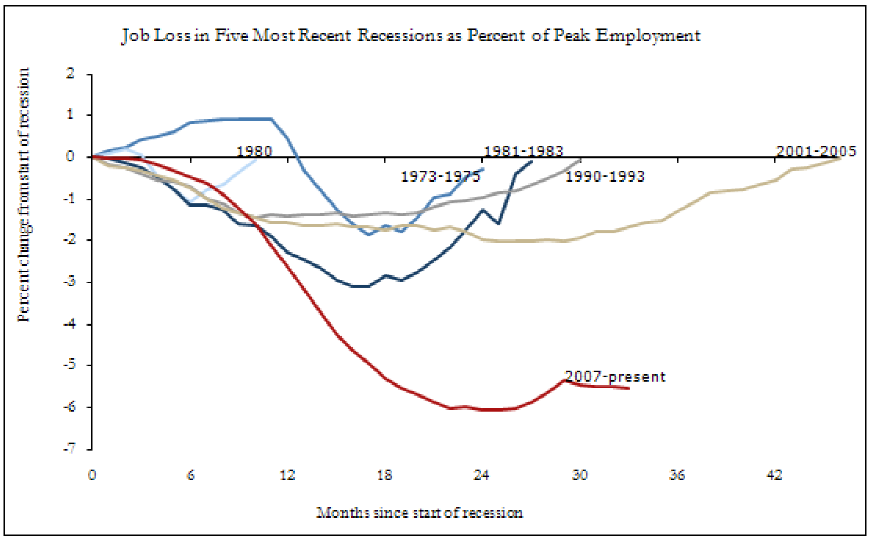
Inadequate Response to the Jobs Crisis

Three years after the start of the recession, and a year-and-a-half after it was declared over in June 2009, the U.S. job market remains in crisis. Job creation should be at the top of the national agenda. The initial policy response to the developing crisis in the labor markets was inadequate. Concern about the harsh realities confronting the unemployed has now fallen off the radar altogether in favor of a message that focuses attention instead on the run-up in the stock market and the great gains in corporate profits.

Job Market in Crisis

The economy lost 8.5 million payroll jobs between the start of the recession in December 2007 and December 2009, when job losses finally bottomed out. Job losses in this recession have been steeper and more prolonged than in any contraction in the last 60 years. As Figure 3 shows, the economy lost 6% of payroll jobs at the worst of the current recession compared with 3% in the 1981 recession and smaller losses in other downturns.

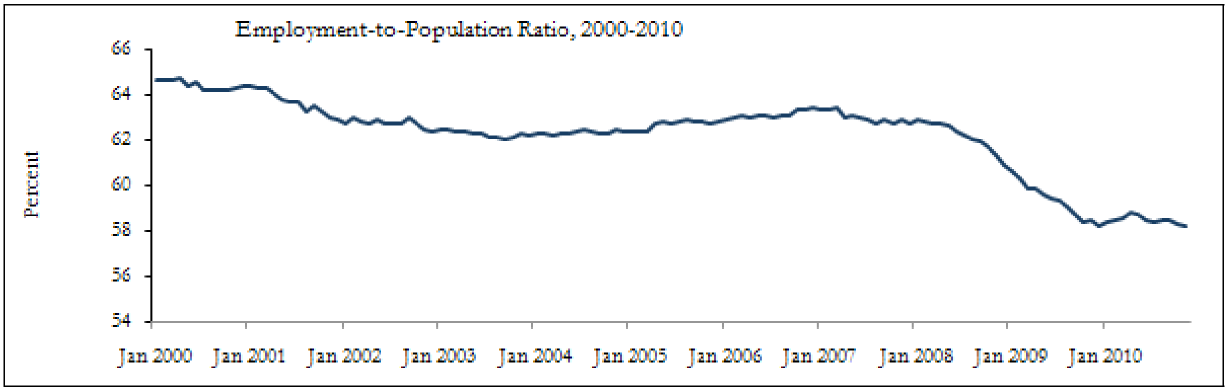
FIGURE 3
Sharp Decline in Payroll Jobs



Source: Bureau of Labor Statistics.

The unemployment rate hit 10% in October 2009 and remains stubbornly high. December 2010 marked the 20th month in which the unemployment rate remained above 9%—a post-Depression record, and 40% of the unemployed have been jobless for more than 26 weeks. More than 25 million workers—one in six—are unemployed or underemployed. Moreover, nearly 4 million workers have gone missing: they have dropped out of the labor force. As Figure 4 shows, there has been a precipitous drop in the employment to population ratio, which captures both the increase in the number of unemployed and the decline in labor force participation among the adult population.

FIGURE 4
Millions of Workers Left the Labor Force



Source: Bureau of Labor Statistics, Consumer Population Survey.

The problem, as we document below, is a lack of demand. A comparison of job openings with job seekers shows that there are five workers looking for employment for every job that is available. There is no evidence that this high rate of unemployment is due to a structural skills mismatch. If a skills mismatch were at the heart of the persistence of high unemployment, we would observe some economic sector(s) that exhibited a strong increase in job openings, rising vacancies, rapidly rising wages, and an increase in weekly hours as employers used overtime to make up for their inability to hire people with the requisite skills. There is no sector of the economy where this is true today.

Inadequate Policy Response

By the time that Barack Obama won election as U.S. president in the fall of 2008, the economy had plunged into a deep recession and a serious financial crisis. The bursting of the housing bubble and the drop in the stock market had wiped out $12 trillion of housing and stock market wealth. Economists' estimates of the wealth effect is that households spend an amount equal to about 5% of their wealth on consumption—the so-called wealth effect. Now the economy was experiencing the wealth effect in reverse: a drop in consumption of about $600 billion a year. The decline in house prices caused residential construction to tumble. In the fall of 2008, it was falling at about a $450 billion annual rate. Non-residential construction, which had remained strong through the first half of that year, was now also falling. It was declining at about a $200 billion annual rate. The declines in household consumption and in residential and non-residential construction opened up a hole in private sector demand of about $1.2 trillion. This hole would have to be filled by spending by other economic actors—a pickup in business investment, an increase in government expenditures, or increased exports to the rest of the world—in order for the U.S. economy to return to full employment. With consumer demand falling, businesses had few incentives to increase investment in new plant and equipment. And the global nature of the recession made an increase in exports challenging. That left government spending to take up the slack.

In contrast to the bold and innovative policies adopted by the administration of George W. Bush to bail out the financial sector and continued by the Obama administration, fiscal policies to put people back to work were conventional and too small to do the job. Policies like the government's Troubled Asset Relief Program provided taxpayer funds to bail out the banks, but these funds provided no stimulus to the economy. The stimulus enacted in February 2009, shortly after President Obama took office, was timely but much too small to stimulate robust growth. The American Recovery and Reinvestment Act, which passed without a single Republican vote, provided an increase in government spending of $784 billion over two years, or about $400 billion a year. This was enough to stop the free fall in jobs, but small in relation to the $1.2 trillion hole in private demand and not enough to ignite robust job growth.

The stimulus was small, in part, because of opposition from Republicans in Congress. But that is not the whole story. The president's economic advisors, who had failed to recognize the housing bubble, now underestimated the severity of the recession that followed. Administration economists had expected unemployment to peak at 8.8% in the absence of the stimulus. Instead, despite the stimulus, unemployment hit 10% in October of that year. The Obama administration over-promised results, professed to see "green shoots" (glimmers of good news), and sent Treasury Secretary Timothy Geithner out to proclaim a "summer of recovery" in 2010. The public, facing persistent high unemployment, was disappointed and confused. Many people concluded that the stimulus had not worked when, in fact, it had the effect one could expect in such a deep recession from a stimulus of this magnitude.

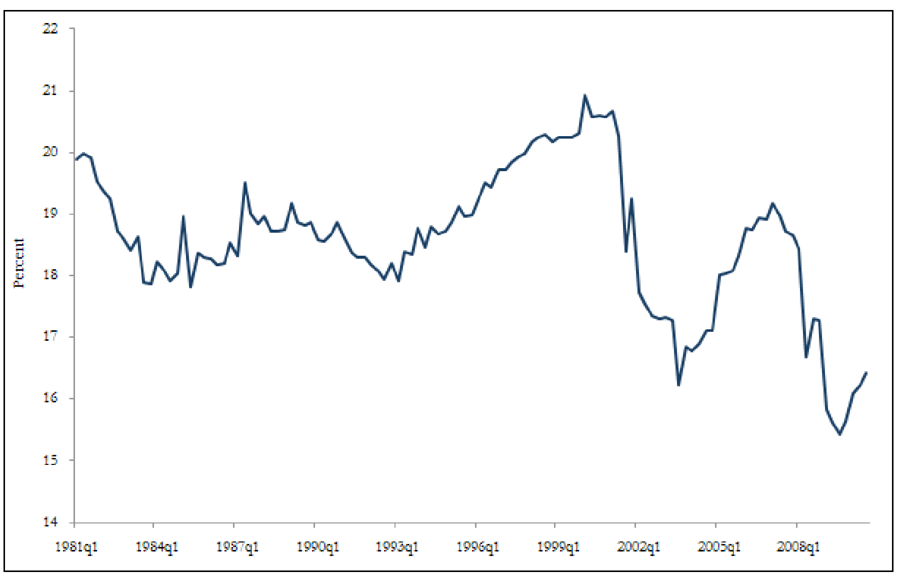
What About the Deficit?

Efforts to undertake a jobs program or adopt measures to further stimulate the economy have been stymied by concerns about the deficit. The United States presently has a large deficit, and projections show it rising sharply after 2020. What are the sources of the short-term and long-term deficits, and what kinds of economic problems do they create?

The Deficit in the Short Run

The recent increase in deficit spending by the federal government is not the result of explosive growth in spending by the federal government. Non-interest spending by the federal government amounted to 19.8% of GDP in 1980 and is projected to reach 21.1% in 2011—an increase of 1.3 percentage points over three decades. Rather, increases in the deficit have been driven mainly by sharply lower federal tax receipts from all sources. As Figure 5 shows, tax receipts, which averaged more than 18% of GDP over the years from 1970 to 2007, fell to 14.8% of GDP in 2009—nearly a 60-year low. A simulation of the path the U.S. economy would have followed in the absence of a policy response to the recession and financial crisis finds that the budget deficit in years 2010 through 2012 would be much larger without the stimulus and bank bailouts.

FIGURE 5
Federal Tax Receipts as Share of GDP, 1981–2010



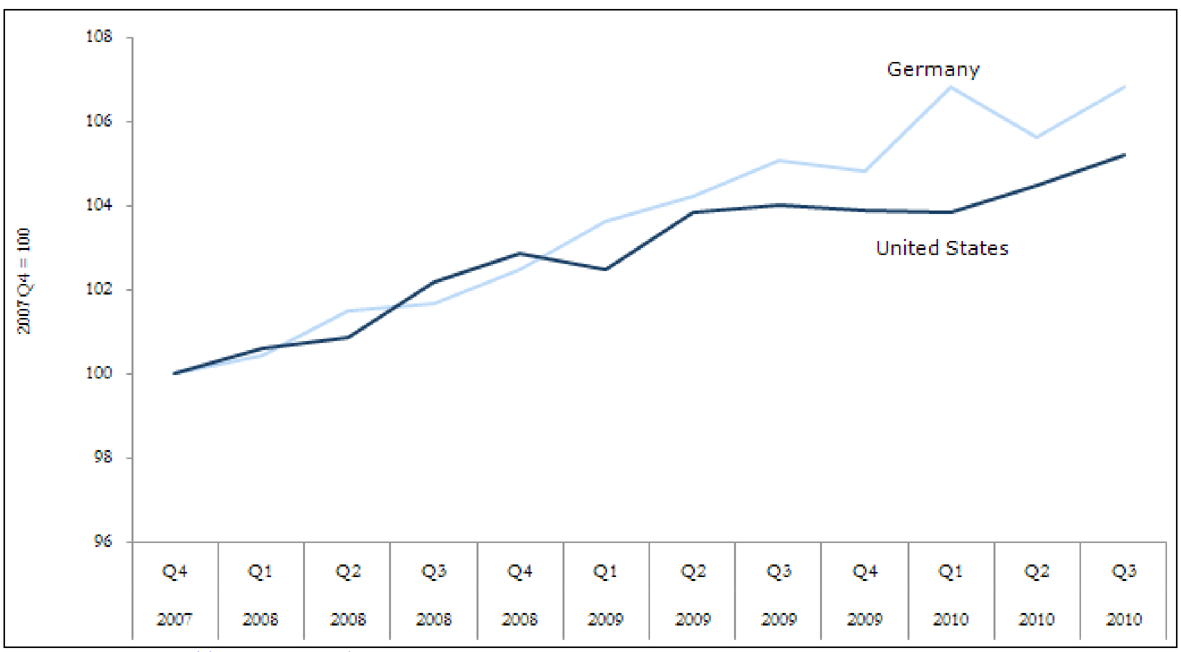
Source: Bureau of Economic Analysis, National Income and Product Accounts.

The argument made by the deficit hawks in favor of austerity is that failure to reduce the deficit now and slow the cumulative effect of deficits on the national debt will lead the so-called "bond market vigilantes" to shun government securities, resulting at minimum in a harmful increase in interest rates and at maximum in a Greek-style crisis of confidence in U.S. government debt. But interest rates at every maturity have plunged to new lows as bond traders have demonstrated their willingness to buy U.S. government debt. Until the economy recovers, there is little chance that government spending will drive up interest rates and crowd out private demand for borrowed funds. Nor is the United States in any danger of "going broke." Unlike Ireland or Greece, The United States owes its debts in a currency it controls—the dollar. As a result, we will always be able to pay interest on Treasury debt.

Demands for austerity rest as well on the argument that as the economy recovers, interest rates will rise as a share of the government's budget, squeezing discretionary government spending on programs people value and burdening future generations. This outcome can be avoided, however, if the Federal Reserve buys a significant amount of the debt issued by the Treasury. Interest earned by the Fed is remitted to the Treasury, thus holding down interest rates and keeping the interest paid on the debt from burdening taxpayers. This is, in fact, what is happening under the Fed's current policy of quantitative easing. The Fed returned $45 billion to the Treasury in 2009 and a record $78.4 billion in 2010.

Deficit hawks also point to Germany as a country that has restored economic growth by practicing austerity. In fact, Germany has talked about austerity but is waiting for growth to be firmly established before actually cutting spending. A comparison of government expenditures over the 2007–2010 period in the United States and Germany finds a greater increase in spending in Germany (see Figure 6).

FIGURE 6
Myth: German "Austerity" vs. U.S. "Profligacy"—Change in Government Expenditures, 2007–2010



Source: OECD, http://stats.oecd.org/Index.aspx?DatasetCode=SNA_TABLE1.

Premature fiscal consolidation will slow growth and reduce tax revenues further. It won't achieve the hoped-for reduction in the deficit. While unemployment remains high, a large deficit is not a burden: it is not inflationary when there are unemployed resources. And, as we have seen, the Fed can buy Treasury debt and return the interest to the Treasury. Later, the Fed can raise bank reserves to unwind this policy.

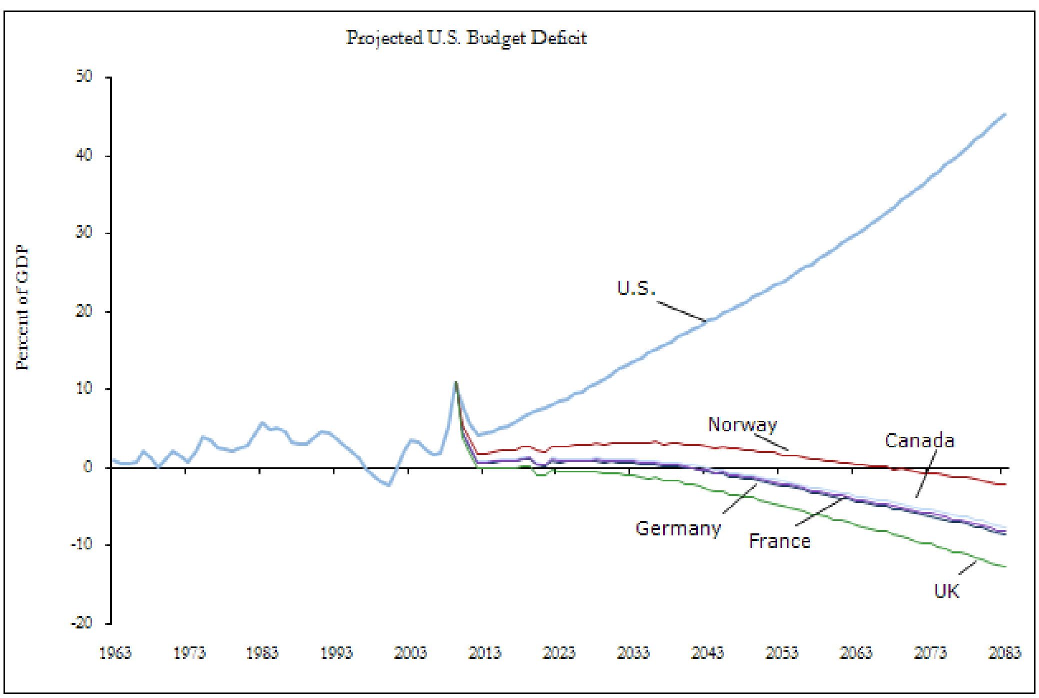
There are reasonable steps the president and Congress can take on both the spending and the tax sides to reduce the deficit without painful austerity measures. As the president and the Defense Department have made clear, there is room to cut military expenditures without undermining the safety of Americans. Corporate welfare can be eliminated. The government should be allowed to negotiate with drug companies over the prices it pays for medications in government-sponsored health care programs. Subsidies for oil and gas exploration and production can be cut, as can farm subsidies to big agro-business.

On the tax side, a number of reforms of the tax code are possible that will raise revenue without disadvantaging middle-class Americans. Enacting a small financial speculation tax—a fraction of 1% of the sale price on stocks, bonds, derivatives, and credit default swaps—would reduce the rapid turnover of stocks and other financial assets based on computer algorithms and high-speed computers in favor of longer-term investments based on market fundamentals. It would also increase annual tax revenues by more than $150 billion. Taxing dividends, capital gains, and so-called "carried interest" earned by investors in private equity as ordinary income would raise needed revenue while making the tax code more equitable. Finally, as we have seen, the top 1% of households has captured a very large share of national income. A higher top marginal tax rate on household income for this group would help reduce the deficit without imposing undue hardship.

The Long-Term Deficit

The United States does have a long-term deficit problem. The non-partisan Congressional Budget Office projects a dramatic increase in the deficit after 2020, with the rate of increase exceeding the growth rate of GDP. This has been framed as an entitlement crisis and as a reason for dramatic cuts in spending by the federal government. Yet, as Figure 7 makes clear, the U.S. deficit will increase in the long-term because the country has a long-term health care crisis, not because it spends too much on entitlements or on discretionary programs in education and social services. The long-term structural deficit in the federal budget is driven almost entirely by explosive growth in per capita health care costs. The United States already pays twice as much for health care as other wealthy countries, with the same or longer life expectancy as Americans enjoy, and this is expected to rise even further over the next decade. If the United States had per capita health care costs similar to other wealthy nations, we would be looking forward to budget surpluses, not budget deficits.

FIGURE 7
The Benefits of Controlling Health Care Costs



Source: Analysis of Congressional Budget Office and World Bank data.

Dealing with the long-term increase in the federal budget deficit will require dramatic reductions in the rate at which per-person health care costs increase; bringing down the growth in health care costs will go far toward making fiscal deficits manageable. The Obama administration's health care reform includes important developments in this direction, but much more will need to be done. This, rather than slashing Medicare and Medicaid expenditures, is the way to reduce government spending on health care without simply transferring those costs onto families or denying health care to poor children and vulnerable adults. It is worth noting that Social Security does not contribute to the deficit. By law, the program cannot pay out more than it has on hand. Cutting Social Security benefits directly or by increasing the retirement age will not reduce the federal deficit.

Digging Out

Employment growth in the recovery from the Great Recession has been shallow and slow. The labor market added 1.1 million jobs in 2010, but must still add more than another 7 million to get to the December 2007 level of employment—and this does not account for the increase in the working age population over the last three years. Much more needs to be done.

Immediate Policies with Little Impact on the Deficit

The continued crisis in the housing market in which homeowners who are underwater or unable to make their mortgage payments face foreclosure and the loss of their homes is a contributing factor in the slow recovery from the recession. Changing the rules on foreclosure temporarily to allow homeowners to remain in their homes for a substantial period of time as renters, paying the fair market rent, would increase the bargaining power and security of homeowners. The failure of the federal government to provide effective relief for homeowners facing foreclosure is a personal tragedy, a blight on many neighborhoods, and a drag on the economy.

Worksharing, in which employers temporarily reduce the workweek by, say, a day instead of laying workers off, has the potential to prevent layoffs, retain workers, and preserve skills. Unlike furloughs, which are unpaid, in worksharing workers collect unemployment insurance benefits for that day. In Europe, where it is more common than in the United States, the government typically subsidizes employers and tops off the UI benefit for workers so that workers lose very little income. The benefit for both employers and workers is that skills remain up to date, much long-term unemployment is avoided, and the country faces a much smaller increase in the unemployment rate. The millions of workers trapped in long-term unemployment will have difficulty finding re-employment, and the economy will suffer permanent losses in GDP. In addition, long-term unemployment has devastating effects on workers and their families.

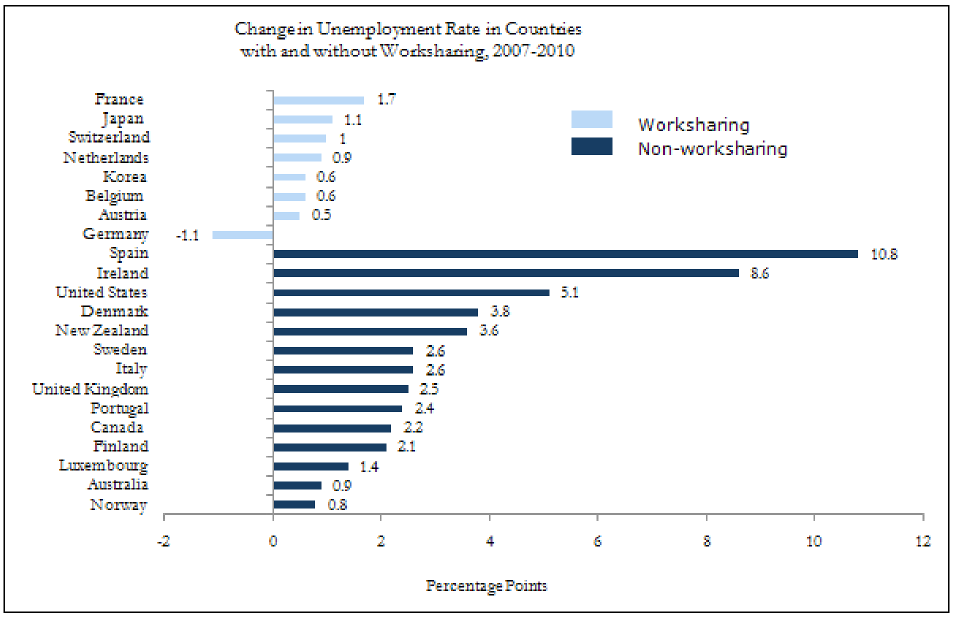
The United States is a very dynamic economy. Nearly 4 million workers separate from their employer each month, about half of them involuntarily. Currently, with employment growing slowly, a similar number are hired each month. If worksharing prevented one-tenth of these involuntary separations, it would be equivalent over a one-year period to an increase of about 2.4 million jobs. As Figure 8 shows, these programs have been effective in holding down the unemployment rates in countries that make use of them.

Policies that enable working families to meet both work and care responsibilities make it easier for workers to hold their jobs. Every employer should be required to provide a minimum of seven paid sick days a year to all their employees, not just managers and professionals, so that workers don't lose their jobs if they or a child gets the flu. A national system of family leave insurance, which could be employee-paid as it is in California and New Jersey, would provide workers with income when they need to care for a seriously ill parent, child, spouse, or partner or to bond with a new child—and would improve job retention.

The banking system has been a major beneficiary of taxpayer bailouts and special facilities that enable them to borrow funds from the Fed at below-market rates. They have received the bailouts and access to cheap money with no strings attached—shareholders and bondholders in these institutions have suffered no losses as a result of poor business practices and lax lending standards. Banks should be required to use funds that the Fed now provides at near 0% interest rates to lend to creditworthy small businesses on favorable terms.

Finally, President Franklin Delano Roosevelt, confronted with the massive unemployment of the Great Depression, pursued policies intended to increase wages in order to sustain increases in aggregate demand. He appointed Frances Perkins, a highly regarded and passionate advocate for the rights of workers, as labor secretary and, from the start, was committed to enacting systemic changes to reduce economic insecurity and encourage the growth of unions. Roosevelt won passage in 1935 of the National Labor Relations Act (the Wagner Act) that supported unions and collective bargaining. And in the midst of the Depression he won passage of the Fair Labor Standards Act, which guaranteed most workers a minimum wage and established the 40-hour workweek. Similar policies are needed today. Workers need to be able to organize via card check and to have the right to first contract arbitration if no contract is negotiated in a reasonable time after workers win union representation. The minimum wage needs to be increased and indexed to half the median wage so that no one who works full time will live in poverty and to provide an effective floor under middle-class wages.

FIGURE 8
Worksharing Implies a Smaller Rise in Unemployment



Source: OECD.

Returning to Full Employment Will Cost Money

While these are relatively low-cost or no-cost steps the government can take to increase economic growth and create more jobs, they will not be sufficient to return the economy to full employment. Households need to pay down debts taken on during the boom and bubble, and they are doing this. With households tightening their belts in these difficult economic times, the government has to step up its spending to fill the gap in private demand. What the economy needs is more stimulus, done well—a stimulus that yields maximum bang for the buck. High on this list of effective actions the government can take to stimulate the economy are making extended unemployment benefits available to out-of-work workers for as long as the unemployment rate remains high; increasing eligibility for food stamps; and revenue sharing with the states to staff essential services appropriately. It makes no sense to reduce the number of K–12 teachers at the same time we as a nation are placing renewed emphasis on increasing the number of workers with a college degree. Refundable tax credits for low- and middle-income households are an effective way to increase consumption and stimulate growth. Finally, we must invest in America's future now, while interest rates are low and resources are underutilized. High-return public investments in early care and education, in transportation infrastructure and mass transit systems, and in roads, bridges, and water systems increase the deficit in the short run but reduce it in the long run by increasing productivity and reducing costs.

Conclusion

In the short run, the choice is stark—more stimulus or persistent, high unemployment. The build-up of the housing bubble and the recession and financial crisis that followed when it popped are due to lax regulations and incompetent management of the economy. If economic policy focuses on deficit reduction and fails to provide a stimulus for more rapid economic growth and job creation, workers and their families will continue to experience high unemployment, declining wages, and economic insecurity due, again, to economic mismanagement.

For the long run, the recession and financial crisis have exposed the downsides of an economic model based on weakly regulated financial markets, stagnant wages, extreme inequality, and few employment protections for workers. Debt-financed consumption is not sustainable and cannot provide a stable foundation for economic growth. It is not a substitute for consumption growth and economic growth led by wage increases at the median in line with the economy-wide rate of productivity growth.