

Senate Democratic Policy Committee Hearing

“Will the Bush Economic Plan Create Jobs?”

MARK ZANDI

Economy.com

June 9, 2003

Mr. Chairman and members of the Committee, my name is Mark Zandi, I am the Chief Economist and Co-founder of Economy.com.

Economy.com is an independent provider of economic, financial, country, and industry research designed to meet the diverse planning and information needs of businesses, governments, and professional investors worldwide.

Economy.com was founded in 1990. We are an employee-owned corporation, headquartered in West Chester, Pennsylvania, a suburb of Philadelphia. We also maintain an office in London.

The economy is struggling and nowhere is this clearest than in the job market. The economy has lost over two million jobs in the past more than two years and the job losses have been notably broad-based across industries and regions of the country.

The economy needs more help from monetary and fiscal policymakers, and the recently passed *Jobs and Growth Tax Relief Reconciliation Act*, is a laudable effort, given substantial political limitations, to provide that help. The plan does nothing to directly support the job market, however, and although employment will be higher this year and next as a result of the legislation, these job gains will at best be very modest.

While expectations are strong that the economy will soon rebound and job growth soon thereafter, it clearly may not. Policymakers must therefore prepare now to provide even more economic stimulus, which should be specifically designed to help increasingly disenfranchised workers and induce businesses to resume hiring. Steps that should be considered include expanding the availability of extended unemployment insurance benefits, a payroll tax holiday, and specifically addressing the large and mounting burden businesses bear providing healthcare benefits to their employees.

I will address each of these points in some detail.

The economy is eking out real GDP gains and the housing and mortgage market continue to boom, but there's not much else positive in the economy to point to. Most disconcerting is that the economy's problems are particularly prolonged and broad-based. Job rolls have been more or less declining for over two years. Even by this stage during the jobless recovery of the early 1990s the economy had begun to generate a substantial number of jobs. Not since the Great Depression has the economy lost jobs over such an extended period.

The job losses are particularly widespread. Industries as wide-ranging as manufacturing, commercial construction, travel, retailing, investment banking, and now state governments are reducing payrolls. The economy's difficulties are also widespread from coast-to-coast. Large economies ranging from Boston and New York in the Northeast, to Atlanta and Dallas in the South, to Chicago and Detroit in the Midwest, to the Bay Area of California and Denver in the West, are engulfed in full-blown recessions.

The recent passage of more tax cuts and aid to state governments will provide a modest but much needed near-term boost to the struggling economy. The economic stimulus provided by the plan will add an estimated one-half a percentage point to annualized real GDP growth during the second half of this year and a like amount in 2004. Through the potpourri of provisions in the plan it will quickly put cash into household pockets, increase tax incentives for business investment, and provide aid to hard-pressed state governments. Investors will also receive a break from lower dividend and capital gains tax rates, although this will provide little boost to the economy even if investors attach a high probability to the possibility that the tax breaks will be renewed when they are set to expire later in the decade.

The plan does nothing to directly lower the cost of labor to businesses, however. Indeed, the plan is expected to result in some 250,000 more jobs by the end of this year and 500,000 jobs by year's end 2004. While not unimportant, the positive job impacts are small (the economy has lost over half a million jobs since the beginning of this year alone), and the cost to the Treasury of generating these jobs is substantial. Not much of an employment bang for the buck. Moreover, even assuming the sunset provisions in the plan are adhered to, the larger budget deficits and higher long-term interest rates that result from the plan will lead to fewer not more jobs in the longer-run.

Most economists, me included, are expecting the economy to soon rebound and to resume creating a meaningful number of jobs by this time next year. Improved confidence and lower energy prices in the wake of the Iraq war, a renewed vow by the Federal Reserve to be more aggressive in easing monetary policy, a lower value of the dollar, continued resilient productivity gains, and more tax cuts should soon reap economic benefits. Most economists, me included, have been wrong, however, about the strength and staying power of the current recovery. It is not inconceivable that economists, again me included, could once more be wrong.

Fiscal policymakers should thus be prepared to quickly come again to aid of the economy. This time, that stimulus should be explicitly designed to help the hardest-pressed part of the economy, namely the job market. What should policymakers be considering? First, to help those that most need it, and at the same time get a large bang for the economic buck, the availability of extended unemployment insurance benefits, beyond those provided by the recently renewed temporary extended unemployment compensation program, should be expanded. No more than a handful of states, whose jobless rates are high and have risen significantly, are eligible for these benefits. The requirements for eligibility for this aid should be relaxed. The change in the unemployment rate is a particularly poor measure of job market stress. Given the very prolonged problems in the job market in many communities, many previous workers are stepping out of the job market altogether, and thus not even being counted as unemployed.

Second, policymakers should consider a payroll tax holiday for both employees and employers. This would benefit all workers, wealthy and poor, and all employers, large and small. It would directly lower the cost of labor, and thus reduce the incentive for businesses to shed more workers. And since it is a holiday, the length of which would be determined by the severity of the economy's problems, it will not impact the federal government's long-term fiscal health and thus long-term interest rates. Such a holiday would be particularly efficacious leading up to and during the key Christmas buying season.

Finally, and perhaps most importantly, it is time for federal policymakers to carefully consider becoming more proactive in addressing what threatens to be large increases in employer health care costs long into the future. Businesses are not only considering their current health care bill when making hiring decisions, but they are considering the discounted cost of providing future health care benefits to additional employees. These costs appear particularly daunting given that there appears to be little meaningful reaction by policymakers to date. Partial privatization of Medicare, in exchange for new prescription drug benefits, is not a meaningful first step. The federal government instead should take a cue from state governments working to rein in their Medicaid costs, and enhance and use its size and market power to negotiate better terms and prices for beneficiaries.

The economy and the job market in particular have struggled significantly since the beginning of the millennium. Policymakers have acted aggressively to jump-start both, but so far to little avail. Even more help from policymakers may be needed in the months ahead. That help should be designed to directly support the willingness and ability of businesses to increase their payrolls.