The Economy and Higher Education
Forum for the Future of Higher Education

The Brookings Institution
Washington, D.C.
January 24, 2012

<u>U.S. Economic and Budget Outlook -- Transcript -- Summary</u>
Karen Dynan, Charles Schultze and Alice Rivlin

Karen Dynan is vice president, co-director of the Economic Studies program, and the Robert S. Kerr Senior Fellow at the Brookings Institution; Charles Schultz is a senior fellow emeritus in the Economic Studies Program at the Brookings Institution; and Alice Rivlin is a visiting professor at the Public Policy Institute of Georgetown University and a senior fellow in the Economic Studies Program at the Brookings Institution. They discuss the U.S. economic and budget outlook, and explain why the recovery from the financial crisis is as sluggish as it has been. The panelists also describe the nation's most serious problems as political, not economic.

Key Observations:

- Recent positive economic data has dissipated concerns about a double-dip recession in the United States.
- Nine million jobs were lost to the great recession. Given population growth, roughly 12 million jobs need to be created to get back to full employment. Even at the recent good rates of job growth seen in the past few months, it could take another 10 to 12 years to reach full employment.
- Unemployment is holding steady at about 8 percent. When the underemployed – those working fewer hours than they'd like to and those who have given up looking for work -- are included, the rate nearly doubles to about 15 percent of all workers.
- Housing market conditions are bleak. Demand is weak because soft income and wealth have depressed household formation rates. High rates of mortgage distress and foreclosures have exacerbated supply problems.
- Estimates of the shadow inventory of foreclosures -- that is, foreclosures yet to come -- range from a conservative 1.5 to 2 million up to two or three times that size. Weak

demand and extra supply will lead to further declines in house prices.

- Typically, in a dynamic economy like that of the United States, the ongoing pace of innovation, in combination with eased monetary policy, will stimulate an increase in investment by individual firms, whose future depends on keeping up with their competitors in terms of modernization of their production facilities and the sales of new and improved products.
- Those inherent growth forces, however, continue to be overwhelmed by the fallout of the financial crisis: namely, the decline in wealth and the greater insecurity that entails, leading people to spend less and save more.
- Eventually the inherent growth factors in the United States' dynamic economy will begin to outweigh the residue of the financial crisis. History shows, though, that the pace at which that recovery will occur will be far slower than recoveries from non-financial recessions.
- The most serious problems facing the United States are political, not economic. Economic recovery will be slow, but it will happen. Political partisanship and brinkmanship on the part of Congress, on the other hand, are dashing hopes of solving the short-term economic and long-term deficit problems the nation faces.
- Solutions to these problems are widely agreed upon across political parties. What's needed is legislation that provides additional meaningful stimulus now, and simultaneously enacts an increasingly rigorous deficit reduction program that begins several years from now, when recovery is well under way and assured.
- Inexorable increases in the cost of health care are driving up expenses faster than the economy can grow and generate tax revenue for Medicare, Medicaid and, to a lesser extent, Social Security. Health care costs must be contained and the tax code reformed so that our long-term budget deficit can be addressed. Political partisanship, however, has led to complete failure to act responsibly on these issues.
- The failure of the Joint Select Committee (aka, the Super Committee) to secure a bipartisan agreement to reduce the budget deficit was very discouraging. We are now left with only two forcing events that might lead to bipartisan budget compromise. First, the expiration of the Bush tax cuts at the end of 2012, which will raise tax revenue but not as a result of any tax reforms. Second, the sequestration mandating automatic cuts in

discretionary spending beginning in 2013.

- These two events will require action, probably in a lame duck session after the election, but given this Congress's recent record, it seems unlikely it will achieve a bipartisan compromise on a grand budget bargain in a lame duck session. More likely it will kick the issues down the road for at least a few months.