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THE Nation.

18 MILLION JOBS

HOW OBAMA CAN SAVE HIS PRESIDENCY 2012

BY ROBERT POLLIN

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Help Wanted

There is no more robust piece of conventional wisdom in Washington right now than this: Congress and the White House need to "do something" to address the jobs crisis.

EDITORIAL

In the wake of Scott Brown's Massachusetts victory, amid the conflicting messages—scale back the agenda! commit to a bolder agenda!—politicians and pundits across the spectrum were unanimous that delivering jobs is now Washington's job number one. "All of these things," said Rahm Emanuel, referring to the political messages of the past weeks, "all of these things start and lead to one place: J-O-B-S."

And yet. The jobs proposals on the table are paltry. As usual, the House acted first, passing a far smaller than necessary but at least decent jobs package with a price tag of $180 billion. In the Senate, the bipartisan compromise offered by the Finance Committee's Max Baucus and Chuck Grassley came in at $85 billion, $31 billion of which consisted of tax cuts with no job-creating justification (including an estate tax repeal that would benefit the richest 0.25 percent of households). So egregious was the bill that majority leader Harry Reid scratched it once its details were announced, replacing it with a $15 billion bill that still does less than the absolute bare minimum necessary.

It's difficult to overstate just how mismatched such proposals are with the scale of the crisis. As Robert Pollin notes in this week's cover story, we need to create somewhere near 18 million jobs over the next three years to get the economy back to full employment. Viewed in this context, the math is damning. By conservative estimates, last year's $787 billion recovery act is set to deliver 2.5 million jobs, but that leaves a gap of at least 10 million more jobs just to get back to pre-recession levels; and it is scheduled to taper off just as unemployment peaks. By leveraging $700 billion in private sector investment as Pollin suggests, we can probably create the needed jobs with an additional $200 billion in federal funds to shore up state and local governments. Yet here we are, talking about $15 billion. Imagine for a moment the reaction on the Sunday talk-shows if, after President Obama called for 20,000 more troops in Afghanistan, Congress approved spending for just 333.

As wrenching as it is, the unemployment crisis is not a policy problem without a policy solution, as Pollin persuasively demonstrates. The problem is politics. The deficit fearmongers have a stranglehold on the debate. At the same time, however, over the next few years the single most important political imperative for the White House and the Democratic Party is lowering the jobless rate. And despite the obstacles, there is a lot they can do to make this happen. For one thing, as Pollin notes, the Fed could use its sway to bring the banks on board.

But the proposals offered here could also be put to Congress, creating a series of difficult votes for the opposition. A bill that would require banks to lend more of their reserves for productive investments and small-business job creation—or, better yet, one that would tax their "excess" reserves—would be hard to oppose in an election year. Since much of the agenda revolves around leveraging private investment, promising coalitions could be assembled: small business associations should be happy to see the government expand loan guarantees, to choose but one example. To avoid death by filibuster, each jobs bill could be run through reconciliation, since each will almost certainly have a "substantial budgetary effect." The political case for ambitious federal action on jobs is nearly as compelling as the moral case.

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Unemployment in the United States stands officially at 9.7 percent. This represents 14.8 million people out of work. By a broader official measure that includes people employed fewer hours than they would like and those discouraged from looking for work, the unemployment rate is 16.5 percent, or about 25 million people in a total labor force of about 153 million. We have not seen comparable unemployment rates since 1983, twenty-seven years ago, and before that, not since the 1930s Depression.

The job-creation proposals coming from the Obama administration, in the president's January 27 State of the Union address and elsewhere, generally point in the right direction, with more spending for clean energy, infrastructure and support for small businesses. These proposals follow from Obama's February 2009 economic recovery program, which injected $787 billion in new spending or tax relief into the economy over two years. However, just as last February's stimulus program was too small to counteract the evaporation of $16 trillion in household wealth resulting from the financial collapse, the scope of Obama's current proposals is nowhere near large enough for the situation today.

For example, Obama has proposed $33 billion in new tax credits for small businesses. By contrast, private borrowing by businesses over the previous six months was down by $1.5 trillion relative to 2007, with the largest proportional cutbacks coming from small businesses. What's more, Obama's call to freeze discretionary federal spending in nonmilitary areas is dangerously misguided. The fiscal deficits of 2009 and 2010—at between $1.4 trillion and $1.6 trillion, or around 10 percent of GDP—are indeed very large. But the freeze obscures what Obama and his advisers clearly know—that deficit spending is part of the solution to our economic predicament and will remain so until we see millions of people getting hired into decent jobs.

Here is what we need: a commitment from the Obama administration to create 18 million new jobs over the remaining three years of the presidential term. That would mean an average increase of about 500,000 jobs per month, or a bit more than 4 percent growth in job creation over the next three years. This can be done by combining two broad types of initiatives: measures to buttress the economy's floor and thereby prevent another 2008-type collapse, and measures to inject job-generating investments into the economy. If such initiatives are successful, the official unemployment rate will stand at around 4 percent when Obama runs for re-election in November 2012.

Is This Realistic?

The central features of this plan can remain within the framework of proposals already established by the administration. The key is getting the scale large enough. The only way this can happen is by combining the positive energies of the public and private sectors. This public-private approach is not only practically necessary; it will also counteract right-wing claims that the government is seizing control of the economy in the name of job creation. Most of the financial heft will

have to come from banks and other private financial institutions. The banks alone are hoarding cash reserves totaling about $850 billion in their accounts at the Federal Reserve. Most of that money needs to be channeled into job-generating investments. For this to happen, interest rates and the risks for lending to small businesses need to fall substantially.

But it will be necessary for the government to keep injecting spending into the economy, which will add to the deficit. Scare stories aside, the fiscal deficit is not dangerously large. The interest rates the government is paying on its borrowing—as opposed to the rates that businesses have to pay on much riskier loans—remain historically low, in the range of 2 to 3 percent. This is because the world's financial magicians of just a few years ago have chosen to protect their remaining wealth by buying up the safest possible assets they can find, which are US Treasury bonds. When Ronald Reagan was running up record-breaking deficits in the early 1980s, the interest rates on the bonds were around 13 percent.

This huge gap in interest rates between now and the Reagan era will save the Treasury about $175 billion per year going forward. Also remember that falling unemployment rates reduce the deficit on their own, with each 1 percent drop generating about $90 billion in government revenues or reduced spending obligations. This is because when people are newly employed, they can support themselves and pay more taxes. We also need workers earning decent wages. Even if we didn't care about the ever-widening inequalities of wages, incomes and wealth, we would still need working people to have enough money in their pockets to boost sagging consumer markets. Conversely, when unemployment rises, the government is faced with huge extra spending burdens through unemployment insurance, food stamps, Medicaid and related social safety net commitments. The fiscal deficit could probably be eliminated altogether if unemployment could be driven down to around 4 percent, even without spending cuts or increases in tax rates. Finally, we can extract about $300 billion in savings and new revenues by ending the wars in Iraq and Afghanistan and by establishing a modest tax on speculative Wall Street trading.

One argument against taking bold measures now is that, mass unemployment aside, the official indicators tell us that the recession is over. The economy did grow at a robust 5.7 percent over the past quarter, though that may be only a short-term blip, driven by businesses restocking their depleted inventories. But let's assume that a recovery is indeed under way at more or less the normal rate of progress relative to recent recessions. In fact, under such a "normal" scenario, unemployment would not likely fall to around 5 percent until early 2017. We would not likely hit 4 percent unemployment until mid-2018, assuming the recovery could be kept going for another eight years.

Even with a successful coordination of large-scale expansions of private and public spending, is it realistic to expect that the economy, which has been so trampled down for the past three years, could possibly create 18 million jobs over the next three years? It is an ambitious but realistic goal. This is basically the rate at which employment grew under Gerald Ford and Jimmy Carter coming out of the 1974–75 recession. The Carter years are widely derided through the lens of his 1979 "malaise" speech. Yet the first three years under Carter generated the fastest expansion of job opportunities of any comparable period since, including any three-year stretch under Reagan or Clinton.

The Carter presidency, of course, ended disastrously with the severe 1980 recession. But this was because OPEC and the oil companies doubled oil prices between 1979 and 1980. Even more important, Wall Street insisted at the time that Carter appoint Paul Volcker as chair of the Federal Reserve to stop the inflation that resulted from the oil price shock. Volcker immediately raised short-term interest rates, pushing them as high as 17 percent by April 1980. This brought unemployment up to 7.5 percent in time for Reagan's landslide victory over Carter in November 1980. (It is ironic that among Obama's top tier of economic advisers, the same Paul Volcker is taking the hardest line against Wall Street excesses.)

Is 18 million jobs in three years realistic? It's basically the rate of employment growth under Ford and Carter after the 1974–75 recession.

Of course, we need to control inflation, especially when it results from oil price jumps. But we can do this by getting serious about energy conservation and new renewable energy sources, as well as being prepared to release our strategic oil reserves as needed, to force oil prices back down amid a crisis. Pushing unemployment down to around 4 percent will also provoke inflation fears because it is likely to bring wage increases, as workers' bargaining power improves. But rising wages do not cause inflation on their own, as long as wage increases are in line with how much workers produce on the job. Also recall that the average wage today is about 10 percent below its peak level of 1972, even though average worker productivity has risen by about 90 percent since the early 1970s. In short, now is the time to focus on creating 18 million decent jobs and not to remain fixated—as we were from Volcker's 1979 appointment until the 2008 financial collapse—on fears of moderately rising inflation.

Reducing the Pain

Mass unemployment creates widespread human suffering. Minimizing this suffering has to be the first priority in fighting the recession. Helping people in need also contributes to

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countering a downward recessionary spiral and thus helps prevent another collapse. In general, the Obama administration has done reasonably well on this front, but the demands are great. More than 3 million homeowners have lost their homes through foreclosures or related bank actions since the crisis began, and the foreclosure rate is running at 170,000 per month, near the peak for the crisis. The African-American community, targeted as a large potential market for subprime mortgages during the bubble years, is suffering disproportionately from foreclosures. Clearly, in this case, the administration's efforts have accomplished next to nothing. Economist Dean Baker has proposed the most effective plan to keep people in their homes, which is to allow them to stay in their homes as renters, paying market rental rates. The government also needs to continue extending unemployment benefits and increase support for food stamps to compensate unemployed workers and the poor for their income losses.

In the same vein are work-sharing programs that extend unemployment compensation to workers who accept reduced hours that then enable their companies to avoid outright layoffs. Indeed, work-sharing can be even more effective and fairer than traditional unemployment insurance, since it spreads the reductions in work hours across a wide group of workers rather than concentrating the effects of the recession on the minority of workers who become completely jobless. Work-sharing programs have long been a major part of the social safety net in Western Europe. Over this recession, Germany has been especially aggressive in extending these benefits to prevent rising unemployment.

Such programs already exist on a modest scale in seventeen states. Senator Jack Reed of Rhode Island has introduced a bill that would extend these programs and provide start-up funds to create measures in the remaining states. While this would be a very favorable development, we also need to recognize that work-sharing programs, similar to anti-foreclosure measures, unemployment insurance and food stamps, do not inject any new major source of spending into the economy. They will help firm up the economy's floor. But even here they will need additional support, especially given the budgetary crisis faced by state and local governments around the country.

Increasing support for state and local governments is not merely a stopgap measure but a key element of a long-term job-creation agenda.

Bringing State and Local Governments Back to Health

California's budget is in a deep ditch, with an eye-popping 56 percent gap between expected revenues and spending commitments. Most other states are also staring at huge revenue shortfalls. The jobs recovery will not succeed until this situation is stabilized. How could it be otherwise? State and local governments account for about $2 trillion in annual spending, or 14 percent of GDP. Either directly or indirectly through their supply purchases, they generate 30 million jobs, 20 percent of the entire American workforce.

They are also the institutions most responsible for delivering basic needs to people—education, healthcare, support for the needy, public safety and infrastructure.

Unlike the federal government, nearly all state and local governments are required to balance their operating budgets every year. In a recession, tax revenues decline in step with the decline in people's incomes, spending levels and property values. This means that state and local governments almost inevitably fall into crisis in a recession. There are only two ways to avoid this within our current fiscal arrangements. The first is to build up a major surplus of "rainy-day funds." But keeping large amounts of cash on reserve is very difficult to do even during healthy economic times, given that the demands for health, education and public safety programs are persistent. The other way for states to avoid cutbacks during a recession is to receive financial injections from the federal government.

The February 2009 recovery program provided $144 billion in support to offset that year's state budget shortfalls. This money was well spent. I know this firsthand through my own employer, the University of Massachusetts. We received around $50 million last year, which enabled us to prevent hundreds of layoffs. The layoffs would have sent shock waves throughout the region, since UMass is the largest employer in western Massachusetts. One can tell comparable stories in scores of communities around the country. Another roughly $200 billion is needed now. The Obama administration is supporting measures that would amount to perhaps $30–$50 billion.

Increasing support for state and local government activities should not be seen as merely a short-term stopgap but also as a major element of a longer-term job-creation agenda. The main activities supported by state and local governments are all effective sources of job creation, in comparison for example with military spending. Thus, infrastructure projects create 40 percent more jobs per dollar than spending on the military, healthcare creates 70 percent more jobs and education creates 240 percent more jobs. So if the government just moved its 2008 budget of $188 billion for Afghanistan and Iraq into support for education and infrastructure programs at the state and local levels, this alone would produce a net increase of about 2.3 million jobs per year.

Scaling Up the Green Recovery

One of the Obama administration's main jobs initiatives is retrofitting buildings, especially private homes, to make them more energy efficient. The president has described home retrofitting projects as a "sexy" way to save money. In fact, even relatively small investments in home retrofits, in the range of $2,500, can pay for themselves in three to four years, since they can lead to monthly energy bills falling by

between 25 and 30 percent. These measures also produce rapid environmental benefits, since raising energy efficiency is the easiest way to cut greenhouse gas emissions.

Despite these attractions, private investments in retrofits have not expanded quickly enough to serve as a major jobs engine. The private market for retrofits remains underdeveloped. This is because homeowners are understandably wary about making investments when they are cash-strapped and their home values have collapsed. They are also not eager to face the hassles of dealing with banks, utility companies and work crews. This could all change rapidly if banks, utilities and community organizations could, in various combinations, figure out how to make retrofits easy and widely accessible for homeowners.

In the meantime, the government needs to take the lead by immediately advancing a major nationwide retrofitting initiative. The opportunity is enormous. There are roughly 24 billion square feet of building stock in hospitals and healthcare, education and government buildings. This is about 20 percent of all US building stock. Retrofitting these buildings would cost about $150 billion. If we assume this program is implemented over three years, at $50 billion per year, this would generate about 800,000 jobs per year over those three years. Retrofits are a highly efficient source of job creation, since all the work must be done within local communities, and a large proportion of the budgets go to hiring workers, as opposed to buying equipment, land and energy.

This government-led project could be the launching point for a larger effort to build the institutional and market support for retrofitting remaining private-sector structures on an economy-wide scale. In addition to private hospitals and schools, the potential market for private retrofits for commercial and residential buildings is in the range of $650 billion. If even 20 percent of these buildings were retrofitted by the end of 2012, it would create another 800,000 jobs per year. Retrofitting alone could thus generate about 1.5 million of the 18 million jobs we need to create by the end of 2012. About 600,000 of them would be in construction, making up for one-quarter of the 2.6 million construction jobs lost since mid-2007.

Of course, the broader green investment project will need to expand well beyond retrofits to encompass public transportation, electrical grid upgrades and the creation of a competitive renewable-energy manufacturing sector. These will all be major sources of job creation over time. The same is true for investments in rebuilding our traditional infrastructure of bridges, roads and water management systems. But if we are serious about creating 18 million jobs within three years, retrofitting is the place to begin.

The most powerful force for creating the jobs we need will be the same financial institutions that caused the crisis in the first place.

Making the Banks Respectable

The most powerful factor for creating 18 million jobs in three years will be the country's private financial institutions. Yes, I am referring to the same institutions—the banks, savings and loans, brokerage houses, insurance companies and hedge funds—whose reckless practices created the economic crisis in the first place.

That is the point. Financial institutions are a formidable force for both good and bad. They were effectively regulated for roughly thirty years after World War II, in the shadow of the 1930s financial collapse and Depression. This played a major role in generating the "Golden Age" of American capitalism through the mid-1970s, with rapid growth, low unemployment rates, diminishing inequality and historically unprecedented levels of financial stability. Without delving here into the details of today's debate on how to re-regulate finance—a debate, incredibly, still dominated by Wall Street—let's be clear on first principles. This is simple: we need regulations that will help channel credit toward productive, job-generating activities and away from hyper-speculation. For starters, that means pushing the lion's share of the banks' $850 billion in cash reserves into productive investments.

Of course, the banks need to maintain a reasonable supply of cash reserves as a cushion against future economic downturns. One of the main causes of the 2008–09 crisis and other recent financial crises was precisely that the banks' cash reserves were far too low.

In 2007 banks were holding only $21 billion in cash reserves. But increasing reserves from $21 billion to $850 billion in little more than a year is a new form of Wall Street excess. Let's say that banks should keep $200 billion in reserves as a cushion, a level roughly in line with the amounts they held during the era of regulation. The banks could still lend $650 billion to businesses just from the funds they are sitting on. At the very least, we could assume that overall new lending for productive, job-creating activities could be in the range of $700 billion or above, once we allow for funds coming from savings and loans, insurance companies and other financial institutions in addition to the commercial banks. We would then anticipate that the financial institutions would increase business lending by comparable amounts in 2011 and 2012. Doing so would help set a level of overall lending at roughly its average level during previous economic recoveries. At the same time, expanding credit and productive business investments by around $700 billion per year could by itself deliver nearly 18 million new jobs by the end of 2012.

A big problem is not only that banks are reluctant to lend but also that businesses are unwilling to borrow. Businesses have been heavily scarred by the recession and are not eager to take on new risks. Financial market policies therefore need to focus on helping to boost business confidence and reduce the risks of job-creating investments. The first step here would be for the Federal Reserve to substantially lower the interest rates at which private businesses may borrow. The Fed has been maintaining the interest rate at which private

banks borrow among themselves—the "federal funds rate"—at little more than zero for more than a year. But the rates at which nonfinancial businesses may borrow are at historic highs relative to the nearly zero federal funds rate.

An average solid business now has to pay about 6.5 percent interest for a long-term loan, roughly 6 percent more than the rate at which banks may borrow. The Fed needs to push the business borrowing rates down to 3 to 4 percent. The Fed has the power to make such a move, though to do so would certainly deviate from standard practice. But let's recall that nothing the Fed did during the 2008–09 crisis to bail out the banks followed the rule book. It is time for the Fed to pursue innovative policies that will directly benefit ordinary businesses and working people.

The government also needs to intervene to lower the risks facing banks making loans for productive investments and the businesses doing the investing. The policy tool to ramp up here is the government's loan guarantee programs, which support small businesses, green investments, students, rural development and affordable housing. In 2007, the last year before the recession, the government guaranteed about $250 billion in private-sector loans.

It is time for the Fed to pursue innovative policies that will directly benefit ordinary businesses and working people.

The government should roughly double the level of support—i.e., guaranteeing another $250 billion in loans per year—to dramatically expand low-risk opportunities for a wide range of job-generating investments. The proposals being advanced to create a specialized Green Bank as well as an Infrastructure Bank fit comfortably within this broader agenda of channeling the country's financial resources to high-priority projects. At the same time, if banks decide they still can't resist pouring huge sums into the Wall Street casino, they will have to forfeit their eligibility for loan guarantees. The banks should also be required to continue holding high levels of cash reserves as a cushion against their high-stakes gambling. Keep in mind that the government holds controlling stakes in AIG—what had been the world's largest and most sophisticated financial insurance company—as well as Fannie Mae and Freddie Mac, still the most influential mortgage-lending institutions. AIG, Fannie and Freddie could easily convert part of their operations previously devoted to hyper-speculation to supporting guaranteed loans focused on job creation.

What happens when businesses default on these guaranteed loans? Won't this blow a hole in the government's fiscal deficit? Here is what recent experience tells us. In 2007 about 4 percent of the government's guaranteed loans went into default. If we assume that the default rate remained at roughly the 2007 level for this expanded program, that would add about $9 billion, or 0.3 percent, to the federal budget. Even if, implausibly, the default rate on the new loans doubled relative to the 2007 level, that would still increase the federal budget by only 0.6 percent. In short, roughly doubling the government's traditional loan-guarantee programs is eminently affordable as well as an effective means of reducing risks for private businesses, which in turn would encourage them to make the $700 billion in new job-creating investments we need.

How does the set of proposals outlined here realistically get us to 18 million new jobs by the end of 2012? Starting with the $850 billion cash hoard that commercial banks are holding in their Federal Reserve accounts, we move about $700 billion in new credit into domestic employment-focused investments. Assuming we have established a firm floor for the economy through the measures discussed above, injecting $700 billion in new spending into the economy will generate about 5.5 million jobs in 2010. That's because this $700 billion will generate a 5 percent rate of GDP growth, which in turn translates into about 4 percent employment growth. My calculation here assumes that the mix of total employment will shift toward green activities and education, where the jobs per dollar of spending are significantly higher than alternatives such as fossil fuel energy and military spending. We then build from the momentum of a strong 2010 recovery to maintain the roughly 4 percent rate of employment growth in 2011 and 2012, which will create about 6 million jobs in 2011 and 6.5 million in 2012. By the end of 2012, about 156 million people would be employed, 18 million more than the 138 million working today (see www.peri.umass.edu for details on these and related calculations).

The necessity of advancing a jobs program on this scale follows from the fact that the crisis before us is not just 9.7 percent unemployment, narrowly defined, or 16.5 percent unemployment, more reasonably defined, though these figures obviously speak volumes about the interlocking failures of our political and economic systems. Even under a fairly favorable economic scenario, we will be saddled with deep unemployment problems well beyond the 2012 presidential election and perhaps up to the 2016 election, unless we take dramatic action now. Given the severity of the 2008–09 financial crash and recession, it would also be foolish to assume that a healthy recovery is a sure bet. Making things worse is that the Obama administration and Democratic Congress—yes, the Democrats do still hold strong majorities in both Houses—appear unwilling to take actions consistent with the depth of the problems at hand.

Perhaps one can forgive them for underestimating what was needed with the February 2009 recovery program. The full extent of the financial crash and recession were not evident then. I too underestimated what was needed at the time, writing in these pages fifteen months ago ("How to End the Recession," November 24, 2008). The facts and choices before us are now much clearer. We can indeed create 18 million jobs and drive the unemployment rate to 4 percent by the end of 2012. But we have to begin now, we have to stop thinking small and we have to be willing to fight. ■