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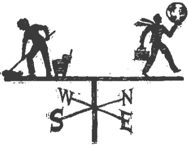

ECONOMIC PROSPECTS

Fighting Seriously for Jobs and Social Security

As the severe unemployment crisis drags into its third year, proposals for solving the crisis are proliferating. Even more ideas will be tossed into the mix as the 2012 election season intensifies.

Some of these proposals are good, some are less good, and some are truly awful. The plan offered by President Obama last September included a mix of some good ideas, such as more spending on infrastructure and education, along with some bad ones, like cutting Social Security taxes (otherwise known as payroll taxes). The single worst idea in the mix, supported by deficit hawks in both the Democratic and Republican parties, is that we are facing a fiscal train wreck and we therefore, above all, need to cut government spending. At the same time, there are actually some major avenues still open for stimulating job creation—both because they could create lots of jobs relatively quickly and because they could do so cheaply—that most policymakers and politicians have thus far ignored.

THERE IS NO FEDERAL DEBT CRISIS

The official debate over the economy shifted decisively last summer, away from proposals for job creation to obsessing over the size of the federal government's deficit (how much we are borrowing each year) and debt (how much we owe overall). The federal deficit has, indeed, been historically large since the recession began, running at about 10 percent of GDP for the past three years, as opposed to the historic average of 2 percent of GDP. But that is only because the jobs crisis itself is of historic magnitude. Solving the unemployment crisis would accomplish far more than any other measure toward bringing the federal deficit down. This is simply because when more people have jobs, they also pay more taxes and rely less on government support, such as unemployment insurance and Medicaid.

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There is another point to emphasize here. Despite the historically large fiscal deficits, the federal government is now paying interest on the total outstanding debt at a rate that is historically low, not high. This is for the simple reason that the interest rates on U.S. Treasury bonds are themselves at historic lows, at around 2 percent. As such, while it is true that the government will need to reduce its borrowing once the recession is behind us, there is no immediate crisis whatsoever in terms of the government paying off the debt obligations it faces now or over the next few years.

CUTTING SOCIAL SECURITY TAXES AS A JOBS PROGRAM IS PERILOUS

Since its inception in 1939, the political right in the U.S. has been trying to kill Social Security. These efforts have failed up until now because the program has maintained overwhelming political support. The enduring popularity of Social Security follows from the fact that, over seventy-two years, it has succeeded in reducing poverty for retired people and those with disabilities, and has done so at minimal administrative expense.

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The 2011 cut in the payroll tax, from 6.2 percent to 4.2 percent, that applied to workers is costing the system $112 billion, or 15 percent of total expected revenues for this year. Obama's proposal for 2012 would reduce the rate further, which could bring the overall loss of funds for Social Security to more than 25 percent of committed outlays for 2012.

The Obama administration says that the lost Social Security revenues resulting from the payroll tax cuts will be replenished from general revenues. It is no doubt sincere in this intention. But cutting the traditional source of Social Security revenues, even temporarily, entails compromising the principle that Social Security is a self-financed, stand-alone program, whose funding is inviolate. If funding for Social Security starts being treated regularly in the same manner as all other government programs, it then becomes vulnerable to the types of attacks that have already occurred over the past year with public education, public safety, and pension programs for state-level workers.

SMALL BUSINESSES NEED CREDIT

The biggest single drag preventing a recovery from taking hold has been the dramatic contraction in credit flowing to smaller businesses—i.e., those with five hundred or fewer employees. Beginning in 2008 and continuing into 2011, non-corporate businesses as a whole have undertaken *zero* net borrowing to finance business expansion and job creation. This was in contrast to 2007, the last year before the financial crisis, when they borrowed more than $500 billion to expand their operations and hire new workers. This pattern is especially damaging for prospects of a jobs recovery since smaller businesses account for more than 60 percent of all jobs in the U.S. economy. They are also the main source of both job expansions and contractions.

One major factor holding back small businesses is the recession itself. They continue

to experience weak demand for their products in the marketplace, so they are unwilling to put money at risk by expanding their operations. But the other overarching problem is that small businesses are getting locked out of credit markets even when they are ready to start spending. A summer 2011 survey by Pepperdine University's Graziadio School of Business and Management found that 95 percent of business owners report wanting to execute a growth strategy, but only 53 percent were obtaining the funding they needed to execute that strategy. Meanwhile, bankers were reporting that they were rejecting 60 percent of their loan applications. Getting money into the hands of small businesses that are primed to invest and hire workers should be an idea that all Democratic and Republican politicians support.

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COMMERCIAL BANKS ARE HOLDING MASSIVE CASH HOARDS

While small businesses continue to be short of investment funds, the U.S. commercial banks are now sitting on an historically unprecedented cash hoard of $1.6 trillion, equaling more than 10 percent of U.S. GDP. In previous recent periods after recessions, the banks' cash reserves averaged well less than 1 percent of GDP.

The main reason the banks have built up this unprecedented cash hoard is that, since the recession began, the Federal Reserve has pursued an aggressive policy to stimulate the economy, accompanying the Obama administration's other efforts at stimulus. The main tool deployed by the Fed has been to hold the short-term interest rate that it controls—the "federal funds rate"—at near zero since mid-2008. As a result, the banks have accumulated their massive cash holdings precisely because they have been able to obtain these funds virtually for free. Fed Chair Ben Bernanke has also recently announced that it will continue to hold this interest rate at near zero through 2013.

But the point of the Fed's zero-interest-rate policy is obviously not to just provide the commercial banks with unlimited free cash which the banks then hoard, but rather to have these funds moved into productive investments and job creation. The banks claim that they are unable to expand lending now because they also see weak market demand and a high-risk environment. Such concerns are real, but not to the extreme where banks should reject 60 percent of loan applicants while they continue to receive unlimited free cash from the Fed. Another factor here is that the banks have become more adept at various forms of financial engineering and speculation, as opposed to seriously exploring possibilities for underwriting the growth of small businesses. Until smaller businesses start receiving these funds and putting them to productive uses, all other efforts at pushing the economy out of its slump will be greatly weakened.

PUSHING THE BANKS TO SUPPORT JOB CREATION

Two straightforward and inexpensive policy initiatives—one carrot and one stick—could themselves transform the landscape. The carrot is an expansion of existing federal loan guarantees by something like $300 billion. This would roughly double the number of annual guarantees provided by the federal government. In a stroke, it would dramatically lower the risks facing both small businesses and banks as they calculate their prospects for investing in what remains a highly tenuous environment. Of course, some businesses will default on these loans. But even if we allow for an implausibly high default rate of, say, 12 percent—which is three times higher than the rates on the government's existing guaranteed loans—the costs to the government would still be only about 1 percent of its overall budget.

Injecting $800 billion [into the hands of small businesses] should lead to the creation of about twelve million new jobs.

The stick is for the government to tax the excess cash reserves now held by banks, to push the banks to become more bullish on loans for job-creating investments, again especially for small businesses. The tax rate only needs to be high enough to persuade the banks to stop hoarding mountains of cash. A 1 percent tax on money they received for free may well be adequate. The revenues from the tax could also cover the costs of the defaults on guaranteed loans.

If administered effectively, these two measures should be capable (over about three years) of moving at least half of the idle cash now sitting with the banks—i.e., $800 billion—into the hands of the small businesses that are prepared to expand and hire workers. The total impact of injecting $800 billion should lead to the creation of about twelve million new jobs, which could help drive the unemployment rate down to around 5 percent.

It would thus serve as an effective complement to the types of public spending proposals—for infrastructure, the green economy, state and local governments, and unemployment insurance—proposed by Obama. The success of this initiative could therefore provide the foundation for delivering what working Americans need and deserve right now—an environment supporting the long-term defense of Social Security, along with the basic right to a decent job.