“The Trump Stimulus and the Money Obama Left on the Table”

Remarks by Dean Baker
Co-Director, Center for Economic and Policy Research (CEPR)

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In his campaign, Donald Trump committed himself to a substantial infrastructure spending program as well as a set of classic Republican-style tax cuts. There are many questions to be asked about the shape of the infrastructure program. Trump has indicated he wants to promote privatized projects, which are often invitations to waste and corruption. He also has explicitly said that he doesn’t believe in human-caused global warming, which means that his plan may not be good news for the environment.

On the tax side, we know that the wealthy will be the primary beneficiaries. According to an analysis of one version of Trump’s proposal by the Tax Policy Center, the richest one percent of households would get more than half of the tax savings, with the richest 0.1 percent getting an average savings of almost $1.5 million a year. The cut in the corporate tax rate is likely to be a further boon for higher income households.

Apart from the equity issues, and the fact that wealthy people are less likely to spend a tax cut than middle- and lower-income people, the tax cuts combined with the infrastructure plan are likely to provide a substantial boost to demand. This will lead to more economic growth and most importantly, more people will have jobs.

In spite of the sharp drop in the unemployment rate under President Obama, the labor market is still quite weak by many measures. The employment rate for prime age workers (ages 25–54) is still 2.0 percentage points below its pre-recession level. It is 4.0 percentage points below its 2000 level. This corresponds to between 2.5 to 5.0 million missing jobs.

Most of these people are not counted as unemployed because they are no longer looking for work. It’s common for people to give up looking for work if they have been unsuccessful for six months, one year, or longer. In spite of not actively looking for work, there are good reasons for believing that a substantial share of these people would still take jobs, if they were available. After all, not many people can afford to retire in their early 40s.

It is important to note that a popular media theme, that the problem is men watching Internet porn and playing video games and suffering from drug addiction, doesn't fit the data. The drop in employment rates since 2000 has been very similar for men and women. This suggests that the problem is a weak labor market, not behavioral problems of men, although it is undoubtedly true that men facing long-term unemployment often face serious psychological problems.

This weak labor market is the reason that Trump's plans actually could provide a substantial boost to the economy and employment. If the economy were actually near full employment, the additional spending would lead to higher interest rates and/or higher inflation. In that scenario most, or all, of the boost to demand would be offset by a drop in investment, net exports (due to a higher valued dollar), and home building and buying.

This weak labor market is the money that President Obama effectively left on the table. It is the additional room left to expand the economy, which we have not used because we didn't have enough spending. In fairness to President Obama, he repeatedly proposed spending more in infrastructure, child care, education and other areas, but the Republican congress blocked him at every step. They argued that the resulting budget deficits were bankrupting the country and were prepared to shut down the government rather than let President Obama succeed.

The switch from staunch deficit hawks under Obama to big spenders under Trump will be one of the greatest exercises in hypocrisy in modern times (perhaps the media will be able to take a few minutes form reporting on Hillary Clinton's e-mails to notice). Nonetheless, stimulus is the right policy, even if the composition of the stimulus is awful.

The potential gains from further boosting employment are enormous. The people who get jobs are disproportionately those at the bottom of the ladder, people with less education and African Americans and Hispanics. Furthermore, the tightening of the labor market will give tens of millions of people more bargaining power, which means that they will have the opportunity to see wage gains. The only time in the last four decades where workers at the middle and the bottom of the wage distribution were able to see sustained wage gains was in the period of tight labor markets in the late 1990s.

The longer term benefits from a tightening of the labor market could be even more important than the short-term benefit. The reason is that the actual state of the labor market sets a benchmark for future performance. There are many economists in policy positions who are arguing that the current employment-to-population ratio is the best we can do, and that the economy is now at or very close to full employment.

In effect, they are saying that the millions of people who dropped out of the labor market really don't want to or are not able to work. This means that we should not even try to further boost demand, since it would just lead to higher inflation, without generating a substantial number of new jobs. Given the authority of the people making this argument, even if they lack supporting evidence, the only way to win is to actually push the employment rate higher than its current level.

We saw exactly this story back in the 1990s. In the mainstream of the economics profession it was considered an absolute truth that the unemployment rate could not get much below 6.0 percent without triggering an inflationary wage-price spiral. This wasn't just conservatives who held this position, but also liberals like Alan Blinder, Paul Krugman, and Janet Yellen. To argue that the unemployment rate could substantially lower was not just wrong, it was laughable.

It turned out that this economic consensus was wrong, which we were able to prove by virtue of the fact that the unemployment rate fell below 4.0 percent, and actually stood 4.0 percent for a year-round average in 2000. This happened because Alan Greenspan, who was not a mainstream economist, was chair of the Fed at the time. When many of his colleagues at the Fed, including Clinton appointees like Yellen, insisted that he raise interest rates to slow growth and job creation, he refused. He argued that he did not see evidence of rising inflation and therefore didn't see a reason to slow the economy.

The benefits of Greenspan's decision were not limited to the strong economy and the opportunities it created for people in the late 1990s. The fact that we could have a 4.0 percent unemployment rate without an inflationary spiral, meant that the six percenters were undeniably wrong. We could have much lower rates of unemployment than they claimed. The result was that the Congressional Budget Office and other official forecasters adjusted downward their targets for unemployment. In 2005, it was not acceptable to say that 6.0 percent unemployment is the best we could do, as had been the case a decade earlier. We were expected to pursue policies that would push the unemployment rate lower. And the beneficiaries of the lower unemployment would be disproportionately the most disadvantaged in society.

In the current context, the gains will be less in the measure of unemployment than in the employment rate. If we pull millions of people who are currently not working back into the labor force, then we don't have to argue whether they are willing and able to work. The facts will have to speak for themselves. The result will be that it will no longer be acceptable for people in policy debates to claim that 2.5–5.0 million prime age workers decided to retire early.

There is also an international aspect to this issue that is worth mentioning. There have been similar declines in labor force participation in many European countries. Sharp reductions in government spending have limited demand, leading many to view their employment prospects as hopeless. The leadership in the European Union is happy to ratify this situation, running policies that lead to sub-2.0 percent annual growth, a pace that will make little if any dent in the large number of people without jobs.

The example of a program of tax cuts and spending in the United States, however poorly targeted, leading to more growth and employment, will likely strengthen the forces in the European Union pushing for policies to reduce unemployment. At the very least, it will be a bit harder for the proponents of the status quo to argue that such a stimulus program is not possible.

The Democrats have put themselves in an awkward situation relative to a Donald Trump stimulus. President Obama was forced by the Republican Congress to cut back spending and implement austerity. He asked many times for additional spending in a variety of areas, but the Republicans were not going to cooperate. They are now prepared to allow Donald Trump get away with much larger deficits since they are primarily the result of tax breaks for the wealthy.

But this hypocrisy doesn't change the fact that these deficits can still provide a boost to the economy. It would have been helpful if President Obama had continually repeated his requests for more spending and pointed out the obstructionism of the Republican Congress. Unfortunately he let the issue slide, and in her campaign, Hillary Clinton made it a virtue that she was paying for all her spending. The implication was that adding to the deficit would be a problem.

It is important to acknowledge the economic reality, even if it implies some reversal from the recent political path followed by the Democrats. We can have arguments over policy and even the underlying economics, but we can't fall into the trap of saying that Trump's policies will fail just because we don't like him. Economic denialism makes no more sense than global warming denial. We have to do our best to understand the world as it actually is, and that should be the jumping off point for our actions.