The U.S. Economic Recovery and Outlook

Remarks by Jason Furman
Chairman, Council of Economic Advisers

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It is wonderful to be here in Bogotá. Colombia is a key partner to the United States in every respect—including in the economic partnership that my friend Minister Cárdenas and I will be discussing today. Our nations traded $39 billion in 2014, including in important areas like energy, agriculture, and aircraft equipment—and we can expect to see trade ties continue to deepen as a result of the U.S.-Colombia Trade Promotion Agreement. Indeed, both Colombia and the United States are growing at a strong pace despite slowing global demand. Colombia is among the fastest-growing economies in Latin America, with steadily declining unemployment and poverty rates, in part because your strong economic policies have helped unleash the power of the private sector in areas like manufacturing, finance, and transportation. Colombia's flexible exchange rate, fiscal rule, and inflation target all promote strong and sustainable macroeconomic growth. Moreover, Colombia's successful national resource management is helping to create a more diversified economy. Even with falling oil prices, Colombia's economy still grew 4.6 percent in 2014. The United States is also enjoying an increasingly rapid expansion that is reducing our unemployment and poverty rates as well.

But both our countries also face important challenges. In my remarks today, I will review the progress of the economic recovery in the United States and address the headwinds and opportunities that we face. I hope that you will find the U.S. experience of intrinsic interest and that it may also provide an informative context for thinking about some of the policy issues you are facing in Colombia.

The U.S. Economy in 2015

The Recovery So Far

After the global financial crisis, the United States and many other countries faced obstacles to recovery that were more challenging than those posed by a normal cyclical recession. The recession began with a collapse in household wealth and global trade that initially exceeded the declines at the onset of the Great Depression, as shown in Figure 1A and Figure 1B. The headwinds to recovery included weak bank balance sheets that constrained credit supply, highly indebted consumers that constrained credit demand, and substantial investment overhang in key cyclical sectors such as housing. The recovery's challenges were compounded by unprecedented State and local government spending cuts that dragged on growth through the first few years of the recovery. Despite these challenges and the steeper initial declines, both trade and wealth recovered faster after the Great Recession than after the Great Depression.

Figure 1A

Global Trade Flows in the Great Depression and Great Recession

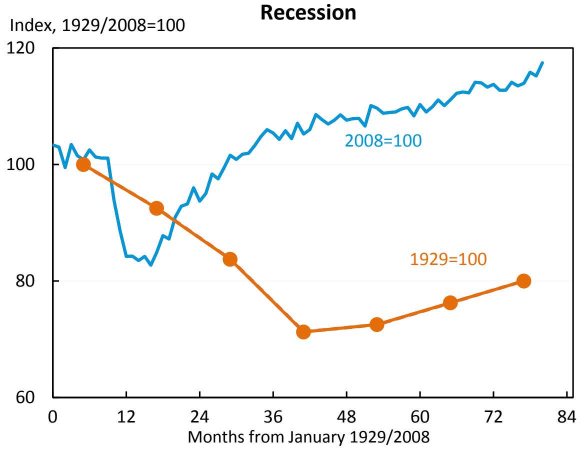
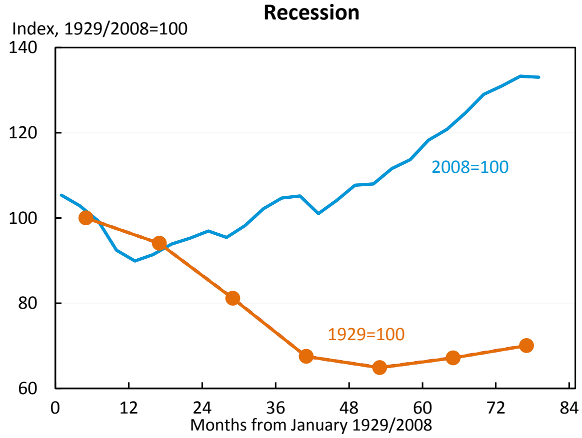


Figure 1B

Household Net Worth in the Great Depression and Great Recession



In 2013 and 2014, the U.S. economy grew 0.6 percentage point faster per year than in the first three-and-one-half years of the recovery, as shown in Table 1. A large increase in personal consumption growth and a shift from State and local contraction to expansion contributed to the pickup over this period. More recently, growth in 2014 was aided by a shift toward a more neutral stance for Federal fiscal policy.

Table 1

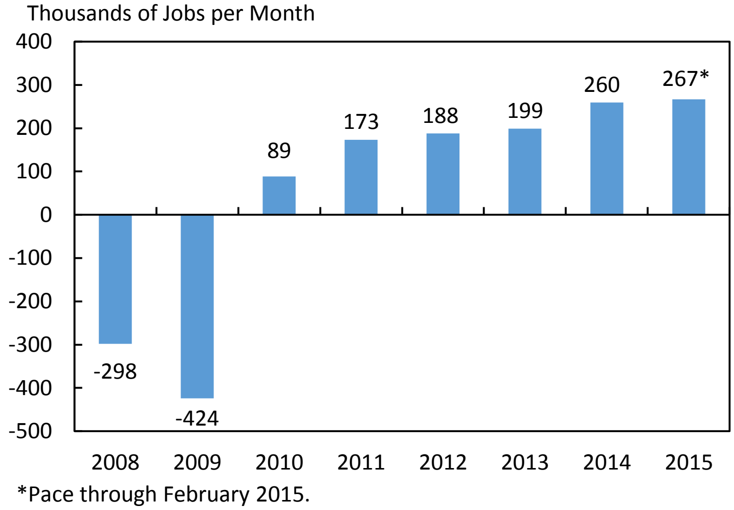
Components of Real GDP

(percent change at an annual rate)

	Start of Recovery (09:Q2-12:Q4)	2013 and 2014 (13:Q1-14:Q4)
Gross Domestic Product	**2.1**	**2.7**
Consumer Spending	2.0	2.8
Business Fixed Investment	5.2	5.4
Residential Investment	5.9	4.6
Exports	7.4	3.6
Imports	6.8	4.0
Federal Gov't	- 0.6	- 3.1
State & Local Gov't	- 2.2	1.2

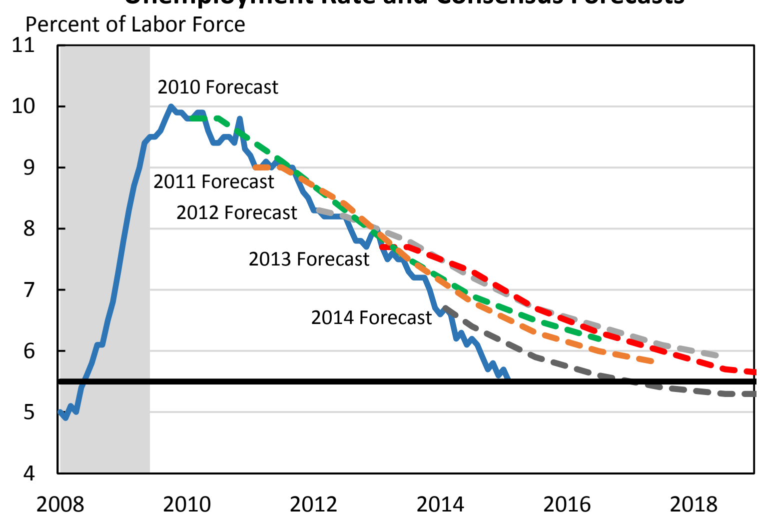
The recovery’s strength has been particularly pronounced in the labor market. The pace of total job growth rose to 260,000 a month in 2014, up from 199,000 a month in 2013, as shown in Figure 2. This pace has persisted through the first two months of 2015.

Figure 2
Average Monthly Nonfarm Employment Growth



As recently as 2013, most forecasters expected that the unemployment rate would remain above 5.5 percent until at least 2019. But unemployment fell to 5.5 percent in February 2015, as shown in Figure 3—four years ahead of schedule. Moreover, the labor force participation rate has stabilized since fall 2013. Long-term unemployment and the number of workers employed part-time because they cannot find a full-time job—while still elevated—have also declined.

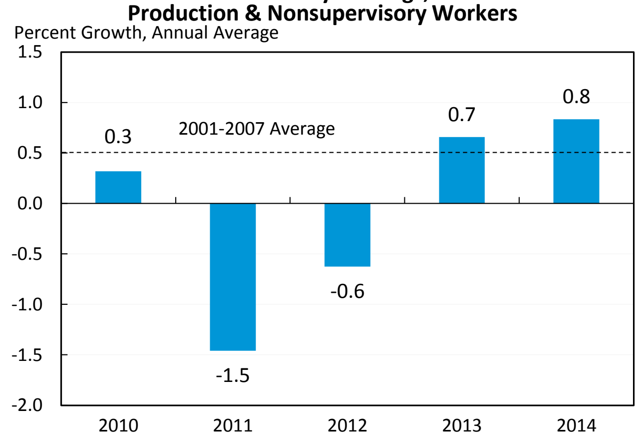
Figure 3
Unemployment Rate and Consensus Forecasts



These labor market improvements have begun to translate into wage gains for middle-class workers. Average earnings for production and nonsupervisory workers, shown in Figure 4, function as a reasonable proxy for median wages. Real hourly earnings for these workers rose 0.7 percent in 2013 and 0.8 percent in 2014.

Figure 4

Real Hourly Earnings, Production & Nonsupervisory Workers



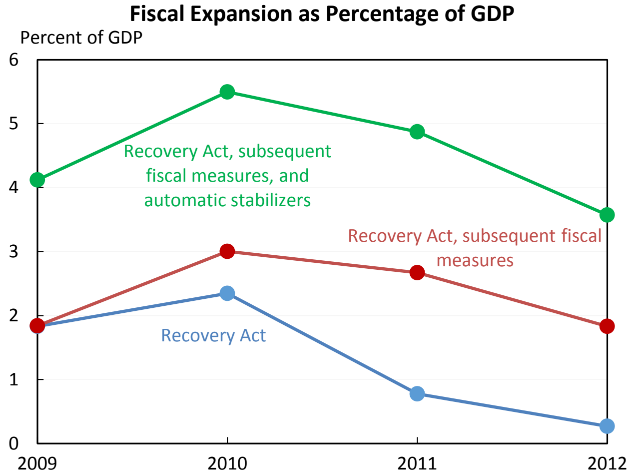
Overall, the United States has recovered further and faster than most advanced economies. We were among the first crisis-struck countries to recover our pre-crisis GDP peak and one of the few advanced economies to see both our short-run and medium-run growth prospects upgraded by the International Monetary Fund (IMF).

The Policy Response

I believe the United States is in this stronger position because, broadly speaking, we have gotten policy right. The United States passed its first round of fiscal support in February 2008, when the unemployment rate was still 4.9 percent and virtually no economist even realized the economy had already slipped into recession. The Recovery Act signed into law by President Obama a year later was the largest single countercyclical effort in American history and it was followed by a dozen additional fiscal-jobs measures that, together, provided a combined fiscal expansion of $1.4 trillion, doubling the initial expansion provided by the Recovery Act itself. Together with automatic stabilizers, the fiscal support to the economy totaled 5.5 percent of GDP, as shown in Figure 5. In fact, we would have been in even better shape if we had not missed some fiscal opportunities in the years that followed.

Figure 5

Fiscal Expansion as Percentage of GDP



The Administration's fiscal efforts were accompanied by accommodative monetary policy. The Federal Reserve cut the target Federal Funds rate to effectively zero at the end of 2008 and has kept it there ever since. On top of zero rates, the Fed implemented unconventional policy tools that have helped further extend the recovery.

These macroeconomic policies complemented the rescue of the financial sector through capital injections, an effective stress testing regime that helped to restore credibility to the banking system, and additional initiatives to support the automotive and housing sectors. These steps, together with Dodd-Frank Wall Street Reform and Basel III, have resulted in substantially healthier capital ratios for our banks and a more broadly robust financial system.

Altogether, well-known U.S. economists Alan Blinder and Mark Zandi estimated that the combination of these macroeconomic and financial policies prevented the loss of a further 8.5 million jobs and prevented the unemployment rate from rising above 16 percent in the wake of the crisis.[1]

This policy response has helped to speed the return of our economy to using its full potential. At the same time, we have enacted a number of structural reforms that will enhance our ability to expand our potential. These include investments in infrastructure, education, research, clean energy, and policies to support and catalyze further private investment in each of these areas.

The Global Context for Growth

The U.S. and Colombian economies are both contending with slowing global demand. Advanced economies—most notably the euro zone and Japan—and large emerging economies alike have contributed to the slowdown, which has proved a headwind for export growth in the United States, as shown in Figure 6.

Figure 6

Foreign Real GDP and U.S. Export Growth

[1] Blinder, Alan, and Mark Zandi. 2010. "How the Great Recession Was Brought to an End." July (http://www.economy.com/mark-zandi/documents/end-of-great-recession.pdf).

Aggregate output in both of our countries is relatively well insulated from the *direct* effects of the global slowdown because exports comprise only 13 percent of our GDP and 17 percent of Colombia's, as compared with 45 percent in the euro zone and 28 percent in the United Kingdom.

But the global economy also has *indirect*, and significant, impacts on your economy. With petroleum products accounting for more than half of Colombia's exports in 2014, the oil price decline has created a new headwind for Colombia. In contrast, the United States' status as a net oil consumer suggests that the impact of the oil slide will remain on balance positive for domestic output.

The Role of Growth, Inequality and Participation in Shaping Middle-Class Incomes

Although the United States continues to remain vigilant regarding short-run macroeconomic risks, the principal focus of our economic policy is to ensure faster income growth for middle-class households. Wages are rising again, but the pace of growth remains below what we have observed in previous decades and what economic fundamentals would suggest. Increasing middle-class incomes more quickly will require us to make improvements in three areas: (i) increasing the growth rate of productivity; (ii) reducing the rise in inequality; and (iii) ensuring that more people can participate in the labor force.

Historically, economists had seen a trade-off between these goals, and conventional wisdom suggested that a more equal society tended to grow slower. One common argument emphasized that high-income households save more, increasing the quantity of capital and thereby boosting output to a greater extent in more unequal economies. But increasingly, organizations like the IMF, the Organisation for Economic Cooperation and Development (OECD), and other economists are appreciating the many ways in which growth and equality can be complementary.

These views begin with the observation that the traditional emphasis on the quantity of capital, even if true, is dwarfed by the importance of the quality of capital, technology, and entrepreneurship. Moreover, pervasive market failures and incomplete markets mean that the efficiency of outcomes may depend on the distribution of income. In particular, this approach emphasizes a number of channels by which inequality could harm growth: (i) by reducing access to the education necessary for the full population to reach its full potential; (ii) by reducing entrepreneurship and risk taking; (iii) by undermining the trust necessary for a decentralized market economy and increasing monitoring costs; and (iv) by leading to increased political instability, growth-reducing policies, and uncertainty.

Until recently, the empirical macroeconomic evidence on the link between equality and growth was ambiguous. At a minimum, it tended to rule out large negative effects of more progressive policies on economic growth. But the latest cross-country regressions from Jonathan Ostry, Andrew Berg, and Charalambos Tsangarides at the International Monetary Fund (IMF) using a better data set are more encouraging[2]—with the caveat that one should never place too much

[2] Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides. 2014. "Redistribution, Inequality, and Growth." February. International Monetary Fund Staff Discussion Note.

weight on any cross-country regressions, no matter how well implemented. The IMF study finds that: (1) inequality is bad for both the magnitude and sustainability of growth; (2) progressive policies, by themselves, are neutral for the magnitude and sustainability of growth (with a small caveat that very large amounts of redistribution—those that redistribute above the 75 percentile of income—could have a small negative effect on growth); and thus (3) that to the degree that progressive policies improve the distribution of income, they can improve the magnitude and sustainability of growth.

The emerging view that greater equality can promote growth is a part of the reason that both Colombia and the United States have taken steps in recent years to make our tax systems more progressive, helping to ensure that the benefits of growth are more widely shared.

Structural Opportunities for the U.S. Economy

The United States has a number of structural opportunities with which to meet these challenges and foster stronger middle-class income growth. In particular, I want to highlight three of them: the development of new technologies, the transformation of the energy sector, and the structural reforms to our health system.

The Development of New Technologies

For an advanced industrial economy such as the Unites States, innovation is necessarily the wellspring of economic growth—catching up to the productivity frontier is not an option when you are already there. Therefore, the first structural opportunity I will discuss today relates to investments in innovation and our efforts to ensure that those investments are as productive as possible.

The long-term benefits of both private and public investment in science and engineering are evident in the way that technology is creating new industries and transforming old ones throughout the economy. Some of the most visible changes are occurring in the information and communications technology sector, where a combination of smaller, more powerful computing and communications devices as well as improvements in mobile broadband connectivity have unleashed a new wave of development in applications. Moreover, those who watch and predict developments in this sector suggest that we are on the cusp of a full-fledged "internet of things," where it is not just your smartphone that is always connected to the network, but also the lights and thermostat in your home, your car keys, and even your heart rate monitor.

While many of us feel the impact of the computing revolution every day, many scientists believe that we are also on the cusp of a revolution in life sciences. The first complete human genome was sequenced in 2003 at a cost of roughly $3 billion, but today it can be done for as little as $1,000 per person. Some medical researchers tell us that we stand poised to enter an era in which personalized medicine meets evidence-based medicine: a patient's genomic information, when combined with insights from both basic and clinical research, could soon help doctors to diagnose and treat a variety of both present and latent diseases by selecting or even designing the drugs that would be most effective, given that individual patient's condition, medical history, and genome. While I remain circumspect because much more investigation is needed before we can fully appreciate the benefits of this development, the medical potential here is truly incredible.

Transformations similar to those that we see in mobile computing and health are occurring throughout the economy, for instance, in other areas such as advanced materials and renewable energy generation. Progress in the domain of nanotechnology holds tremendous potential at the intersection of these two areas: the efficiency of both energy consumption and production can be greatly improved using new materials for light bulbs, insulation for wiring, combustion engines, and photovoltaic cells, to name just a few.

The Administration's policies are contributing in all of these areas. We are working to expand the amount of spectrum available for mobile broadband—just like Colombia. We have made openness and interoperability the new defaults for government data, and moved to ensure that the data and findings of all government funded research are freely available to the public within a year of publication. And we are working to ensure that our patent and copyright laws, which help drive the creation and commercialization of new ideas, are well-suited to the modern age.

The Transformation of Our Energy Sector

The second structural opportunity I will address is the transformation of the American energy sector.

The recent increase in U.S. oil production is well documented, with 2014 production more than 3 million barrels per day above the expectation we had as recently as 2006. But the sharp decline in U.S. oil consumption is much less widely appreciated. In fact, in 2014 U.S. oil consumption was more than 4 million barrels per day lower than what we had expected in 2006. The after-effects of the Great Recession itself has contributed somewhat to lower oil consumption, but the increased fuel economy of the vehicle fleet has also played an important role.

At the same time, the revolution in unconventional natural gas extraction has sharply increased natural gas production, with the United States the world's leader in this regard. Already, well over half of natural gas production is from unconventional plays (tight gas and shale gas), a fraction that is projected to increase.

Electricity generation from renewables is soaring as well: early estimates show wind generation more than tripled between 2008 and 2014, and utility-scale generation from solar is up more than twenty-five times. In 2014, wind power accounted for over 4 percent of total generation, versus only 2.3 percent in 2010. And new installations of solar photovoltaic systems now rival the amount of wind and natural gas capacity being added to the system.

Finally, the United States has cut carbon emissions by 10 percent from 2007 through 2014. About half of these emissions reductions are due to the recession, but the other half are due to the positive structural trends I have discussed.

The Environmental Protection Agency (EPA) has released draft rules to reduce carbon emissions by 30 percent in 2030 from the power sector, which is responsible for 32 percent of U.S. carbonequivalent emissions. Overall we are on track to meet our Cancun commitment to cut greenhouse gas emissions in the range of 17 percent below 2005 levels by 2020 and the new goal that was agreed to in discussions with China of 26-28 percent below 2005 levels by 2025. And these efforts strengthen our position to secure similar commitments from other nations.

Colombia is seeking to boost its own energy production, including through off-shore and unconventional sources. For the United States, helping other countries learn from our experience is a priority for both energy security and energy diplomacy. During the December 2013 meeting between President Obama and President Santos, our leaders pledged to boost cooperation on a wide range of energy issues—as well as technology—and the United States committed to share its lessons learned on the development of unconventional resources with Colombia. We are sharing U.S. experiences and best practices associated with unconventional gas development with Colombia and other partners via the Department of State's Unconventional Gas Technical Engagement Program. This type of engagement helps countries tackle many of the technical, operational, environmental, regulatory, legal and commercial challenges that need to be addressed in order to create a sustainable unconventional gas sector.

Structural Health Care Reform

Finally, U.S. health care reforms are also contributing to a structural improvement in the U.S. economy, at the same time that Colombia is recognizing health care as a constitutional right. Health care prices are growing at the slowest rate in nearly fifty years, in part because of reforms in the Affordable Care Act (ACA) that have reduced overpayments in Medicare (the federal health program for seniors and people with disabilities) and undertaken delivery system reforms. Moreover, this slowdown in health cost growth has coincided with a 16 million reduction in the number of people without health insurance.

The U.S. Economic Agenda

The extent to which the United States economy makes the best use of its opportunities and offers the best response to its challenges will depend on the policy choices we make. Indeed, policy has been an important component of the recovery thus far. But there is more work to do to boost productivity, reduce income inequality, and ensure that more people can participate in the labor force.

Labor is more productive when it is mixed with productive capital. That is why President Obama supports substantial investment in infrastructure, an important component of the United States' physical capital, to repair crumbling bridges and roads. Workers are also more productive when they are better educated, and President Obama supports a range of new education investments from pre-kindergarten to college to help develop the United States' human capital. Moreover, President Obama's approach to business tax reform boosts productivity through several distinct channels, including by encouraging domestic investment from the private sector and reducing the inefficiencies of the international tax system—while also financing infrastructure. All these fiscal policies are complemented by expanding trade.

To help reduce income inequality and ensure that more economic growth is shared, President Obama supports increasing the minimum wage and expanding the tax credits for lower-income households. Moreover, continued investments in education and skills training will also curb the trend of worsening inequality by helping ensure that children of all backgrounds have much to offer the 21st century labor market. These measures build on earlier progressive steps to reduce inequality, including the Affordable Care Act's exchange subsidies and Medicaid expansion, as well as President Obama's progressive reforms to the individual income tax code.

Labor force participation also matters. Expanding job creation would help create new opportunities and draw people into the workforce. Moreover, President Obama has proposed new tax credits for childcare and second earners in working families, as well as policies that promote workplace flexibility and paid sick leave. In addition, President Obama's executive actions on immigration will help increase the labor force, and he supports comprehensive immigration reform that could do even more.

Conclusion

The strength of the United States' economic recovery—and the strong growth here in Colombia—are a testament to the policy choices our countries have made and the strong underlying fundamentals of our economy. Continued dialogue between our two nations—particularly in the areas of our combined structural opportunity such as technology, energy, and health care—can strengthen both our recoveries.

The United States' policy response to the global financial crisis was characterized by quick and aggressive action. As we shift our focus to the structural challenges of productivity, inequality, and participation, we must continue to choose policies that squarely address these challenges while taking advantage of our unique economic opportunities. I look forward to discussing more with you the nexus between the challenges our two economies face.

Notes to Figures and Tables

Figure 1
Note: Red markers represent annual averages.
Source: CPB World Trade Monitor; Statistical Office of the United Nations; Federal Reserve Board of Governors; Mishkin, F. S. 1978. “The Household Balance Sheet and the Great Depression.” *Journal of Economic History* 38: 918-937; CEA calculations.

Table 1
Source: Bureau of Economic Analysis.

Figure 2
Source: Bureau of Labor Statistics.

Figure 3
Source: Bureau of Labor Statistics; Blue Chip Economic Indicators; CEA calculations.

Figure 4
Source: Bureau of Labor Statistics; CEA calculations.

Figure 5
Note: Data is displayed in calendar year terms for all series.
Source: Congressional Budget Office, The Budget and Economic Outlook: 2014 to 2024; Office of Management and Budget; Bureau of Economic Analysis, National Income and Product Accounts.

Figure 6
Source: Bureau of Economic Analysis; national sources via Haver Analytics; CEA calculations.