THE SLOW RECOVERY: SOURCES AND SOLUTIONS

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Information Management Network Super Bowl of Indexing
Phoenix, Arizona
December 5, 2011

People sometimes ask me what my happiest day in the White House was. For me, there is no competition—it was December 3rd, 2009—almost exactly two years ago. That was the day of the White House jobs summit.

A number of us had spent the summer and fall of 2009 pushing for more fiscal measures to lower unemployment, and now the Administration was ready to move forward. The President was preparing to announce a range of measures, including more state fiscal relief, more infrastructure investment, and a hiring tax credit. We had a large group of business leaders, labor representatives, and economists to the White House to talk about these and other jobs measures.

Then, at around 6 p.m. that day, the employment report for November arrived in my office. One of the jobs of the chair of the Council of Economic Advisers is to look at an advance copy of various data reports, and alert the Secretary of the Treasury and the Chairman of the Federal Reserve if the data to be released the next morning could cause market instability. I would also brief the President.

That day, the report was much better than expected. The market was expecting continuing job losses of around 150,000 or so. The actual loss was just 11,000, and the unemployment rate ticked down.

When I went over to the Oval Office and told the President the numbers, he actually corrected me: "You mean a minus *a hundred* and eleven thousand." When I told him that he hadn't heard wrong, I got four hugs and a kiss. My favorite picture is of the two of us in front of the Christmas tree in the Oval Office, celebrating this bit of unexpected good news.

The President's reaction gives you a sense of how central employment and unemployment were in his mind—and how hungry we, and obviously the American people, were for some sign that the national unemployment nightmare was finally ending.

Sadly, the promise of that happy December day wasn't matched by the reality. Some of our additional job creation plans made it to fruition, but most died on the floor of the Senate. And that one unexpectedly good employment report was replaced by a series of less good ones, before job growth began in earnest in mid-2010.

More fundamentally, the recovery that was just beginning in the fall of 2009 has turned out to be a disappointing one. Real GDP, which would normally be expected to grow like gangbusters coming out of a recession this severe, has struggled to grow at even its trend rate. Annual real GDP growth has averaged just 2.4% since the trough of the recession. To put this number in perspective, in the nine quarters following the trough of the 1982 recession, real GDP growth averaged 6.3%. We have had none of the catch-up in growth needed to undo the damage from the recession. And virtually no one expects a dramatic acceleration.

The recovery of the labor market has been similarly anemic. Even with last Friday's unexpected decline, the unemployment rate has dropped by only 1½ percentage points from its high, and remains at a painful 8.6%. Payroll employment, which fell by more than 8 million during the recession, has grown by less than 2½ million since the recovery began. And just in case anyone was thinking of doing a victory dance because we added 120,000 jobs in November, remember we need to add about 100,000 jobs every month just to keep up with the normal growth of the labor force. So at a rate of job creation of 120,000 per month, it would take about 40 years to undo the damage inflicted by the recession.

We remain a deeply troubled economy with few prospects for a speedy return to prosperity. In my talk this morning, I would like to discuss what I see as the main reasons for this slow growth. Why isn't the recovery gaining more steam, and why is the labor market still so far from healthy?

More important, I would like to discuss what we can and should be doing about it. There are steps we could take to restore American prosperity, if only our policymakers were willing to take them.

II. EXPLANATIONS FOR THE SLOW RECOVERY

Let's start with the first question: Why is the U.S. recovery so darned slow? A good place to begin is with some things that I think are *not* the explanation, because there are a few frequently mentioned hypotheses that are, frankly, pretty silly.

Faulty Explanations. One is the regulatory uncertainty story. According to this hypothesis, the reason firms aren't investing or hiring is because of all the pending regulations imposed by the EPA, the Affordable Care Act, and the Dodd-Frank financial regulatory reform bill. Supposedly, firms are afraid to do anything because they don't know what the regulations will be.

One piece of evidence given for this explanation is the continued volatility of the stock market. The rise in the VIX, a common measure of American stock price volatility, since the summer has been dramatic. Now, I am actually pretty sympathetic to the notion that uncertainty is high and causing trouble today. But the cause of that uncertainty is mainly macroeconomic developments, not pending regulations. It stems from concern over future growth and the future of the Euro.

Perhaps the best evidence that uncertainty is not being driven by regulatory changes in the U.S. is that the German measure of stock price volatility, the VDAX, has behaved almost identically to the American version. It clearly can't be the Affordable Care Act that is causing the uncertainty since the same thing is happening in Europe, with extremely similar timing.[1]

Another pretty compelling piece of evidence against the regulatory uncertainty hypothesis comes from the sectoral behavior of profits and employment. The sectors where regulation is supposedly changing the most are health care, finance, and energy. Yet those are three of the sectors where profits are doing the best these days. And job growth has been above average in both health care and energy.

So I really think we should put aside the regulative uncertainty story as a serious explanation for the anemic recovery.

Another explanation I would like to take off the table is structural change. There is a lot of talk these days that our high unemployment is due to a mismatch between worker skills and the jobs available. The idea is that the composition of what we produce has changed radically. There are jobs, but unemployed workers don't have the needed skills—in the colorful word of Charles Plosser, President of the Federal Reserve Bank of Philadelphia: We need to turn "the carpenter into a nurse" and "the mortgage broker into a computer expert."[2]

Now, of course there is an element of mismatch between worker skills and jobs. There always is in a dynamic economy. But the idea that the unemployment is 8.6%

today largely because of structural factors strikes me as absurd.

First, the structure of the economy evolves gradually over time; it doesn't change radically in a year or two. The changes that people cite for the mismatch—the decline of manufacturing, outsourcing, and expansions in health care—are all trends that have been occurring for decades, with unemployment for most of that time being below 6%.

Second, when scholars look carefully at the numbers, there is little evidence of mismatch. For example, economists have examined the exit rate from unemployment for people whose last jobs were in various industries.[3] What they find is that exit rates haven't fallen more for people whose last job was in construction and finance, two industries that are likely going to be permanently smaller, than they have for people whose last job was in less troubled fields.

The key fact is that exit rates are low for everybody. The problem is a general lack of jobs, not a lack of jobs in certain industries or certain kinds of jobs.

Now, I don't want to push this too far. The best studies suggest that structural change and extended unemployment insurance may have raised our normal unemployment rate by a percentage point or so.[4] And I am very worried that the longer unemployment stays high, the more likely it is to become permanent. But for now, the evidence is clear that most of the unemployment we are experiencing is still old-fashioned cyclical unemployment.

The bottom line is that our current problems don't stem from structural or supply factors. Rather, they are the result of a profound shortfall in demand. Consumer spending and investment are still well below their pre-recession trajectories. Investment is even below its pre-crisis *level*, some four years after the recession started.

So what's holding demand back? There are many factors. But I think three are most essential. And all of them have to do with the unique nature of this recession.

Wealth and Debt. One is over-indebted consumers. It is no secret that the recession had its origins in the boom and bust of house prices. As house prices soared in the early and mid 2000s, many families took on more housing debt and used it to fuel a consumer spending binge. The crash of house prices destroyed a huge amount of household wealth, and put tremendous strain on our financial system. Both of these developments played a central role in the horrific downturn of late 2008 and early 2009.

Household wealth is still down more than $9 trillion from its high point in early 2007. Lower wealth and fear of continued house price declines are surely important reasons why households are hesitant to spend.

But recent evidence suggests that the deterioration of household balance sheets has had a separate negative effect on consumer spending. My colleague at Berkeley Atif Mian, and his co-author Amir Sufi, have done a series of interesting studies looking at indebtedness and spending across U.S. counties.[5] They obtained data on household leverage by county from Equifax—one of the big credit-reporting bureaus. They then collected spending data by county from various sources. For example, we have excellent data on new car registrations by county.

What they found is that spending, especially on big ticket items like cars, fell much faster in counties with more leverage build-up before the crisis. And, that spending has been slower to recover in counties where households have higher debt loads.

These findings are consistent with some of the research on Japan following its boom and bust in housing prices. And they suggest that high debt burdens are playing an important role in the slow recovery of consumer demand.

Housing. A related source of our anemic growth is the oversupply of housing. Normally, residential investment is a big source of the surge in demand and growth coming out of a recession. That is true because normally recessions result from tight monetary policy, which raises interest rates and crunches housing. Then, once monetary policy loosens up, housing construction comes roaring back.

But the recent recession obviously didn't follow this usual pattern. It had its origins in a building boom that left us with an oversupply of housing. One indicator of this oversupply is the home vacancy rate. This rate is still more than 50% above its pre-crisis level.

Of course, we will eventually need to build more houses. Population growth and general recovery will gradually work off the excess inventory, and construction will pick up again. But I fear that day is still a long way off. As a result, we will be missing a key source of demand for the foreseeable future.

Europe. Finally, a third source of anemic demand is the fear related to Europe. If you remember back to late 2009 and early 2010, the recovery here in the United States was looking pretty promising. GDP growth was initially strong. Equipment investment and exports were surging at the start of the recovery. But following the meltdown in Greece, growth slowed noticeably in the U.S.

The troubles in Europe have been a slow-moving train wreck we have all been watching for more than a year and a half. We have seen expectations move from "there is no chance they will let Greece default" to "of course Greece will default—the only question is whether Italy, Spain, and the Euro itself will also collapse in the process."

The troubles in Europe have slowed the American recovery in numerous ways. Most obviously, the European crisis and the swing to fiscal austerity in Europe have taken a toll on European growth and kept the Euro weak. Since Europe is one of our key trading partners, this has reduced demand for our products.

Fear of turmoil in Europe may also be affecting lending here in the U.S. Despite abundant reserves and strong profits, American financial institutions continue to be extremely cautious in their lending. This is another reason why household consumption and small business spending have been weak. I strongly suspect that American financial institutions are being particularly cautious because the risk of another financial panic coming out of Europe has risen steadily.

Finally, troubles related to European sovereign debt have focused attention on the United States's terrible long-run fiscal outlook. If this focus led to wise fiscal policy decisions, that could be helpful to our long-run prospects. But, so far it has led to policy paralysis and a deeply counterproductive spitting match over the debt ceiling last summer. The result has been increased uncertainty and concern about the ability of the American political process to deal with our economic challenges. It is surely no coincidence that consumer sentiment plummeted during the debt-ceiling debacle. And consumer and business spending slowed as a consequence.

The bottom line is that the United States is largely in a holding pattern. We have just enough demand to keep the economy where it is, but not enough to repair any of the damage done during the downturn. Until we find a way to get demand up, we are going to continue to have painfully high unemployment.

III. Ways to Strengthen the Recovery

Well, that's the grim part of my talk: We face severe economic challenges. Let me turn now to some possible solutions. What could we do to raise demand and strengthen the recovery? Let me again start with something that I think isn't right.

There is a lot of interest these days in policies focused on long-run growth. This is true of politicians from both parties. Republicans tend to talk about things like tax reform, free-trade agreements, and improving government regulation. President Obama has discussed many of those same issues. If you recall, his State of the Union address last January was focused on a "Winning the Future" agenda, which is largely about long-run growth. And, the President just recently signed three new free-trade agreements. Congressional Democrats talk a lot about job training, an infrastructure bank, and public-private partnerships to stop the decline in manufacturing.

Now, many of these actions suggested by both parties are important. They would help raise our normal growth rate over time. That is, they would help increase our productive capacity. But, they won't deal with our immediate and most fundamental problem—which is that profound lack of demand.

To actually get us back to full employment over a reasonable time period, we need to focus on policies that could raise demand substantially. For that, we need to go back to the big three—monetary policy, housing policy, and fiscal policy. Everything else is just tinkering around the margin.

Monetary Policy. Let me start with monetary policy. To my mind, the most realistic hope we have for helping the U.S. economy get back to normal is an aggressive change in Fed policy.

When interest rates are near zero, as they are today, the tools the Fed has for helping the economy are obviously limited. They can basically do three things. They can purchase unusual assets, such as mortgage-backed securities or long-term government debt, to try to lower any interest rates that are not yet zero. They can try to lower the exchange rate through asset purchases and communications policy. And they can try to change expectations of future growth and inflation.

In the last couple of years, the Fed has done a modest amount along two of these dimensions. There have been additional asset purchases, which, the evidence suggests, helped to flatten the yield curve.[6] But the actions have been deliberately limited in size and duration, and so have had a limited impact.

The Fed has also tried to signal that it expects monetary policy to remain accommodative through at least 2013. But, the communications value has been limited by the conditional nature of the statement. Fed members aren't promising to be bold; they are indicating that they think the economy is going to be so weak that they won't want to raise rates for quite a while.

I think the Fed needs to do something much more dramatic if they are actually going to make a big difference. That is why many economists have urged them to adopt a new operating procedure: specifically, to target a path for nominal GDP.[7] Such a target would commit the Fed to getting us back on the trajectory for nominal GDP that we were on before the crisis—and then to keep us there.

In a recent *New York Times* column, I described this as a "Volcker moment."[8] Back in 1979, Fed Chairman Paul Volcker made a dramatic switch to money targeting, as a way to finally break the grip of inflation. And it was very effective. Adopting a nominal GDP target today could help the Fed deal with its current unemployment crisis in some of the same ways that Volcker's money target helped to lower inflation.

One thing it would do is pack a big expectations wallop. A new operating strategy is something that could really break through and affect people's behavior. Here I disagree with some who say that a nominal GDP target is just a sneaky way to increase inflationary expectations.[9] It may do this somewhat. And, frankly, when nominal interest rates are at the zero lower bound and inflation is below the Fed's target and at risk of falling further, a little more expected inflation *can* be helpful. It can lower real borrowing costs and stimulate investment spending.

But I think the far more important effect of a nominal GDP target would be to raise expectations of real growth. If people believe the Fed is committed to raising real incomes, this could encourage them to spend today. Likewise, if businesses believe growth will pick up, this could create incentives for investment and inventory production right away. Thus, adopting a nominal GDP target has the potential to raise demand substantially today.

Indeed, the one time in our history when aggressive monetary policy helped the economy escape from a liquidity trap was in the 1930s. Interest rates were near zero then, as they are today. But nevertheless, rapid money growth and a commitment by policymakers to return incomes and prices to their pre-Depression levels led to double-digit output growth in the mid-1930s.[10] And a great deal of research suggests that these policies worked primarily through the expectations channel.[11] We should be designing monetary policy to use that channel as effectively as possible today.

Another way that a nominal GDP target would be helpful is in leading to additional actions, such as another significant round of quantitative easing. Right now, every little move by the Fed is a big internal fight. As a result, it is hard for them to do much.

If the FOMC committed to a path for nominal GDP, additional actions would follow naturally. To recoup all the ground lost over the recession, nominal GDP would need to grow rapidly. So additional actions would surely be part of an overall strategy to get nominal GDP back on track.

The great virtue of this new operating procedure is that it would pack an expectational punch today, without causing expectations to become untethered over the long run. Once nominal GDP is back to the pre-crisis path, the Fed would be committed to doing what it normally does: keep inflation at 2% or below, and unemployment at its normal, sustainable level. So this is a good strategy for dealing with our current problems, without harming long-run price stability.

Housing Policy. That's monetary policy. The second tool we need to use more effectively is housing policy. As I mentioned earlier, housing is at the center of the slow recovery, just as it was at the center of the deep recession.

When the Administration was designing its housing programs, foreclosure prevention was the main goal. That was appropriate, because foreclosures are devastating to families; hard on neighborhoods; and incredibly economically wasteful.

The best research at the time showed that most underwater homeowners didn't default. What tended to push people over the edge was something that temporarily lowered their income: unemployment, illness, or some other adverse life event.[12] This analysis suggested that if we wanted to reduce foreclosures, the important thing was reducing mortgage payments for troubled homeowners—to help them get through these rough patches.

And that is just what the HAMP program did. It modified mortgages to lower interest rates and reduce payments for families at risk of default. And it has been at least moderately helpful. Of the 4 million homeowners the Administration thought might be helped, 2 million have gotten a trial modification, and 1 million have gone on to a permanent modification.[13]

But what new research has shown is that negative equity and high indebtedness are a problem even if they don't lead to foreclosure. They depress consumer spending as households struggle rebuild their wealth and to dig out from under a mountain of debt.

Now general recovery measures like monetary and fiscal stimulus can help deal with negative equity and indebtedness. Such measures lead to better economic conditions in general, and stronger growth tends to raise house prices. This is surely the fastest and easiest way to eliminate the problem of negative equity and increase wealth. And anything that lowers unemployment will allow families to have the income to pay off debt. It will also make them feel more secure about spending, even at current debt loads.

But, attacking the problem of negative housing equity more directly would also be helpful. Now, I wouldn't be in favor of just having the government foot the bill for principal write-downs. It would be very expensive. And I would be nervous about using lots of government money to help people well off enough to own houses.

But, there are sensible ways we could encourage or even force financial institutions to do the write-downs on their own dime. For example, the case is very strong that we should reform the bankruptcy law to allow judges to modify mortgages, including reducing principal. The inclusion of so-called "cram down" in the bankruptcy law would encourage financial institutions to deal proactively with the most troubled borrowers. At the same time, it would preserve incentives for borrowers to behave responsibly in the future—because declaring bankruptcy is not something households do lightly.

Fiscal Policy. The third tool we need to be using to accelerate the recovery is fiscal policy.

The first thing I have to say is that, despite all the political rhetoric to the contrary, fiscal stimulus absolutely does work. One of the very few silver linings to this horrible economic cloud we have been under is that it has generated renewed academic interest in the effects of fiscal policy. There has been just an outpouring of rigorous new studies about the impact of fiscal changes in general, and about the Recovery Act in particular. I recently gave a lecture at Hamilton College discussing this new evidence, which is available on my Berkeley website—in case you want the references.[14]

Almost all of these new studies conclude that fiscal stimulus can help to heal a troubled economy. Those looking specifically at the Recovery Act find that it helped to stop the freefall of the economy in 2009.

The flip side of the notion that fiscal stimulus can be helpful is that fiscal contraction tends to lower growth. Again, careful new research has documented this. A comprehensive study by the IMF using the experience of 15 countries over the past 30 years has shown that deliberate fiscal austerity to lower the budget deficit lowers growth and raises unemployment.[15] And the recent experience of European countries adopting austerity is certainly consistent with this finding. The United Kingdom, for example, has seen its recovery stall since it undertook a budget-cutting program.

Another essential fiscal fact is that the United States, like many other advanced countries, has a terrible long-run fiscal outlook. Here, it is important to emphasize the phrase "*long-run*". Our current deficit is high in large part because unemployment is high. And the near-term deficit is expected to fall as the economy recovers.

What keeps experts up at night are the *long-run* projections. Our spending is projected to rise substantially over the next several decades because of the retirement of the baby-boom generation and rising health care costs. As a result, by 2035, even at full employment, the Federal deficit is projected to be almost 16% of GDP, and on the way to even higher numbers.[16] No country has ever run deficits like that for a sustained period and remained solvent.

These essential facts—fiscal policy matters and we have a terrible long-run deficit problem—point to an obvious fiscal strategy. We need a bold two-part plan. We need substantial fiscal stimulus today, to help raise demand and near-term growth. And we need an aggressive plan to lower our long-term deficit. But that deficit-reduction plan must to be back-loaded—that is, the actual spending cuts and tax increases should phase in only gradually—as the economy recovers. If we move immediately to deficit reduction, unemployment would rise, making actual progress on the deficit nearly impossible to achieve.

On the stimulus side, something along the lines of what the President proposed in the American Jobs Act is sensible. At $447 billion, that proposal is genuinely aggressive—though I think even larger would be desirable.

Many of the particular measures the Administration suggested are very good. I am a big fan of the tax cut for employers who actually increase payrolls. Research we did at the Council of Economic Advisers suggests that this could be a very cost effective way to generate a significant amount of additional employment. I think it would be even more effective if the tax incentives were larger, and rewarded large employers as generously as small employers.

I also think that an ideal stimulus package would have a somewhat different composition than what the President proposed. It would rely less on additional individual tax cuts and more on infrastructure spending. Both of these measures create jobs, but infrastructure spending has been shown to be particularly powerful. And, it leaves us with something useful long after the recession is over, which is good for long-run growth and productivity.

On the deficit-reduction side, we need a grand bargain along the lines of the Bowles-Simpson proposal.[17] One of the great tragedies of the past year is that this genuinely bipartisan plan never got past the proposal stage. It has two key virtues that make it a good way to go.

First, it's *big*. It reduces the deficit by $4 trillion over the next decade. That is about twice as much as the compromise hashed out this summer during the debt-ceiling debate. That's important because the problem is very large and needs a truly aggressive solution.

The second key virtue of the Bowles-Simpson proposal is that it fires on all cylinders. Once you are committed to serious deficit reduction, you quickly realize that it can only be done if everything is on the table. The Bowles-Simpson proposal lowers discretionary spending, raises tax revenue by cutting loopholes, and significantly slows the growth of entitlement spending.

I sometimes wonder if one reason the super committee failed to come up with a plan was that their mission was too small. If they had had to come up with $3 or $4 trillion of deficit reduction over the next decade, instead of just $1 trillion, maybe everyone would have realized that both entitlements *and* revenues would have to be part of the bargain.

The main change that I would make to the Bowles-Simpson proposal is to have it be more back-loaded. By design, it was a fairly gradual fiscal consolidation plan. But given the current state of the economy, it would be prudent to slow the deficit reduction down further—perhaps even tying the pace of deficit reduction to the pace of the recovery.

The bottom line is that the combination of an aggressive short-term fiscal stimulus package and a grand bargain on long-run deficit reduction could be a game changer. If anything could get growth going fast, this is it. The fiscal stimulus would be helpful on its own. But pairing it with a comprehensive, gradual solution to our long-run fiscal challenges would be much more powerful.

I don't usually believe in what Paul Krugman calls the "confidence fairy." But the sheer relief we would all feel to see our government actually take aggressive action on both our fundamental macroeconomic problems could well give a major jolt to consumer and business sentiment. And because the actual deficit reduction would be phased in gradually, there would be no off-setting immediate fiscal contraction.

European Policy. I have talked about three big actions that I think would help heal the American economy. Finally, let me say a word about what is going on in Europe, and its interaction with American policy.

The United States is unfortunately largely a bystander to the European crisis. The future of our recovery depends in large part on what the Europeans do. Yet they show little interest in our advice. And, I can't imagine that the U.S. would take any actions that would put more of our resources on the line, say through additional contributions to the IMF.

Perhaps the most useful thing we could do is to lead by example. By solving our own problems, we can model sensible policy responses.

On the monetary side, just about everyone agrees that the only near-term way to prevent defaults and save the Euro is for the European Central Bank to buy a lot of sovereign debt. They need to reduce the borrowing costs for troubled countries like Spain and Italy. The whole question for this coming week is whether European leaders can reach agreement on a fiscal plan that makes Angela Merkel and Mario Draghi both willing for the ECB to do what needs to be done.

The Fed obviously wouldn't have anything to do with such sovereign bond purchases. But more aggressive Fed action at home, like adopting a nominal GDP target, could demonstrate that a responsible central bank can put preserving stability and growth ahead of a single-minded focus on inflation. This just might help spur the ECB to the necessary action.

On the fiscal side, European governments and the IMF need to admit that immediate radical fiscal austerity is not working. Many countries are caught in a vicious downward cycle. Near-term budget cuts have led to rising unemployment. Higher unemployment has lowered tax revenues. This has led to calls for yet more austerity. My great fear is that any fiscal agreement European leaders come up with this week will just call for more of the same.

A much better approach would be immediate structural reforms and more back-loaded fiscal contraction. Countries like Italy should take measures to improve the flexibility of labor markets and the ease of doing business. But they should phase in aggressive deficit reduction only gradually—because what these countries need more than anything else to remain solvent is to start growing again.

The United States can model this better approach. Exactly what I have proposed for the U.S. is phased-in deficit reduction. And, we have the luxury that some countries don't have of being able to do additional near-term fiscal stimulus. We should do that to strengthen our own recovery and that of the rest of the world—and to encourage other countries with fiscal space to follow similar responsible, pro-growth policies.

IV. CONCLUSION

Early on, I got pegged as the optimistic member of the economics team. I still haven't forgiven the *San Francisco Chronicle* for topping an otherwise very nice profile with the headline "Obama's Sunny Economic Forecaster." (Personally, I just think that anyone looks cheerful next to Larry Summers.)

It's not that I don't see America's economic challenges. Of course I do. As I have described, the United States is currently caught in a terrible holding pattern. It's as if we are circling Heathrow, and air traffic control never lets us land. We are growing so slowly that it feels as though we may never fully recover.

What has always given me hope is the fact that sensible policies can make a tremendous difference. The evidence is very strong that sound monetary, fiscal, and housing policies could improve growth, and help reduce unemployment much more quickly. And I have suggested a number of bold actions along those lines that we could take that I believe would make a huge difference. Everything from a dramatic change in monetary policy, to a reform of the bankruptcy law, to the grandest of all fiscal bargains—more stimulus today and aggressive deficit reduction as we recover.

But I have to confess that the current situation tries even my optimism. I can see policies that would lift us out of our current economic mess. But like everyone, I am having a hard time imagining that our policymakers will actually do them.

The easiest of the actions I have suggested, another round of fiscal stimulus, looks unlikely to make it through Congress. And nobody is expecting a serious deficit reduction agreement until after the presidential election. Likewise, the Fed may take some additional steps, but they show no signs of moving aggressively enough to actually make a meaningful difference.

For all of our sakes, I desperately hope that our policymakers surprise us. And use the tools that they have to finally heal this deeply troubled economy.

NOTES

[1] This fact is from Assistant Secretary of the Treasury for Economic Policy Janice Eberly's excellent blog post on the relative unimportance of regulatory uncertainty, http://www.treasury.gov/connect/blog/Pages/Is-Regulatory-Uncertainty-a-Major-Impediment-to-Job-Growth.aspx.

[2] "The Fed's Easy Money Skeptic," *Wall Street Journal*, February 12, 2011, http://online.wsj.com/article/SB10001424052748704709304576124132413782592.html.

[3] Michael W. L. Elsby, Bart Hobijn, and Ayşegűl Şahín, "The Labor Market in the Great Recession," *Brookings Papers on Economic Activity*, (Spring 2010): 1-48; and Michael W. L. Elsby, Bart Hobijn, and Ayşegűl Şahín, "Updates of a Selection of Figures from Elsby, Hobijn and Şahín (2010)," March 2011, http://3583186936760192052-a-1802744773732722657-s-sites.googlegroups.com/site/mikeelsby/documents/Update-March-2011.pdf.

[4] See, for example, Rob Valetta and Katherine Kuang, "Is Structural Unemployment on the Rise?" *Federal Reserve Bank of San Francisco Economic Letter*, 2010-34, November 8, 2010, http://www.frbsf.org/publications/economics/letter/2010/el2010-34.html.

[5] Atif Mian and Amir Sufi, "Household Leverage and the Recession of 2007-09," *IMF Economic Review* 58 (August 2010): 74-117; and "What Explains High Unemployment? The Deleveraging-Aggregate Demand Hypothesis," unpublished paper, University of California, Berkeley, October 2011.

[6] Arvind Krishnamurthy and Annette Vissing-Jorgensen, "The Effects of Quantitative Easing on Interest Rates," *Brookings Papers on Economic Activity* (Fall 2011), forthcoming. Earlier papers showed that the first round of quantitative easing (in late 2008 and early 2009) was also effective. See Joseph Gagnon, Matthew Raskin, Julie Remache, and Brian Sack, "The Financial Market Effects of the Federal Reserve's Large-Scale Asset Purchases." *International Journal of Central Banking* 7 (March 2011): 3-43; and Andreas Fuster and Paul S. Willen, "$1.25 Trillion is Still Real Money: Some Facts about the Effects of the Federal Reserve's Mortgage Market Investments," Federal Reserve Bank of Boston Public Policy Discussion Papers, No. 10-14, November 2010.

[7] See, for example, Jan Hatzius and Jari Stehn, "The Case for a Nominal GDP Level Target," *US Economics Analyst*, Issue No: 11/41, October 14, 2011, http://www2.goldmansachs.com/our-thinking/global-economic-outlook/global-econ-outlook-pdfs/case-for-nominal-gdp-level-target.pdf; and Scott Sumner, "Re-Targeting the Fed," *National Affairs*, Fall 2011, pp. 79-96, http://www.nationalaffairs.com/publications/detail/re-targeting-the-fed.

[8] Christina Romer, "Dear Ben: It's Time for Your Volcker Moment," *New York Times*, October 29, 2011, http://www.nytimes.com/2011/10/30/business/economy/ben-bernanke-needs-a-volcker-moment.html?_r=1.

[9] See, for example, Paul Krugman, "A Volcker Moment Indeed (Slightly Wonkish)," http://krugman.blogs.nytimes.com/2011/10/30/a-volcker-moment-indeed-slightly-wonkish/.

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