



## C H A P T E R   1

# RECOVERING FROM THE PAST AND PREPARING FOR THE FUTURE

**A**lthough economics has long been called “the dismal science,” it is more appropriately viewed as a “hopeful science.” The right mix of economic policies and leadership can help a country to recover from a deep recession and point to the investments and reforms that will build a stronger, more stable, and more prosperous economy that works for the middle class. Conversely, government dysfunction or misguided fiscal policy can cause self-inflicted wounds to the economy. This year’s *Economic Report of the President* highlights the progress that has been made in recovering from the deepest recession since the Great Depression, together with the policies that the Obama Administration is advancing to address the fundamental imbalances and threats that have built up for decades and that have created severe stress on the middle class and those striving to get into the middle class.

As President Obama embarks on a second term, the U.S. economy unquestionably stands on firmer ground than when he first took office, but more work remains to be done. Our Nation’s economic recovery continued to make progress in 2012: payroll employment rose by more than 2 million, the unemployment rate fell to its lowest level in four years, new cars sold at the fastest rate since 2007, and the housing sector showed clear signs of turning a corner for the first time in more than five years. In the near term, sustaining and building upon this progress must be a priority. At the same time, the Obama Administration also remains focused on addressing a number of underlying, structural problems, many of which developed over the course of decades. Some of these problems—like stagnant middle-class incomes and excessive risk-taking in the financial sector—played a role in bringing our economy to the brink of collapse in late 2008 and early 2009. Other challenges—like the dangers of climate change and rising health care

costs—could jeopardize our prosperity and security in the years ahead. Another theme that runs throughout this *Report* is that demographic changes associated with an aging population are having a profound effect on economic performance in a number of domains, from labor force participation to household consumption, as well as placing increasing pressure on the Federal budget. The Obama Administration is committed to addressing these issues, while also supporting the ongoing recovery, and in turn building an economy that is stronger, fairer and more resilient.

This *Report* reviews the progress of the ongoing economic recovery during 2012 and highlights the main goals of the President's economic agenda. These goals include strengthening the foundations of economic growth by investing in education, research, and infrastructure, and by fixing a broken immigration system through commonsense immigration reform; ensuring fairness for the middle class by reforming the tax code and health insurance system; and bolstering the economy's resilience to future challenges by addressing the dangers of climate change, moving toward energy independence, pursuing a balanced approach to deficit reduction, adding safeguards to the financial system, opening up new markets for U.S. exports, and equipping American workers to compete in the global economy.

## TRACKING THE PROGRESS OF THE RECOVERY

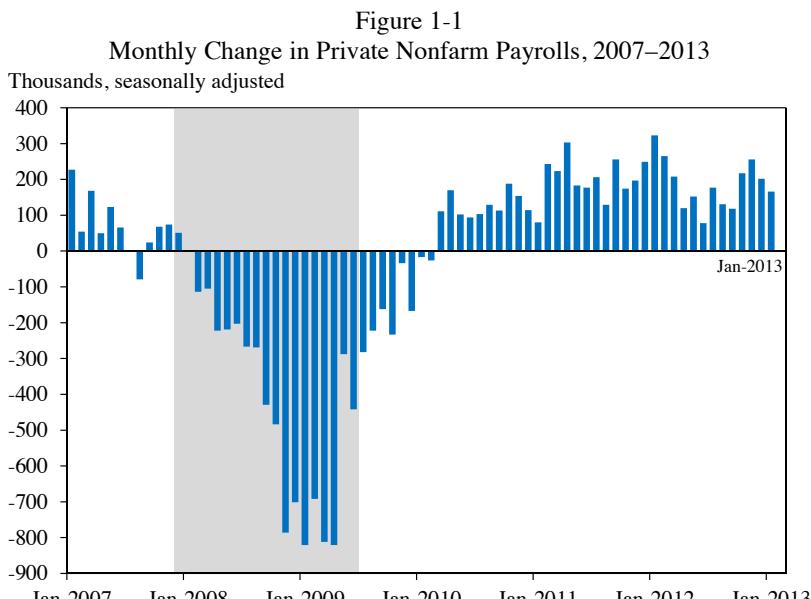
When President Obama first entered office on January 20, 2009, the U.S. economy was in the midst of the worst downturn since the Great Depression. Real gross domestic product (GDP), the total amount of goods and services produced in the country adjusted for inflation, had just contracted at the sharpest rate in any quarter in more than 50 years, shrinking by 8.9 percent at an annual rate. This severe decline in economic output was accompanied by devastating job losses. In the year before President Obama's first inauguration, the U.S. economy lost 4.6 million private sector jobs, including 821,000 in January 2009. As bad as things were at the time, a dark cloud of uncertainty hovered over the economy, and the risk of even further deterioration was still very real. At the end of 2008, the financial system teetered on the brink of collapse and credit for businesses and households had seized up. Home prices were steadily declining, with no bottom in sight, and the fate of the American auto industry hung in the balance, as auto sales in early 2009 plunged to their lowest level in 27 years. A total of \$16 trillion in wealth was erased by the financial and housing crisis, causing families to pull back on spending plans, reduce personal debt and increase savings, in turn leading companies to cut back hiring, lay off valued employees, and halt investment plans. In short, the economy was caught in a downward spiral,

where consumers were pulling back because they had less income and feared job loss, businesses pulled back and reduced employment even further, and around this vicious cycle went.

Against this backdrop, the Obama Administration acted quickly and decisively to raise aggregate demand, stem the job losses, restore the flow of credit, and put the economy in a position to begin growing once again. The American Recovery and Reinvestment Act of 2009 (the Recovery Act) was the boldest measure of countercyclical fiscal stimulus in U.S. history. The Recovery Act's mix of tax cuts for individuals and businesses, aid to State and local governments, and infrastructure investment was designed to provide the economy with an immediate boost. In addition to the Recovery Act, the Obama Administration worked to stabilize the financial sector through a series of measures including stress tests for banks and rigorous requirements for banks to raise private capital and repay the government for assistance from the Troubled Asset Relief Program. The Making Home Affordable program put in place a number of initiatives that have helped millions of Americans modify or refinance their mortgages and stay in their homes. The Administration also rescued and reformed the auto industry by guiding the successful restructuring of two of America's largest automakers and preserving the critical supply network.

Soon after these steps were taken, the economy reversed course. The contraction in economic output eased in 2009 and GDP began to grow again in the third quarter of that year. The economy has now expanded for 14 consecutive quarters. Similarly, the pace of job losses slowed over the course of 2009, and the monthly change in private employment turned positive in March 2010. In recent recoveries following the end of recessions, job growth has lagged economic growth, as employers either managed to implement ways to raise labor productivity to meet demand or delayed hiring out of caution that demand would not recover. During the current recovery, sustained job growth started 9 months after GDP growth resumed, which is sooner than in the 1991 and 2001 recoveries. As shown in Figure 1-1, private employers have now increased payrolls for 35 consecutive months. The 6.1 million jobs added over this time constitute the best 35-month period of job creation since 1998–2001, more than a decade ago. In addition, some \$13.5 trillion of the \$16 trillion in lost wealth has been restored due to the rebounding of the equity markets and firming of house prices, although the gains in wealth have not been uniformly shared.

In 2012, the recovery continued to make progress, and the economy and American people showed their resilience in the face of several headwinds. Total nonfarm payroll employment grew by 2.2 million during the year, or roughly 181,000 jobs per month, a bit above the forecast of 167,000



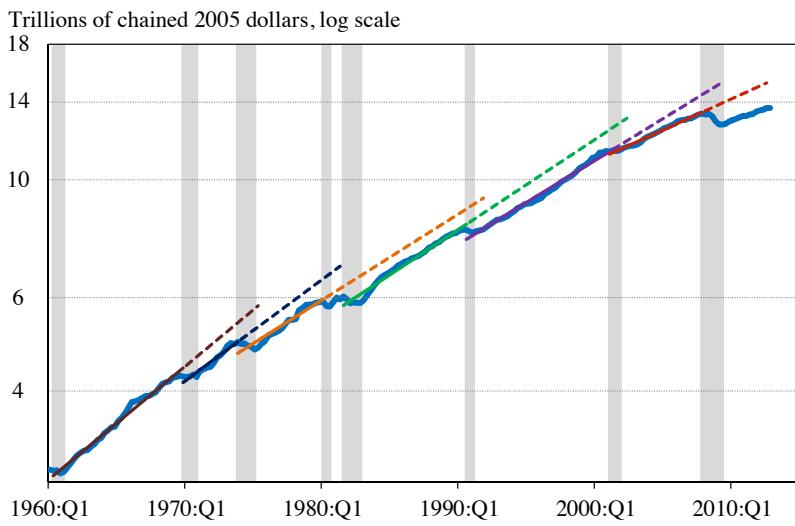
Note: Shading denotes recession.

Source: Bureau of Labor Statistics, Current Employment Statistics.

jobs per month that appeared in last year's *Economic Report of the President*. The unemployment rate fell 0.7 percentage point over the course of the year and reached its lowest level since January 2009. Almost the entire drop in the unemployment rate resulted from increased employment rather than labor force withdrawal. GDP expanded by 1.6 percent during the four quarters of 2012.

Although 2012 was a year of progress, it was not without challenges. A severe drought in the Midwest subtracted from GDP growth in the second and third quarters. Hurricane Sandy struck in late October, and based on the latest estimates of private property damage, it was the second costliest natural disaster in the United States during the last 40 years, behind only Hurricane Katrina. In addition, the euro area slipped back into recession, reflecting continued uncertainty in financial markets, further deleveraging by households and companies, and sizable fiscal austerity measures undertaken by many European governments. The slowdown among our trading partners in Europe and also in Asia reduced overseas demand for U.S. goods and services. And here in the United States, the threat of scheduled tax increases and automatic spending cuts known as the "fiscal cliff" lingered for most of the year. The economy's performance in 2012 is reviewed in greater detail in Chapter 2. Despite the economy's resilience during the past year, the unemployment rate remains elevated, and more work remains to be

Figure 1-2  
Real Gross Domestic Product and Trends, 1960–2012



Note: Shading denotes recession. Trend lines represent the average growth rate between successive business-cycle peaks.

Source: Bureau of Economic Analysis, National Income and Product Accounts; National Bureau of Economic Research; CEA calculations.

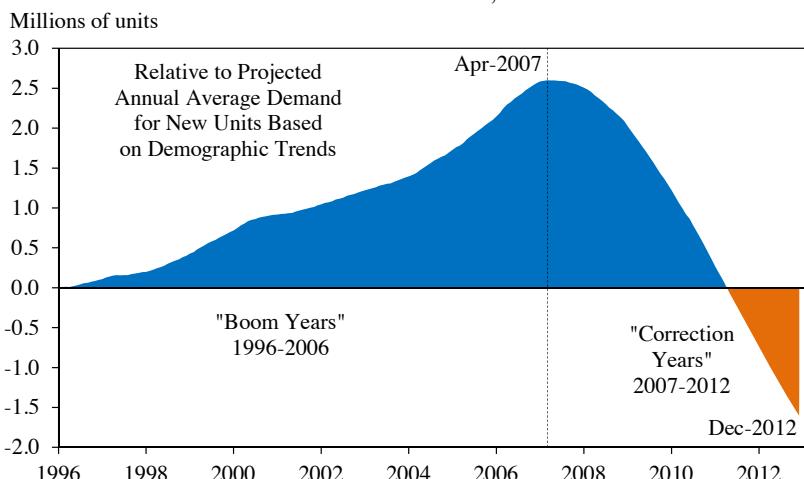
done to boost growth and job creation. In 2013, the Administration remains focused on the need to keep moving forward, while once again avoiding the threat of self-inflicted wounds.

### *Placing the Recovery in Historical Context*

Chapter 2 also places the recovery in broader historical context. The pattern in recoveries over the last 50 years has been that more recent recoveries tend to be marked by slower growth than the recoveries that preceded them. This tendency is documented in Figure 1-2, which shows real GDP along with trend lines based on the average growth rate between successive business-cycle peaks. The current recovery, so far, is no exception to this pattern. The single largest cause of slower trend GDP growth in recent years is changing demographics, as the rate of overall population growth moderates, the baby boomers move into retirement, and the share of the population that is of prime working age begins to decline. Productivity growth also appears to have slowed down after the 1990s, although it is unclear if the slowdown will continue.

At the same time, however, several of the factors that have restrained growth in recent years are temporary constraints that are unique to the current situation and will likely subside in the years ahead. For instance,

**Figure 1-3**  
**Cumulative Over- and Under-Building of Residential  
 and Manufactured Homes, 1996–2012**



Note: The 1998 *Economic Report of the President* projected that 1.6 million new housing units per year would be needed from 1996–2006 to keep pace with demographics. Cumulative over- and under-building is measured relative to this projection.

Source: Census Bureau, New Residential Construction (completions) and Manufactured Homes Survey (placements); CEA (1998); CEA calculations.

a growing body of research has shown that recoveries following financial crises tend to be slower, because of delays in the reemergence of credit and reductions in consumer spending as households pay down debt or rebuild their savings. The Administration expects growth to quicken after households repair their balance sheets and consumers have more money to spend on goods and services. In addition, the housing sector is just now emerging from several depressed years, and much of the overbuilding that took place during the boom years has been offset by underbuilding since 2007. As Figure 1-3 shows, by the Council of Economic Advisers' (CEA) calculations, the U.S. housing market has likely worked off the nationwide cumulative total of excess building that took place in the housing boom years. Consequently, activity in the housing sector is likely to return to more normal levels in the years ahead, although some regions are further ahead in this process than others.

Furthermore, despite the Administration's efforts to support State and local governments through the Recovery Act and other measures, employment in this sector has undergone an unprecedented decline. The Obama Administration will continue to look for ways to boost the hiring of teachers, police officers and firefighters, and these efforts should be helped by a broadly improving economy that eases the strain on State and local

government finances. Thus, while some of the slower growth experienced in recent years is likely the unavoidable consequence of changing demography, there are still strong reasons to believe that the pace of economic growth will nonetheless pick up.

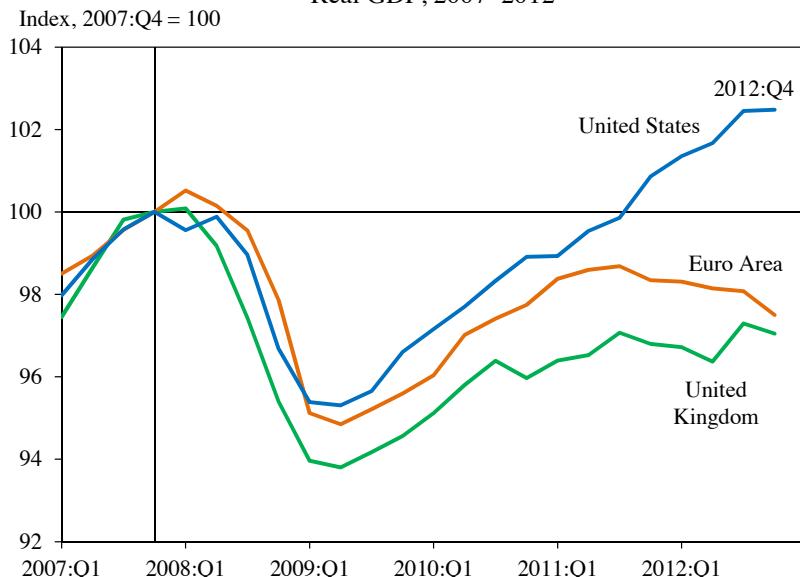
### *Making Progress Toward a Sustainable Fiscal Path*

During 2012, the Obama Administration continued to pursue a balanced approach to fiscal policy that supports the recovery in the near term while looking to reduce the deficit and stabilize the debt over the medium and long term. The Recovery Act provided substantial support for growth in 2009 and 2010, and the economy benefited in 2011 and 2012 from extended unemployment insurance benefits and a 2 percentage point reduction in the employee contribution to the payroll tax, among other measures. At the same time, the Administration agreed to and Congress enacted \$1.4 trillion in discretionary spending cuts, spread over the next decade to ease the impact on an economy that is still healing. Together with the additional revenue from the American Taxpayer Relief Act (ATRA) and interest savings, the deficit has been reduced by more than \$2.5 trillion over the next 10 years. Thanks to these actions and steady economic growth, the Federal budget deficit has declined from 10.1 percent of GDP in 2009 to 7.0 percent of GDP in 2012, the largest three-year drop since 1949. The Congressional Budget Office (CBO 2013) projects that the deficit will fall to 5.3 percent of GDP in 2013. The Obama Administration has repeatedly proposed policies to bring the deficit down to below 3 percent of GDP and stabilize the national debt relative to the size of the economy in the 10-year budget window. A further discussion of the Federal budget outlook can be found in Chapter 3.

A comparison of recent economic performance in the United States with that of countries undertaking more abrupt fiscal consolidation underscores the importance of a balanced and responsible approach to return over time to a sustainable Federal budget. Figure 1-4 shows that while GDP in the United States has expanded for 14 consecutive quarters and surpassed its pre-recession peak, the recovery has faltered in places where austerity has been implemented more rapidly. President Obama has put it succinctly: “We cannot just cut our way to prosperity.”

The American Taxpayer Relief Act, enacted January 2, 2013, represents an important component of the Obama Administration’s approach to reducing the deficit and returning more fairness to the tax code. Before the enactment of ATRA, the Congressional Budget Office (CBO 2012a, 2012b) estimated that if the massive tax hikes and spending cuts originally scheduled to take place in 2013 had been allowed to occur, the full force of

Figure 1-4  
Real GDP, 2007–2012



Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts; U.K. Office for National Statistics; Statistical Office of the European Communities.

these austerity measures, equivalent in dollar terms to roughly 4 percent of GDP, would have caused the unemployment rate to rise by more than one percentage point and likely driven the economy into another recession. The Council of Economic Advisers (CEA 2012) projected that if tax rates rose for middle-class families earning less than \$250,000 a year as was planned under then-current law, U.S. consumers would have reined in their spending by nearly \$200 billion in 2013. To put this in perspective, this reduction of \$200 billion is approximately four times larger than the total amount that 226 million shoppers spent on the post-Thanksgiving “Black Friday” weekend in 2011, or roughly the same amount Americans spent on all the new cars and trucks sold in the United States that year. This would have been a deeply damaging self-inflicted wound to the economy.

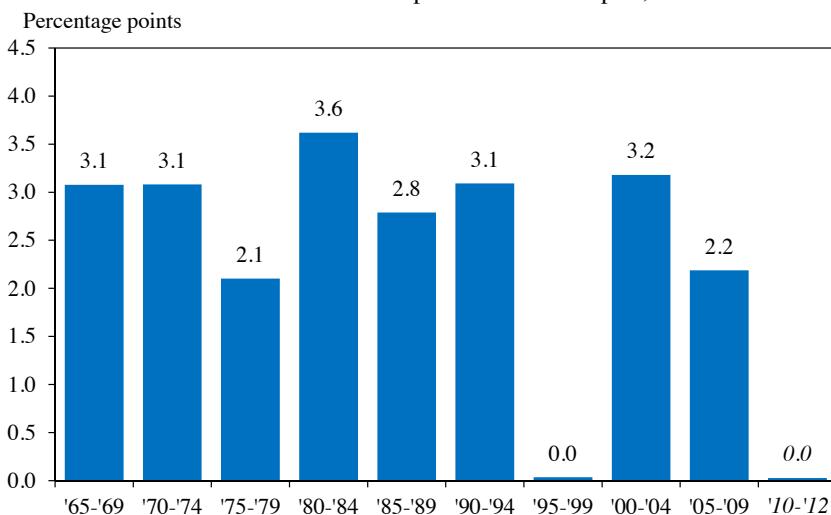
ATRA avoided this massive fiscal retrenchment, securing permanent income tax relief for 98 percent of Americans and 97 percent of small businesses, while also asking wealthier Americans to contribute a bit more to deficit reduction. ATRA reduces the deficit by more than \$700 billion over the next 10 years, largely by restoring the top marginal tax rate on upper-income households to the levels that prevailed in the 1990s and taxing these households’ capital income at a 20 percent rate instead of 15 percent. At the same time, it locks in lower tax rates for the middle class permanently and

extends President Obama's expansions of key tax credits that help working families pay the bills and send their children to college. Other tax credits for business investment and R&D were also extended, as was unemployment insurance for 2 million Americans who are still searching for a job. By avoiding the bulk of the tax increases that would have jeopardized the recovery while also making substantial progress on reducing the deficit, ATRA was a positive step that is representative of the balanced approach that the Administration will continue to pursue.

As this *Report* goes to press, the U.S. economy is once again confronted with the risk of a self-inflicted wound, in the form of automatic, across-the-board spending cuts known as the sequester. When originally put into place with the Budget Control Act of 2011 (BCA), these cuts were never intended to be policy, but rather to force Congress to reach agreement on a broad, long-term deficit reduction package. In the absence of such an agreement, the cuts went into effect on March 1, 2013, and threaten to slow the economy and cause hundreds of thousands of job losses if not replaced. Private economists suggest the cuts could reduce GDP growth in 2013 by around half a percentage point. This potential reduction in output is sizable, considering that most analysts expect the economy to grow around 2 to 3 percent during the year. Moreover, in the weeks and months ahead, sequestration will begin to disrupt basic functions of government on which Americans depend, from education to emergency first-response to airport security. Already, the Navy has been forced to delay the deployment of an aircraft carrier to the Persian Gulf because of the threat of the cuts. The Administration will continue to call on Congress to replace the across-the-board, indiscriminate BCA sequester with a balanced alternative that closes unfair tax loopholes, reforms entitlements, and cuts unnecessary spending. This type of approach is the best way to support the recovery in the short run, while also making progress toward returning to a sustainable budget in the long run.

While the immediate budgetary concern in 2013 is the need to replace the sequester, it is also important to remain focused on the main driver of our long-term budget challenge: the cost of health care for an aging population. One positive development, with significant implications for the economy and Federal budget if it persists, is the recent slowdown in the growth of health care spending. The rate of growth in nationwide real per capita health care expenditures has been on a downward trend since 2002, with a particularly marked slowdown over the past three years. Since 2010, health care expenditures per capita grew at essentially the same rate as GDP per capita. As shown in Figure 1-5, this development is unusual, because growth in health spending has tended to outpace overall economic growth

Figure 1-5  
Average Annual Difference Between Growth in Real GDP Per Capita  
and Growth in Real Health Expenditures Per Capita, 1965–2012



Note: Health expenditures per capita are deflated by the GDP price index.

Source: Bureau of Economic Analysis, National Income and Product Accounts; Centers for Medicare and Medicaid Services, National Health Expenditure Accounts; CEA calculations.

for most of the last five decades. Although some of the narrowing of this gap can be attributed to the effects of the recession, Chapter 5 presents evidence that structural shifts in the health care sector are underway, spurred on in part by the 2010 Patient Protection and Affordable Care Act (Affordable Care Act). If the recent trends can be sustained, the resulting lower health care costs will have a tremendously positive impact on employers, middle-class families, and importantly, the Federal budget. Indeed, if the growth rate of Medicare spending per beneficiary over the last five years persists into the future, then after 75 years Medicare spending would account for only 3.8 percent of GDP, little changed from its share today, and substantially less than what the Medicare Trustees estimate. This should not be interpreted as a forecast but rather an indication of how sensitive long-term projections are to the assumed rate of growth of Medicare spending per beneficiary.

In sum, the U.S. economy has come a long way over the last four years, though more work remains. A staggering total of 8.8 million private sector jobs were destroyed as a result of the Great Recession, but 6.1 million jobs have been gained back. Similarly, \$16 trillion in household wealth was lost when the housing bubble burst and the economy went into recession, but now more than \$13 trillion—over 80 percent—has been regained. And of the estimated \$4 trillion in deficit reduction that many budget experts

agreements are needed over the next 10 years to place the economy on a sustainable fiscal path, more than \$2.5 trillion has been achieved. House prices and residential construction are on the rise, the domestic manufacturing sector is showing signs of resurgence after a decade of shedding jobs, and the U.S. auto industry is back on track, selling new cars at an increasing rate. More work remains to be done, but our Nation has come too far now to turn back.

## BUILDING A STRONGER, FAIRER, MORE RESILIENT ECONOMY

While continuing to build on the progress in recovering from the recession and increasing job creation in the near term, the Obama Administration has also kept a careful focus on preparing the U.S. economy for a stronger, fairer, more resilient future. Many of the problems that caused the financial crisis and recession built up over decades, and our Nation will not have a durable economy that works for the middle class until these underlying, fundamental issues are addressed. For instance, middle-class incomes stagnated in the 2000s, and many economists have argued that households turned to credit to make up for this weak income growth. Lightly regulated—or unregulated—financial companies were all too willing to provide easy credit at nontransparent terms to meet this demand. The borrowing was unsustainable, as evidenced by the bursting of the housing bubble and the fact that outstanding household debt burdens have restrained consumer spending during the course of the recovery.

Part of the weak income growth for middle-class families can be traced to rising health care costs. By one estimate, if health care costs during the 2000s had risen at the same rate as general consumer price inflation—rather than exceeding it—the median family of four would have had an additional \$5,400 in 2009 to spend on other expenses (Auerbach and Kellermann 2011). Slowing the rise in health care costs is therefore a critical part of ensuring that middle-class families can see their take-home pay start to grow consistently again.

This mix of underlying problems—stagnant middle-class incomes, excessive reliance on borrowing, and rising health care costs—motivated two of the Administration’s key initiatives during the first term: the Affordable Care Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Affordable Care Act expands insurance coverage and puts in place meaningful reforms that will reduce the cost of medical care, ensuring that families will not be forced into bankruptcy because of an unexpected illness. The Dodd-Frank law puts an end to taxpayer-financed bailouts for big banks, restricts many of the riskiest financial practices that developed in

the run-up to the crisis, and creates a new consumer watchdog to increase transparency and fairness for American families.

### *Strengthening the Foundations of Growth*

The economy's long-run growth potential fundamentally depends on the number of workers and the productivity of those workers, which, of course, depends on the productivity of American businesses and the creativity and risk-taking of American entrepreneurs. During the second half of the 20th century, the U.S. economy benefited substantially from favorable demographics. The baby boomers were in their prime working years, and women entered the labor force in record numbers. As the size of the labor force grew more quickly during these years, so too did the economy's potential output. However, as discussed previously, population growth is expected to slow in the years ahead, and the United States is expected to undergo a dramatic demographic transition. Figure 1-6 displays the latest projections from the Census Bureau, showing that overall population growth is estimated to decline from an average of 1.2 percent per year since 1950, to just 0.7 percent per year over the next three decades. Notably, as the baby boomers move into retirement, the only major age group that will grow faster over the next 30 years than it did during the last 60 is persons aged 65 and up. As a result, the share of the population that is of prime working age will fall steadily, and the number of retirees per worker will rise. Consequently, one of the major challenges facing the U.S. economy in the decades ahead is the slowdown in potential output growth that will result from a more slowly growing population and labor force.<sup>1</sup>

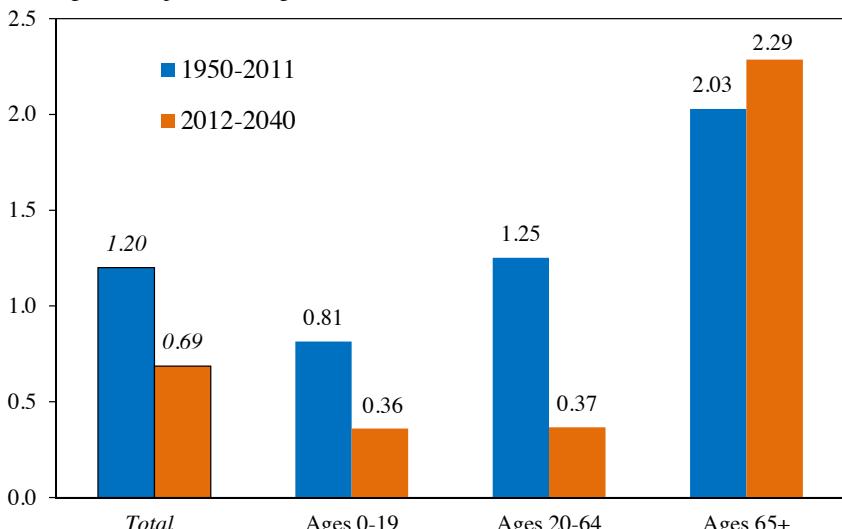
Although the recession caused a decline in the labor force participation rate, it is important to recall that even well before the recession, the labor force participation rate showed signs that it had reached its peak in the late 1990s. This fact largely reflected the aging of the population discussed above and the plateauing of female labor force participation following four decades during which American society was transformed by an increasing number of women in the workforce. So while some discouraged workers are likely to reenter the labor force in the near term as the economy continues to heal, the long-term trend for the labor force participation rate is still likely

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<sup>1</sup> Although the changing demographics of the United States are likely to have a large effect on the economy and the Federal budget in the years ahead, the challenges are even greater in other advanced countries. According to United Nations projections (UN 2011), in 2040, the ratio of persons aged 65 and older to persons aged 20–64 will be even higher in Canada, France, Germany, Italy, Japan, Korea, and the United Kingdom than it will be in the United States. The Organisation for Economic Co-operation and Development (OECD 2012) has said that the aging of populations across developed countries will be the main contributor to slower potential output growth in OECD countries in the decades ahead.

Figure 1-6  
Population Growth by Age Group, 1950–2040

Average annual percent change



Source: Census Bureau, Annual Estimates of the Resident Population and 2012 National Population Projections; CEA calculations.

to be downward. This likelihood was acknowledged in the 2004 *Economic Report of the President*, which noted, “the long-term trend of rising participation appears to have come to an end. . . . The decline [in the labor force participation rate] may be greater, however, after 2008, which is the year that the first baby boomers (those born in 1946) reach the early-retirement age of 62.”

In the face of the demographic challenges of an aging population and a more slowly growing workforce, the Administration believes it is imperative to boost the productivity of American workers by investing in education, innovation, research, and infrastructure. One way in particular to enhance the productivity of the workforce is to have a more educated workforce. As discussed in Chapter 4, the value of a college degree—as measured by the premium paid to college-educated workers—is significant. Shortly after taking office in 2009, President Obama set the goal that America would once again have the highest proportion of college-educated young people in the world by 2020. Chapter 4 details the steps the Obama Administration has taken to meet that goal, including expanding Pell Grants, establishing the American Opportunity Tax Credit, and reforming the student loan system to help make repayment more manageable for 1.6 million responsible borrowers. More recently, President Obama has called for a new Federal-State

partnership that would provide all low- and moderate-income four-year-olds with high-quality preschool.

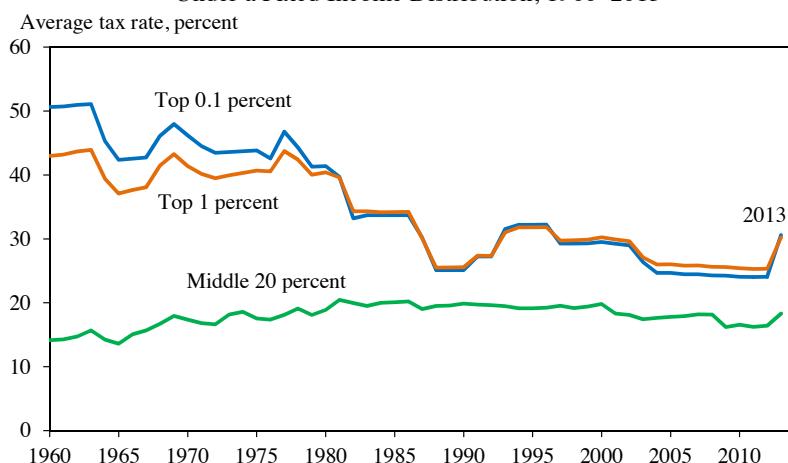
Commonsense immigration reform is another key aspect of the Administration's efforts to enhance the productivity of the American workforce, create more jobs for workers and more customers for businesses, and ease the looming demographic challenges. With a more slowly growing population and more retirees to support, the time is ripe for America to once again renew its long tradition of welcoming immigrants to our shores. Chapter 4 summarizes the economic case for reforming our immigration system to make the American economy more dynamic. Indeed, immigrants founded more than one in four new businesses in the United States in 2011 (Fairlie 2012). Moreover, commonsense immigration reform that gives undocumented immigrants a pathway to earned citizenship is needed to bring these workers out of the shadows and ensure that employers who hire only legally authorized workers and pay a decent wage are not put at a disadvantage. This type of commonsense reform strengthens the economy as a whole by maintaining competition on a level playing field. Immigrants own more than 2 million American businesses of all sizes and were critical to the creation of many of our largest companies like Yahoo! and Google. To make sure that America has a dynamic, competitive workforce and is the home of the next major innovation, it is essential to move toward an immigration system that is geared to help us grow our economy and strengthen the middle class.

### *Ensuring Fairness for the Middle Class*

As discussed above, the American Taxpayer Relief Act was significant not just because it averted the massive tax increases and automatic spending cuts that were slated to occur at the beginning of 2013, but also because it reversed a decades-long trend of declining tax rates for the wealthiest American households. Figure 1-7 shows the average Federal (individual income plus payroll) tax rate for the top 0.1 percent of earners, as well as for the top 1 percent and the middle 20 percent. Since the mid-1990s, the average tax rate on income earned by the wealthiest Americans has trended down and was close to its historical low for most of the 2000s. Beginning in 2013, however, top earners will contribute a bit more to deficit reduction, reducing pressure to cut key investments in education, research, and infrastructure. Even with the tax changes beginning this year, the average tax rate on these high earners is still well within the lower end of its historical range.

The move toward greater fairness in the tax code is motivated by President Obama's belief that the best way to grow an economy is from the middle out, not from the top down. Over the last 30 years, the wealthiest

Figure 1-7  
Average Tax Rates for Selected Income Groups  
Under a Fixed Income Distribution, 1960–2013



Note: Average Federal (individual income plus payroll) tax rates for a 2005 sample of taxpayers after adjusting for growth in the National Average Wage Index.

Source: Internal Revenue Service, Statistics of Income Public Use File; National Bureau of Economic Research, TAXSIM (preliminary for 2012 and 2013); CEA calculations.

Americans have seen their share of the nation's income increase substantially. America celebrates success, but Americans also recognize that when the middle class is squeezed and working families struggle to afford the goods and services that businesses are selling, the prosperity of the nation as a whole is jeopardized. ATRA rolls back some of the inequality that has built up since the 1980s and marks the beginning of the return to a tax code that reflects basic principles of fairness and the critical importance of the middle class to the nation's overall economic health. The Administration has proposed to raise additional revenue by closing loopholes for investment fund managers and cutting tax preferences that benefit only high-income households, as well as by making changes to the corporate tax code that would eliminate special breaks for oil and gas companies and corporate jet owners. Chapter 3 provides further detail on how the President's tax and budget policies are informed by the goal of ensuring fairness for the middle class.

In his 2013 State of the Union Address, President Obama emphasized that “our economy is stronger when we reward an honest day’s work with honest wages. But today, a full-time worker making the minimum wage earns \$14,500 a year. Even with the tax relief we’ve put in place, a family with two kids that earns the minimum wage still lives below the poverty line.” For these reasons, the President proposed raising the Federal minimum wage to \$9.00 an hour and indexing it to inflation thereafter. While economists have

long debated the effects of the minimum wage on employment, the available evidence suggests that modest increases in the minimum wage raise the incomes of low-wage workers as a group and have little, if any, effect on employment. Doucouliagos and Stanley's (2009) careful meta-analysis of the literature concludes, "with 64 studies containing approximately 1,500 estimates, we have reason to believe that if there is some adverse employment effect from minimum-wage raises, it must be of a small and policy-irrelevant magnitude." Similarly, another literature review by Schmitt (2013) considered the most recent research published since 2000 and found, "The weight of that evidence points to little or no employment response to modest increases in the minimum wage."

In addition to being paid a wage they can live on, working families should also have some protection from the tremendous hardship that could arise in the event of an unforeseen illness or medical condition. There is a fundamental economic rationale for providing this sort of protection. As President Obama said in his second inaugural address, "The commitments we make to each other through Medicare and Medicaid and Social Security, these things do not sap our initiative, they strengthen us. They do not make us a nation of takers; they free us to take the risks that make this country great." The insurance coverage expansion and cost reduction measures contained in the Affordable Care Act are the next major steps toward ensuring that American workers have a fair shot at realizing their full potential. Already, the number of uninsured young people is falling, due to the law's requirement that health insurance plans offer dependent children coverage until age 26. In addition, millions of Americans are now receiving rebates from their health insurers as a result of the law's requirement that insurers use no more than 20 percent of premiums for profits, administrative costs, and marketing. Chapter 5 details these and other important steps that are being taken to improve our Nation's health care system, as well as the major benefits that will result for middle-class workers and families.

The President's top priority remains to make America a magnet for jobs and manufacturing in order to strengthen the middle class and promote economic growth. As discussed in Chapter 7, manufacturing has historically provided Americans with a path to the middle class, especially for less educated Americans. But as foreign competition from companies in China and elsewhere began to emerge, manufacturing work increasingly moved overseas, and millions of American jobs were lost. Manufacturing employment in the United States had been fairly stable at around 18 million jobs from 1965 to 2000, but from 2000 to 2007—before the Great Recession—manufacturing employment dropped precipitously, falling by 3.5 million jobs. Another 2.3 million manufacturing jobs were lost in the recession and

its aftermath. Chapter 7 details the Administration's efforts to reverse this trend and bring manufacturing jobs back to the United States. These efforts include supporting new skills training programs for workers, investing in advanced manufacturing R&D to replenish the technology pipeline and strengthen engineering capabilities, providing tax credits for manufacturers that hire more employees in the United States, and encouraging fair trade by expanding America's global market access and leveling the playing field across nations. Many of these initiatives began during President Obama's first term and contributed to the nearly 500,000 manufacturing jobs that have been added over the last 3 years, the best period of job creation in manufacturing since the 1990s. This turnaround in manufacturing would have been inconceivable even just a few years ago, and sustaining this momentum is a key part of the Obama Administration's second-term agenda for the middle class.

### *Making the Economy More Resilient to Future Challenges*

While the Administration works to repair the damage of the Great Recession and build an economy that works for middle-class families, it is critical that we also take steps to ensure that the economy is resilient in the face of gathering challenges. For example, although much progress has been made in moving America toward a clean energy future that does not depend on foreign oil, more work remains to be done. Chapter 6 details the scientific consensus around climate change and the dangerous consequences that could result if greenhouse gas emissions are not reduced. In addition, Chapter 6 discusses the preparatory steps being taken to avoid these harmful outcomes and ensure the economy's resiliency in the face of these risks. The Administration has increased fuel efficiency standards, launched an array of programs to encourage more efficient household energy use, and provided tax credits to companies developing renewable energy sources—all actions that will reduce greenhouse gas emissions. In 2012, net imports of petroleum products were at a 20-year low, domestic natural gas production was at an all-time high, and the use of renewable sources like wind and solar had more than doubled from 2008. These are positive steps in the right direction, and the Administration aims to continue this progress in the second term.

Chapter 8 presents the challenges and opportunities in the U.S. agricultural sector, as well as the lessons learned from the rapid productivity advances in agriculture that can be built on to raise job creation and output in other areas of the economy. In 2012, America's farmers faced the most severe drought since the 1950s but showed their resilience as net farm income for the year as a whole is estimated to have fallen just 4 percent from the record high level reached in 2011. In the years ahead, America's farmers

have an especially important role to play in helping to feed a growing global population. From 2010 to 2050, the world’s population is projected to rise by more than 2 billion people, and most of this increase is expected to occur in developing countries. A growing, increasingly urbanized world population will present unique challenges to the agricultural sector, as urban areas rely heavily on a stable and efficient worldwide food chain to provide nutrient-dense and diverse foods. At the same time, trade in agricultural commodities will continue to be a global endeavor in which prices respond to supply and demand conditions around the world. Chapter 8 outlines the steps the Administration is taking to build on our Nation’s trade surplus in agricultural products and help farmers manage the risk of volatile prices.

## CONCLUSION

As President Obama begins his second term, the U.S. economy is undoubtedly in a far stronger position and headed in a much better direction than it was when he first took office in January 2009, but more work remains to be done. 2012 was a year of progress, with private employers adding more than 2 million jobs and the unemployment rate falling to its lowest level in four years. While the worst of the recession is now behind us, many of its aftereffects still linger, as do a number of underlying, structural issues that built up for decades and could threaten our economy’s prosperity in the years ahead. As such, the Administration’s efforts in the second term will proceed along two critically important and related tracks: recovering from the past and preparing for the future.

The goals of the President’s economic agenda described above—strengthening the foundations of growth, ensuring fairness for the middle class, and making the economy more resilient to future challenges—are all mutually reinforcing. America built the most prosperous economy on Earth because we recognized that investments in our individual success were inextricably linked to our success as a nation. Today, investments in research and innovation can lead to new technologies that allow for more effective, less expensive health care or cleaner sources of energy. To facilitate these new technological innovations, it is critical to have a vibrant manufacturing sector with advanced engineering capabilities. A growing manufacturing sector can also provide a path to the middle class for many American workers. And when middle-class families see their incomes rise, their increased spending on goods and services supports broad-based, sustainable economic growth—in other words, an economy that is built to last. This is just one set of examples of the synergies across the various aspects of the President’s economic agenda—many more can be found in the chapters of this *Report*.

These synergies underlie the economic recovery that began during President Obama's first term and will drive the Administration's work during his second term to continue moving our economy forward.