

INHERITING A LEGACY OF MISPLACED PRIORITIES

Over the decades, the United States has grown and prospered when all Americans have shared in the opportunities created by our economy. Bottom-up growth that empowers hardworking families to climb the ladder of success and raise their children with security, opportunity, and hope for the future lies at the heart of the American dream. It is the responsibility of our elected leaders to create the conditions for our people to aim high, work hard, and realize the full promise of American life.

Yet for far too long, the resilience, optimism, and industriousness of the American people have been frustrated by irresponsible policy choices in Washington. Prudent investments in education, clean energy, health care, and infrastructure were sacrificed for huge tax cuts for the wealthy and well-connected. In the face of these trade-offs, Washington has ignored the squeeze on middle-class families that is making it harder for them to get ahead. Our Government has spent taxpayer money without making sure the numbers add up and without making it clear and understandable to the American people where their money was being spent. Tough choices have been avoided, and we have failed to make the wise investments we need to compete in a global, information-age economy.

While middle-class families have been playing by the rules, living up to their responsibilities as neighbors and citizens, those at the commanding heights of our economy have not. They have taken risks and piled on debts that while seemingly profitable in the short-term, have now proven to be dangerous not only for their individual firms but for the economy as a whole. With loosened oversight and weak enforcement from Washington, too many cut corners as they racked up

record profits and paid themselves millions of dollars in compensation and bonuses. There's nothing wrong with making money, but there is something wrong when we allow the playing field to be tilted so far in the favor of so few.

This is the legacy that we inherit—a legacy of mismanagement and misplaced priorities, of missed opportunities and of deep, structural problems ignored for too long. It's a legacy of irresponsibility, and it is our duty to change it.

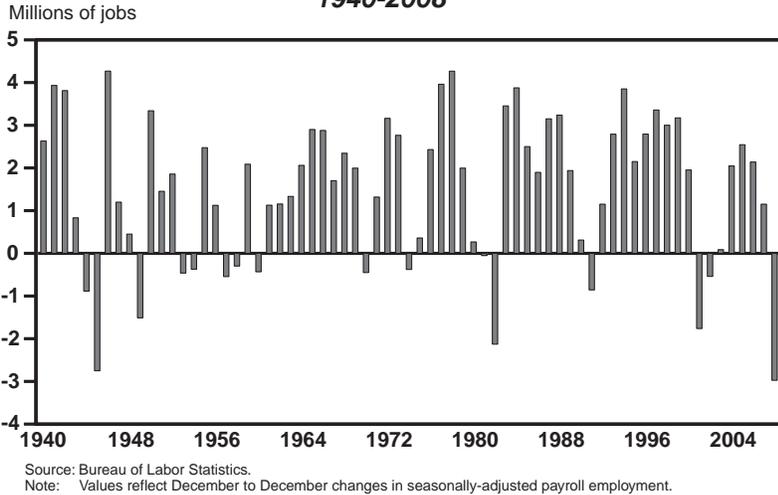
A DEEP AND DESTRUCTIVE RECESSION

No one reading this report needs to be told that our economy is in crisis. We have lost jobs for 13 consecutive months for a total of 3.6 million jobs lost. According to the Bureau of Labor Statistics, more jobs were lost last year than in any year since data collection of this kind began in 1939 (see Figure 1, Annual Change in Payroll Employment, 1940-2008). In percentage terms, the job loss in the current recession is the worst since the early 1980s (see Figure 2, Job Losses in Five Recessions).

Many newly unemployed workers will be facing long odds when they try to find another good job. Since the start of the recession, the number of those unemployed for 27 weeks or more has risen by 1.3 million including a 440,000-person increase in December 2008 and January 2009. Increasingly, workers are giving up looking for work or involuntarily settling for part-time work; in fact, the underemployment rate, which measures all those out of work or underemployed for economic reasons, rose to 13.9 percent in January 2009 (see Figure 3, The Underemployment Rate).

Figure 1

Annual Change in Payroll Employment 1940-2008



Every sector of our economy has been affected by this recession. The automobile industry, which required a Government rescue this past winter, has shed 204,000 jobs since the start of this recession. Over the last year, the Big Three automakers have seen sales plunge anywhere between 39 and 55 percent. Manufacturing as a whole has been hard hit with employment falling to a 60-year low (see Figure 4, Manufactur-

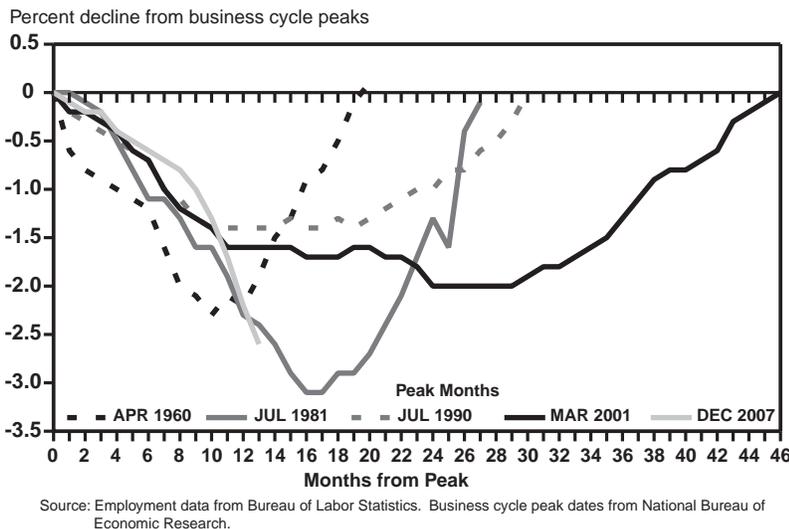
ing Employment). Housing starts and permits continue to fall; in fact, the U.S. Census reported that housing starts were at the lowest levels since monthly recording of these data began in 1959 (see Figure 5, Housing Starts). At the same time, mortgages in the foreclosure process increased 204 percent between October 2006 and October 2008, and over 1 million properties went into foreclosure in 2008.

Unsurprisingly, consumer confidence too is at an all time low (see Figure 6, Consumer Confidence). Some Americans are unable to keep up with the mounting bills and dwindling prospects: last fiscal year, personal bankruptcy filings topped 1 million, an increase of almost 30 percent from 2007. The overall picture is bleak: GDP fell at a 3.8 percent annualized rate in the last quarter of 2008, the biggest economic contraction in more than a quarter of a century.

A central cause of this sudden downturn has been a meltdown in our capital and credit markets. The subprime mortgage crisis is the result of a perfect storm of excessive risk-taking by both investors and borrowers, inadequate disclosure, non-existent or myopic oversight, market gatekeepers compromised by conflicts of interest, and irresponsible lending to thousands of Americans who, when offered the chance to own their own home, were advised to throw caution to the wind. Through sophisticated financial engineering, bad loans made on Main Street made their way onto the books of some of the largest firms on Wall Street, and then were sold to pension funds and individual investors around

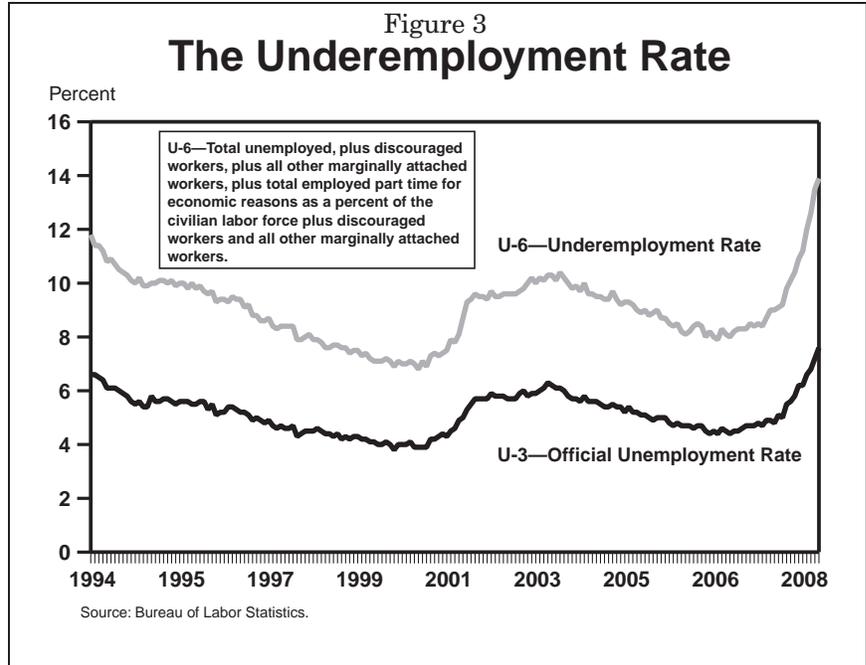
Figure 2

Job Losses in Five Recessions



the world. Once the real estate market began to cool, loans defaulted at alarming numbers, these complex financial products started to lose their value, and the credit boom unraveled, erasing enormous wealth for both families and business as well as the jobs fueled by consumer spending.

The resulting collapse laid low some of the most prominent financial institutions in the American economy, and has wiped out trillions of dollars in wealth and retirement savings for millions of Americans who thought they had successfully provided for their golden years. Uncertainty about how far and wide the contagion has spread has brought our financial system to a near standstill. Loans to consumers, small businesses, and other borrowers are hard to come by, and likewise, the mortgage squeeze acts as a brake on the return of housing demand. The injection of unprecedented amounts of funds by the Federal Reserve and through the Troubled Asset Relief Program (TARP) attempted to restore confidence in the financial markets to get capital flowing once more and has slowed or perhaps halted the meltdown—but it has not been enough to fully restore confidence and the smooth operation of credit markets. A lack of trust still pervades markets. When that happens, investors pull their money out of the market, depositors make runs at banks, and banks stop lending to companies and to one another. Because of this lack of trust, our credit markets are effectively still frozen. As a result, businesses are unable to expand, families are unable to finance a new home, a new car, or a college education for their kids; and our economy suffers.



AN ANEMIC RECOVERY ALREADY HAS HURT AMERICAN FAMILIES

Adding insult to injury, American families have entered this recession weakened by the anemic recovery from the last downturn at the beginning of this decade. For millions of Americans, the recovery from 2001 through 2007 was hardly one at all. Measured by job gains, the economic recovery

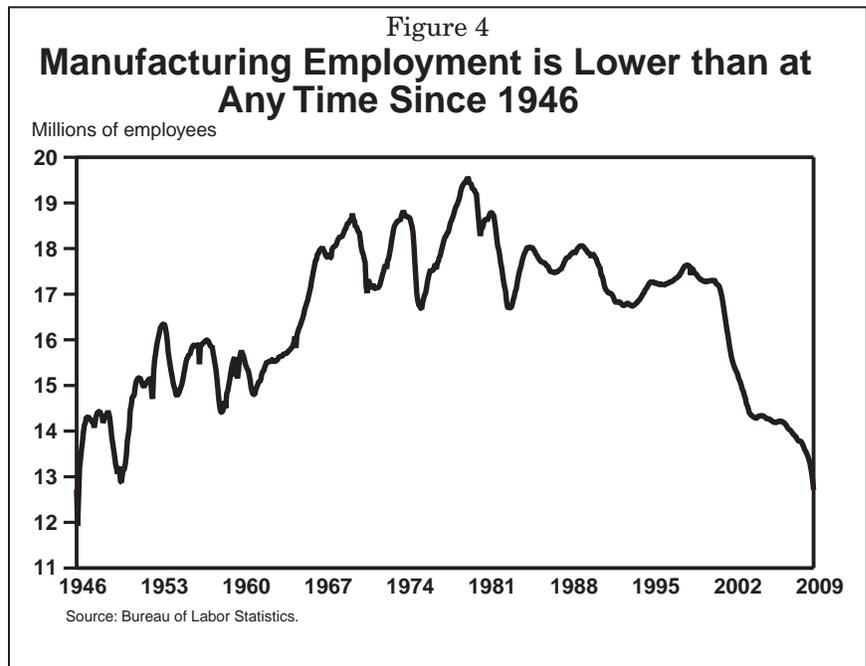


Figure 5

Housing Starts have Reached an All-Time Low



in the 2000s was the weakest one in a generation. From 2001 to 2007, the period in which the economy was expanding as measured by the growth in output, only 99,000 jobs were created each month on average. The period began with an outright decline in employment that did not end until 2003. Average job gains were more than twice as large during the expansions of the 1980s (228,000 a month) and the 1990s (200,000 a month) (see

debt: by 2007, household debt as a percentage of disposable personal income was 133.7 percent. And some Americans have not been able to keep up, falling out of the middle class and into poverty. From 2000 to 2007, the number of Americans living in poverty increased by nearly 5.7 million, and 1.7 more children lived in poverty in 2007 than in 2000. In fact, 18 percent of children, about 13 million in total, lived in poverty in 2007.

Figure 6

Consumer Confidence Has Fallen to a Forty-Year Low

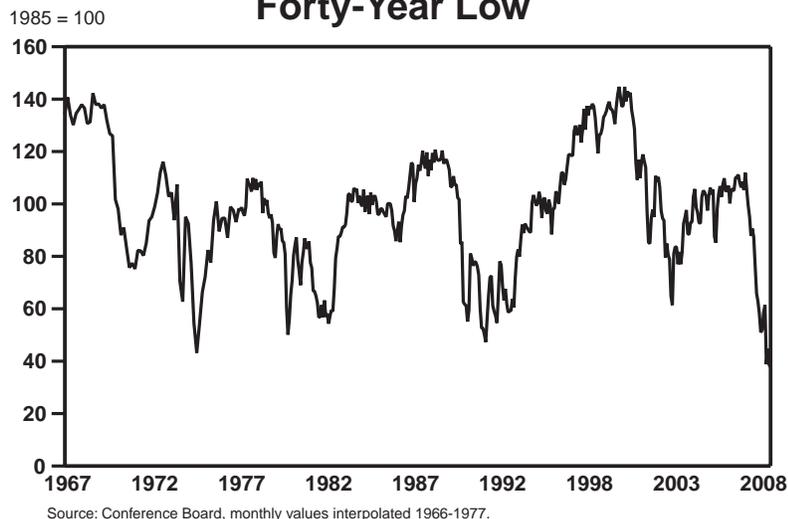


Figure 7, 2000s Economic Recovery Brought Weakest Job Gains). Real wages also showed very little improvement in the latest expansion, rising on average at an annualized rate of just 0.1 percent each month, compared with 0.7 percent during the 1990s expansion.

On top of that, this was the first economic recovery since World War II where real median household income did not rise above its previous peak (see Figure 8, Real Median Household Incomes). Between 2000 and 2007, median income among households headed by those under 65 fell by \$1,951. To keep up, more and more Americans have turned to credit and

IGNORING OUR LONG-TERM CHALLENGES

As the typical family saw its income decline and the underpinnings of our economic growth become increasingly unsustainable, nothing was done to address these mounting problems. These problems then were made worse by policies that benefited those at the top at the expense of almost all Americans and by a failure to tackle some of the most significant, structural impediments to long-term economic growth.

Growing Imbalance: Accumulating Wealth and Closing Doors to the Middle Class

For the better part of three decades, a disproportionate share of the Nation’s wealth has been accumulated by the very wealthy. Technological advances and growing global competition, while transforming whole industries—and birthing new ones—has accentuated the trend toward rising inequality. Yet, instead of using the tax code to lessen these increasing wage disparities, changes in the tax code over the past eight years exacerbated them.

According to the Internal Revenue Service, the Nation’s top 400 taxpayers made more than \$263 million on average in 2006, but paid income taxes at the lowest rate in the 15 years in which these data have been reported. In constant dollars, the average income of the top 400 taxpayers nearly quadrupled since 1992.

It’s no surprise, then, that wealth began to be ever more concentrated at the top. By 2004, the wealthiest 10 percent of households held 70 percent of total wealth, and the combined net worth of the top 1 percent of families was larger than that of the bottom 90 percent. In fact, the top 1 percent took home more than 22 percent of total national income, up from 10 percent in 1980 (see Figure 9, Top One Percent of Earners). And these disparities are felt far beyond one’s bank statement as several studies have found a direct correlation between health outcomes and personal income.

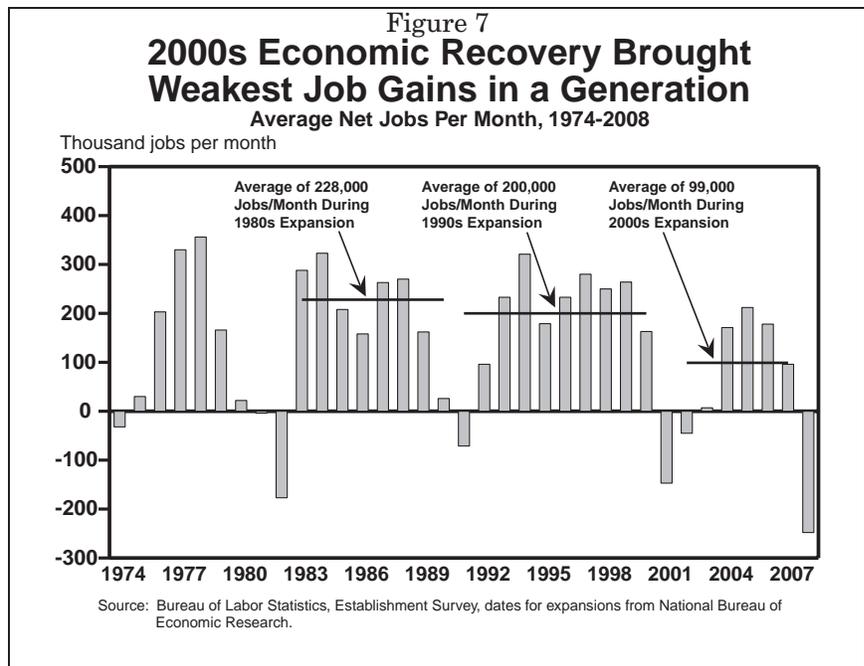
There is nothing wrong with people succeeding and making money. But there is something wrong when the opportunity for all Americans to get ahead, to enter the middle class, and to create a better life for their children becomes more and more elusive. That is what has been happening: The ladder into the middle class and

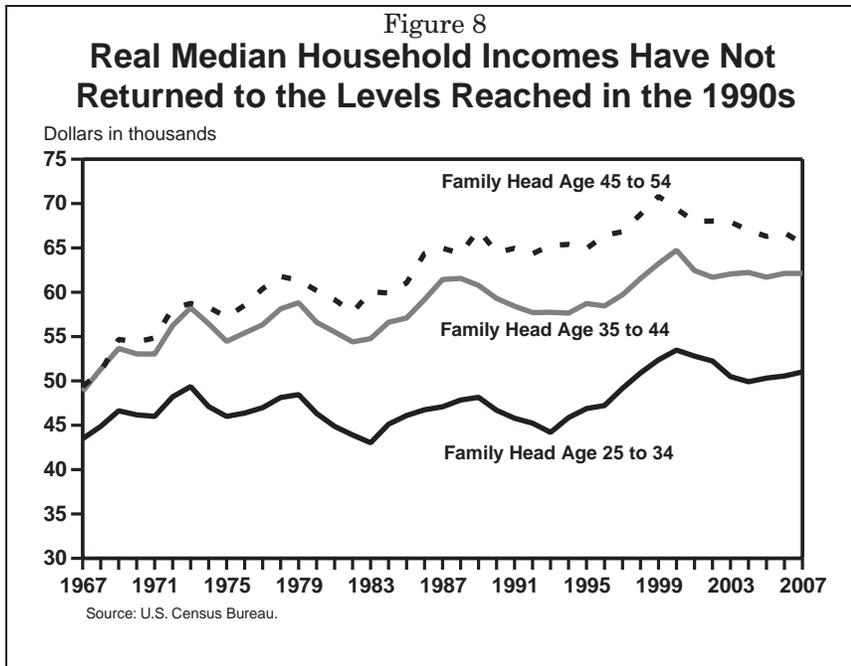
beyond has become harder and harder to climb. The American dream has slowly slipped beyond the grasp of millions as we have deliberately ignored the very investments in our people that strengthen the middle class and neglected the drivers of economic growth that will sustain our economy for the long run.

Education

We know that the key to success in the 21st Century lies in investing in our people—in giving the chance to get a world-class education from cradle to career. Economists from across the spectrum agree that in this digital age, a highly-educated and skilled workforce is critical not only to individual opportunity, but also to the overall success of our economy. The more people we educate to the highest standards possible, the better off all of us will be. Yet too many children are not getting the world-class education that they deserve and that they need to thrive in this information-age economy.

Research has shown that there is a high return for investments made in high-quality, comprehensive programs supporting disadvantaged children, and their families, from birth. Some studies show that for every dollar invested, there is a \$4





to \$9 return to society in higher earnings, higher graduation and employment rates, less crime, decreased need for special education services, less use of the public welfare system, and better health. However, we have yet to make a serious commitment to our youngest learners.

From kindergarten through high school, too many of our students are falling behind. According to the National Assessment of Educational Progress, the Nation's Report Card, in 2007 only one-third of fourth-graders was able to demonstrate solid academic performance in reading. Similarly, only 31 percent of eighth-graders demonstrated solid academic performance, a percentage that has remained stagnant since 1992. Achievement levels are similarly disappointing in mathematics.

We have not yet created a credible system of accountability for strong outcomes and a way to provide teachers and principals with the tools they need to get results. The problem is exacerbated by our failure to invest in the physical structures of our schools. A 2004 report by the National Center for Education Statistics found that 8.5 percent of public schools have exceeded their capacity; in almost one out of five schools, teachers have to teach in common areas such as

gyms and cafeterias; and one in four schools report that teachers do not have their own classrooms in which to teach.

Another part of the problem is that when these students graduate from high school and look toward continuing their education, they face high costs of college attendance. The average tuition and fees at public, four-year institutions between the 2000-2001 school year and 2008-2009 year increased by more than 26 percent, after adjusting for inflation and increases in tax credits and financial aid (see Figure 10, Average Annual Undergraduate Tuition). It's no surprise, then, that

60 percent of college students graduate with debt, and the typical debt load is over \$20,000. Facing numbers like these, many students will simply decide that they cannot afford college, and many more already in college will decide that they cannot afford to stay. While 94 percent of high school students in the top quintile of socioeconomic status continue on to post-secondary education, only 54 percent of those in the bottom quintile do so.

If all our young children are not able to go to a high-quality school with modern facilities and great teachers and if older students are unable to afford to go to college and stay there until graduation, there is no way that our economy will be able to expand opportunity, strengthen the middle class, and compete in a global economy.

Health Care

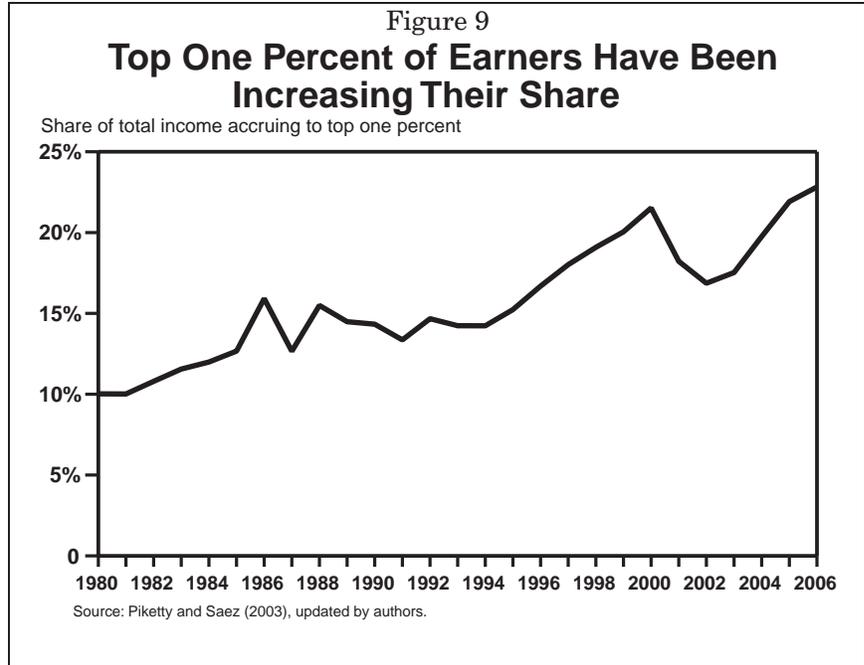
One of the other big drains on family budgets and on the performance of the economy as a whole has been the increasing costs of health care. Yet the evidence suggests that substantial reductions in costs could be achieved without sacrificing the quality of health care delivered. And in part because of the high costs of the current system, too many Americans remain uninsured

or underinsured—causing them to forgo needed care and to bear unnecessary financial risks.

Since 2000, health insurance premiums have increased faster than worker’s earnings. After adjusting for inflation, family health insurance premiums have increased by 58 percent while workers’ wages have increased only 3 percent (see Figure 11, Family Health Insurance Premiums). In 2007, 17 million insured Americans spent more than 10 percent of their salary on health care, and 25 million Americans are underinsured, without enough coverage to keep costs in check.

Over the past eight years, the number of uninsured in America has jumped by 6.9 million and now totals 45.7 million Americans. Moreover, the number of people who have gone without health insurance for at least some portion of the previous 12 months tops 60 million. Many of those are people whom insurers will not cover because they have existing medical problems. Millions more have insurance, but could lose access as soon as they develop a serious medical problem. These Americans suffer, but their lack of health care options impacts all of us: every time an uninsured person walks into an emergency room because there is nowhere else to turn, a hidden tax is imposed on other citizens as premiums go up.

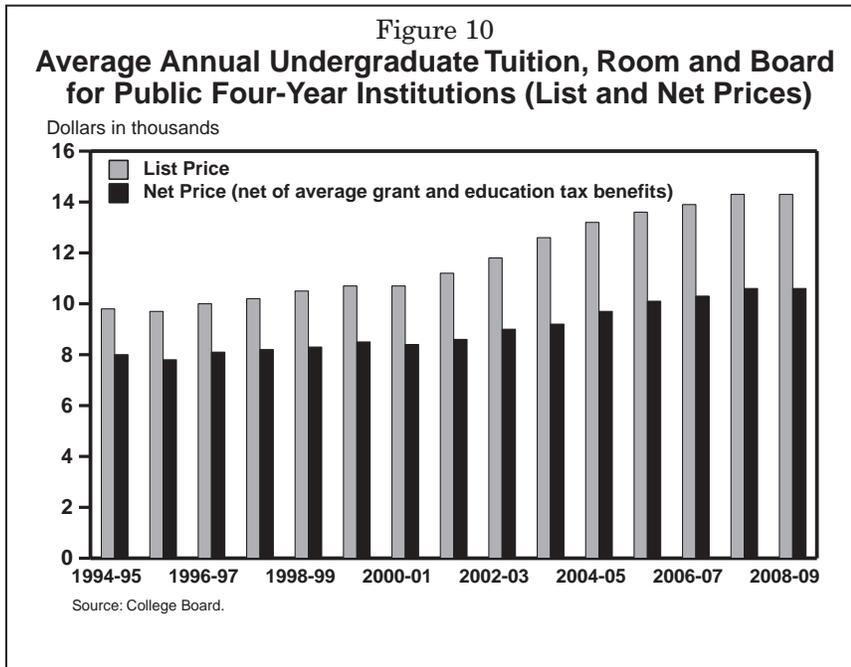
At the same time, health care costs are imposing large burdens on families—often in unexpected ways. Workers’ take-home pay is constrained by health insurance costs to a degree that is both underappreciated and unnecessarily large. For instance, as mentioned earlier, at the state government level, evidence suggests that rising health care costs have crowded out support for higher education—raising tuition levels and impairing the quality of public higher education. Overall, health care is consuming an ever-increasing amount of our Nation’s resources: in 1970, health care expenditures were 7 percent of



GDP; now, it’s 16 percent; and at this rate will hit nearly 20 percent by 2017.

We have a substantial opportunity to improve the efficiency of our health sector. Costs vary widely across areas of the United States, but evidence suggests that the high-cost areas do not generate better health outcomes than the lower-cost ones. Costs are twice as high at some of our Nation’s leading medical centers than at others—and again the high-cost centers do not generate better outcomes than the lower-cost ones. Academic researchers suggest that costs could be reduced by as much as 30 percent—or roughly \$700 billion a year—while protecting the quality of health care delivered if the high-cost areas and hospitals adopted the practices of the low-cost ones. According to Institute of Medicine estimates, as many as 100,000 Americans die each year due to preventable medical errors. Only four cents of every dollar spent on health care goes to preventive care. And while the United States leads the world in health care expenditures by a wide margin, our health outcomes often fall short of those achieved by other developed countries.

The bottom line is that the current path of rising health care costs is unsustainable, not only



for the Federal Budget but also for family budgets.

FAILURE TO INVEST IN THE FUTURE

America's prosperity has always risen from the ground up, seeded by the hard work and ingenuity of our workers, inventors, and entrepreneurs. But germs of a good idea or a new way of doing business cannot take root and flourish without the Nation preparing the conditions for growth. That takes sound management of the economy; access to capital; and investments in science, technology, and infrastructure. That's why we built the great land-grant universities as our Nation expanded west, sent the Greatest Generation to college on the G.I. Bill, and invested in science and technology at the height of the Cold War. It's why previous generations built the Erie Canal at the start of the 19th Century, the transcontinental railroad after the Civil War, and the interstate highway system in the 1950's. It's why we electrified rural America during the depths of the Great Depression and laid fiber optic cables in our own time.

Investing in the future has been critical to long-term economic growth and creating high-paying jobs for our people throughout our history. Yet, over the past several years, we've been delinquent in making these down payments on future growth.

Infrastructure

As our society becomes more mobile and interconnected, the need for 21st Century transportation networks has never been greater. As our economy slows, repairing and upgrading our infrastructure is an effective way to revive it and create new jobs. In the longer term, infrastruc-

ture investment will enable the United States to compete with the rest of the world and keep good jobs here at home. After all, in this day and age, businesses can now locate almost anywhere in the world and bring the jobs they create with them—and a modern infrastructure is critical if those jobs are to come to and stay in America.

Yet too many of our Nation's railways, highways, bridges, airports, and neighborhood streets are not keeping up with the needs of our Nation due to lack of investment and strategic long-term planning. The American Society of Civil Engineers gives our country's infrastructure the grade of a "D." The unsatisfactory condition and operational performance of our roads and bridges carries real costs from billions of dollars in car repairs to wasted fuel and time. The Texas Transportation Institute 2007 Urban Mobility Report estimates that drivers experienced over 4.2 billion hours of delay and wasted approximately 2.9 billion gallons of fuel in 2005.

Looking forward, we are behind in building the infrastructure that we need to compete in the global, information-age economy and are at risk of losing our Nation's scientific dominance. Over the last three decades, Federal funding

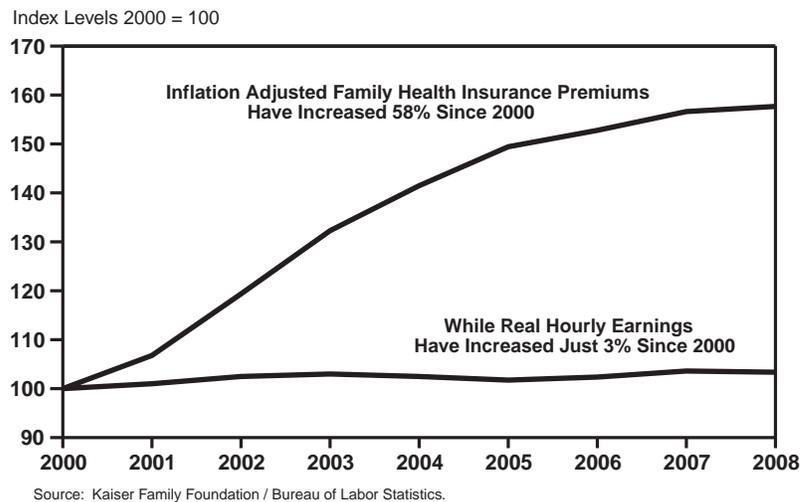
for the physical, mathematical, and engineering sciences has declined as a percentage of GDP at a time when other countries are substantially increasing their own research budgets. At one point not long ago, the United States led the world in broadband deployment; now, that leadership is in question. Wireless networks in many countries abroad are faster and more advanced than our own. Our electrical grid is still constructed around the same model of 100 years ago, and in some places is as old. Power interruptions and outages cost Americans at least \$80 billion each year. Finally, because of an insistence on putting dogma ahead of science, the United States has fallen behind in some of the most important, cutting-edge research such as stem-cell research.

Clean Energy

This lack of investment in the future is most glaring in the area of clean energy. For decades, we have talked about the security imperative we have to wean our Nation off foreign oil, which is often controlled by those whose interests are inimical to ours. And in recent years, a consensus has developed over the need to limit greenhouse gas emissions, which produce global warming and increase the risk of severe storms and weather conditions that might ruin crops, devastate cities, and destabilize whole regions. All of these facts are reason enough to invest in clean energy technologies. But there is an economic imperative to embrace these investments as well.

The clean energy sector presents us with immense promise—to develop and dominate a new industry sector and to create high-paying jobs here at home. From new, highly fuel-efficient cars to renewable sources of power, there are a host of emerging technologies that can spur the growth of new business while creating millions of new jobs. Our economic competitors know that. That’s

Figure 11
Since 2000 Family Health Insurance Premiums Have Increased Much Faster than Workers' Real Earnings



why they are racing to dominate these industries and to transform their economies.

Yet, the last Administration approached our energy needs by focusing on finding more of the fossil fuels we use now. As a result, we are still addicted to fossil fuels and more dependent on foreign oil than ever before. We have yet to make important policy changes and critical investments in the clean energy infrastructure that we’ll need to transform our economy. Beyond clean energy, we have not kept up with investing in the basic science and research that will power this sector and the entire economy in decades to come. In fact, as a share of GDP, American Federal investment in the physical sciences and engineering research has dropped by half since 1970.

ERODING TRUST AND ACCOUNTABILITY

Government is able to work on behalf of the people and attend to their immediate needs and long-range problems when it truly is a government of, by, and for the people. Part of what ails our economy is a profound disconnect between our leaders in Washington and the rest of the Nation.

Over the past eight years, policy was made behind closed doors. In many cases, unprecedented levels of secrecy have been invoked to block public scrutiny. In such an environment, the well connected and those who are able to hire high-priced lobbyists were able to carve out huge loopholes in our tax code, win massive subsidies that shifted the tax burden to small businesses and the middle class, and obtain exemptions from the basic rules of the road for themselves and their clients. And they did this all without paying for it or being held to account. This must change.

Fiscal Irresponsibility

Another manifestation of irresponsibility is the large budget deficits we are inheriting. These deficits, over time, will harm economic growth and impose burdens on our children and grandchildren. For the past eight years, in a time of economic growth, the Government spent recklessly on tax cuts for the few and hand-outs for the well-off and well-connected, mismanaged billions of dollars in taxpayer money, and failed to honor the responsibilities we have to future generations. Massive new programs have routinely been omitted from the Budget to mask their true cost, while a new entitlement program and massive tax cuts were proposed and signed into law without any

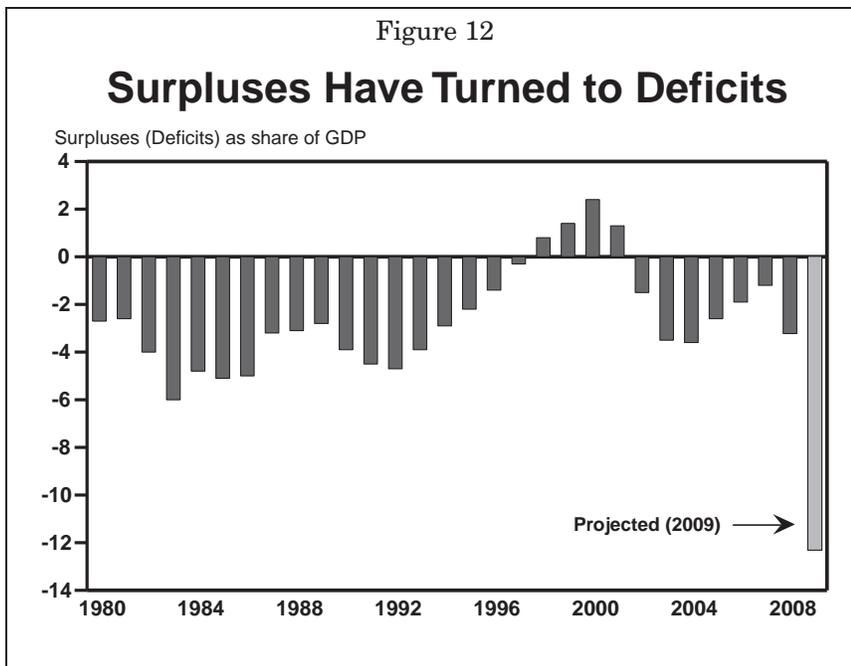
attempt to pay for them. Between 2000 and 2008, real Government outlays increased at a 3.6 percent annual average rate, three times the 1.2 percent annual average rate between 1992 and 2000. This has helped turn a surplus of \$236 billion at the end of the Clinton Administration, that was projected to grow still larger over time, into a deficit of more than \$1 trillion in 2009. (see Figure 12, Surpluses Have Turned to Deficits). Furthermore, the amount of debt held by the public has nearly doubled to \$6.4 trillion from 2001 to 2008. We are now living with the fallout of this deep fiscal irresponsibility.

Unfortunately, we are also inheriting the worst economic crisis since the Great Depression—which will force us to increase deficit spending temporarily as we try to jumpstart economic growth. This is an extraordinary response to an extraordinary crisis, and as we come out of this recession, we must return to the path of fiscal responsibility. It will mean tough choices—choices that are tougher because of the legacy of fiscal irresponsibility left to us.

Erosion of Market Oversight

Our Nation depends on private initiative and on free markets. But the financial crisis has reminded us that without a watchful eye, the markets can spin out of control. In recent years, a dogmatic deregulatory approach to our capital markets, driven by ideology rather than pragmatism, has now put those very markets—the envy of the world—in their most serious crisis in decades. Policymakers forgot that markets work when there is transparency of financial information for investors and consumers alike; independent oversight; and accountability enforced by active and uncompromised regulators. Because of deliberate policy decisions, balance sheets did not accurately reflect the risks that firms were taking; large pools of capital were left unregulated while

Figure 12



more and more investors were exposed to them; and conflicts of interest compromised the credit rating agencies upon which investors relied. Investors and consumers ended up participating in complex transactions without full disclosure of the relevant risks, and eventually these mortgages, credit card debts, and other loans ended up costing many Americans dearly.

Because our regulatory system atrophied and its patchwork quilt of different regulators and standard-setters was left untouched, it failed to keep pace with financial innovation. As a result, investors were led into investments that they neither understood nor were appropriate to their risk profile, and many people took on debts that they never could have hoped to pay. Corners were cut, and rules were bent. At every level, some of the most important market actors failed to live up to their responsibilities and failed to do what investors need of them to invest their hard-earned money wisely.

An Unresponsive Government

It is no coincidence that the policy failures of the past eight years have been accompanied by unprecedented Governmental secrecy and unprecedented access by lobbyists and the well-connected to policymakers in Washington. Consequently, the needs of those in the room trump those of their fellow citizens. We saw this with the Energy Task Force convened in 2002. When a Supreme Court order finally opened up its proceedings to review, it became apparent that regulatory decisions were made that reflected specific requests by industry representatives with the Government's ear.

The growth of Federal contracting is another instance where special interests benefited from special access. Federal spending on contracts more than doubled from about \$208 billion in 2000 to more than \$423 billion in 2006—and yet the number of contract officers overseeing these contracts remained flat. The value of contracts not subject to full and open competition grew from \$48.6 billion to \$112.5 billion during the same period. Cost-type contracts that are particularly vulnerable to waste since they provide no incentive to control costs increased more than 75 percent under the previous Administration.

This special-interest driven use of taxpayer dollars shows up in the billions of dollars in improper overpayments for Medicare and Medicaid, the billions that Federal taxpayers pay out to fund corporate loopholes; and in the \$4 billion in Iraq-related spending auditors estimate is lost to waste and ineffective programs. Most egregiously, we see this irresponsibility in the tens of thousands of Federal contractors and Medicare service providers who make money off of the Government, but fail to pay all their taxes—costing us billions.

For the Nation to move out of this economic crisis, and to put our country on the path to productivity and growth, the American people need its leaders to live up to their responsibilities. That means opening the doors to citizen input; holding those entrusted with taxpayer dollars accountable for their use; and setting strong, enforceable rules of the road to keep our markets free and fair. With a government that is accountable to the people, we can jumpstart our economy in a way that is both quick and wise, and begin to make the long-term investments in areas long neglected.

