Policy Memorandum

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A rescue plan for main street

BY JOHN IRONS AND ETHAN POLLACK

The problem

The economy is undeniably in dire straits and needs help. While the financial market meltdown has received most of the media attention recently, we cannot forget that the real economy is struggling as well. The job market is currently in decline, with nine consecutive months of job losses. This year 760,000 jobs have been lost, including 159,000 in September alone. Housing prices dropped a record 16.3% in the last year (Standard & Poor 2008) resulting in over $50,000 in lost wealth per household (Baker and Rosnick 2008) and the highest levels of foreclosure activity in a decade (RealtyTrac 2008).

Other measures of real economic activity are also showing significant weaknesses. With less housing wealth to borrow against, fewer jobs, and rising energy costs and health care premiums, real consumer spending is expected to decline for the first time in 17 years (Mui and Haynes 2008), leading many economists—including analysts at Goldman Sachs and Morgan Stanley—to project negative GDP growth in the third quarter (*Business Week* 2008).

Seven months ago, Congress responded to the weakening economy by spending $152 billion on rebate checks and other tax incentives. About $100 billion was sent to individual taxpayers, while the remainder was an estimated cost of business incentives. While this cash injection to individuals may have provided some temporary assistance, it is clear that the economic troubles will continue.

The $700 billion financial market bailout recently passed by Congress is aimed at preventing further deterioration on Wall Street. While this is necessary, it is clear that we also need a strategy to stimulate the economy from the bottom up—indeed, Federal Reserve Chairman Ben Bernanke recently endorsed a fiscal stimulus designed to "boost overall spending and economic activity" (Bernanke 2008). A package that provides $175 billion of stimulus—or about 1.2% of GDP—for infrastructure, aid to states, and other provisions would begin to reverse our economic course by creating jobs while meeting national priorities.

Recovery package

The underlying strength of a bottom-up recovery package is job creation. By putting unemployed Americans back to work and tightening labor markets, the stimulus would boost consumer spending and would support incomes even for those with jobs. This stimulus would also improve our crumbling national infrastructure—thereby promoting greater economic efficiency—and supplement state budgets to avoid drastic cuts that would intensify the economic downturn.

Infrastructure—$75 billion

Investing in national infrastructure—rail and mass transit, water treatment, school buildings and grounds, port improvements, levees and dams, and airport improvements—is one of the most effective ways to boost job creation and put money back into the hands of working Americans, leading to higher productivity, better health, and better education of our children. This investment also creates economic ripple effects across the entire economy—for example, by providing more business for construction equipment manufacturers and the steelmakers that supply them—and this money will quickly circulate back into the economy as workers spend their salaries, increasing overall demand for goods and services. Accelerating our infrastructure investments by $75 billion would help grow the economy by creating over one million jobs.[1]

Given the state of the country's infrastructure, more investment is certainly needed:

- ***Roads:*** According to the American Society of Civil Engineers, over two-thirds of roads are in poor or mediocre condition (TRIP 2005), resulting in $54 billion per year wasted on repairs and operating costs (American Society of Civil Engineers 2005a).

- ***Bridges:*** More than a quarter of all bridges are rated structurally deficient or obsolete, leading to closings and in some cases collapse (TRIP 2005).

- ***Waterways:*** Half of all waterway locks are functionally obsolete, resulting in waterway shutdowns and substantial business losses (American Society of Civil Engineers 2005b).

- ***Schools:*** School facilities are also in disrepair, and studies have shown that an additional $127-322 billion is needed to bring facilities into good overall condition (National Center for Education Statistics 2000). A Department of Education survey found that 43% of schools indicate that the condition of their facilities "interferes with the delivery of instruction" (National Center for Education Statistics 2007).

- ***Wastewater management:*** The deficiencies of the wastewater management infrastructure has left 772 communities experiencing a total of 9,471 identified combined sewer overflow problems, resulting in the release of approximately 850 billion gallons of raw or partially treated sewage annually (Mishel, Eisenbrey, and Irons 2008).

Repairing and modernizing our infrastructure has been delayed for years, but these needs cannot be ignored any longer. Greater investment in infrastructure will increase business productivity by lowering the cost of producing goods, leading to lower prices and increased sales. Many infrastructure projects— such as mass transit, home insulation and weatherization, and solar panel installations—have the added bonus of increasing energy efficiency and reducing pollution.

The common critique is that infrastructure projects have substantial lag times between the authorization of infrastructure spending and actual outlays (that "the fire's out by the time the water gets to the hose"). Historically only 27% of federal highway funds are spent within a year of authorization, with 69% spent in the first two years (Buechner 2002). However, there are plenty of examples where the work can begin quickly if there is the will. For example, the replacement of the I-35 bridge in Minneapolis was *completed* just over one year after the original bridge collapsed last August.

To speed the economic impact, the infrastructure investments should focus on maintenance projects—which can be begun and completed faster than new construction—and "ready to go" projects, which have already gone through most of the preliminary stages and are close to construction. Many of these projects have been delayed midway through the process due to lack of funding and would be able to restart immediately if federal funding were made available. For example, the

American Association of State Highway and Transit Officials estimates there are 3,000 "ready to go" transportation projects totaling $18 billion, while the National Association of Clean Water Agencies estimates $4 billion in "ready to go" wastewater treatment projects. These projects could all begin construction within 90 days of legislative enactment. Additionally, school repair and maintenance projects could spend $10 billion over the summer months, while construction of new school buildings could begin immediately in hundreds of school districts around the country.

This critique is also less relevant in light of recent experience with recessions. In the last two recessions, job loss and labor market stagnation persisted well after the "official" end of the recession. Finding projects that will lead to sustained job creation should be seen as a virtue, not a vice.

Finally, because we have an infrastructure maintenance backlog, many of these expenditures are needed anyway. By accelerating federal funding, we are able to fund national priorities while simultaneously creating jobs.

EXAMPLES OF "READY TO GO" PROJECTS

Project #1

Virginia Railway Express

In February, Virginia Railway Express (VRE) signed a contract with MotivePower, Inc. to purchase as many as 20 replacement locomotives. At present, VRE has been able to purchase only two locomotives due to a lack of funding. If federal resources were made available, the railroad could immediately execute options to purchase as many as 18 locomotives. The new locomotives would allow the railroad to increase capacity by deploying longer eight- and 10-car trains. MotivePower locomotives are manufactured in Boise, Ind.

Total cost: *$68 million*

Project #2

Metropolitan Transit Authority, New York, N.Y.

- Station painting/rehabilitation—over two dozen subway stations with deteriorated conditions. Cost: $550 million
- Welded rail—replace obsolete rail and plates with new continuous welded rail and resilient fasteners. Cost: $30 million
- Public address/customer information screens— implement communications infrastructure at 87 remaining stations. Cost: $100 million

Total cost: *$680 million*

Project #3

Waste management, Indianapolis, Ind.

- Three combined sewer overflow abatement projects, including construction of a 6.5-mile long tunnel.
- Two projects to increase wet weather treatment capacity at the city's Belmont Advanced Wastewater Treatment Plant.
- 12 septic tank elimination projects.
- Two sanitary sewer rehabilitation projects.

Total cost: *$250 million*

Source: American Public Transportation Association.

State aid: $50–75 billion

Economic downturns usually cause problems for state budgets—income, sales, and other excise tax receipts shrink, while more people are in need of and eligible for state services. Most states have balanced budget requirements, forcing them to raise taxes and fees (which tend to be regressive) or, more likely, cut services. Both solutions depress overall demand for goods and services and exacerbate the economic downturn.

This time the situation is even more dire. As property values have plummeted, so too have property tax revenues, which flow to local governments to pay for services such as education and public safety. States are forced to backfill the lost revenue, leaving them with even larger holes in their own budgets (National Association of State Budget Officers 2008). The results have been devastating: at the beginning of the fiscal year, 29 states faced a combined $48 billion in FY2009 budget shortfalls, according to the Center for Budget and Policy Priorities (McNichol and Law 2008). Most states closed their shortfalls by raising taxes and fees and/or cutting services, but now recent data show that 29 of those states—plus four more, which did not previously face a budget gap—have opened up new mid-year budget shortfalls totaling $11 billion[2] (Center on Budget and Policy Priorities 2008), forcing even more drastic cuts. Maryland, for example, may cut nearly $400 million in spending on programs such as higher education and community college (raising tuition, which would require students to pay more) and social programs such as child-care subsidies (which might force parents to spend more or work less) (Wagner and Craig 2008).

The credit crunch has further exacerbated the state budget situation by freezing short-term credit usually routinely offered to states—for example, California was not even able to obtain revenue-anticipation bonds to close the temporary $7 billion gap between fall outlays and spring tax revenues. The credit crunch has also prevented many states from issuing bonds to pay for capital projects, forcing many projects to be delayed; for example, the Metropolitan Washington Airports Authority recently postponed plans for a $2.2 billion bond sale to expand the terminals at Dulles and National Airports (Richburg and Vick 2008). These foregone infrastructure projects—which so far have been estimated to total $100 billion—will result in more unemployment, less demand for goods and services, and less overall economic activity.

In the last recession, Congress provided $20 billion in aid to states, split between general revenue sharing and a temporary increase in the federal match for Medicaid. The same kind of assistance should be provided again, with $50 billion split equally between a general block grant and an increase in the Medicaid match. An additional $25 billion would be put in a reserve fund with an automatic trigger—those funds would be made available to states if and only if certain measures of economic health deteriorate beyond a specified threshold.

Further, the federal government could guarantee state and local bonds to shield local governments from the credit crisis and reduce their borrowing costs. Such an effort would cost the federal government very little since state and local bond defaults are very rare.

Consumer supports and a down-payment on reform—$50 billion

While infrastructure and state aid should comprise the lion's share of the recovery package, $50 billion should be spent on other provisions to stimulate the economy. These proposals are aimed at getting money into the hands of consumers who are most likely to immediately spend the money back into the economy.

- ***Unemployment compensation:*** Although unemployment compensation was extended in June by 13 weeks, the worsening economic downturn highlights the need for an additional 7 week extension in all states and a 20-week extension in high unemployment states. Mark Zandi of Moody's Economy.com estimates that the multiplier effect of unemployment compensation is $1.64 for each dollar spent (Zandi 2008), while a 1999 Department of Labor study estimates that each dollar spent boosts GDP by $2.15. The Congressional Budget Office estimates this expansion would cost about $6 billion. Excluding unemployment insurance, benefits from taxation will cost another $4 billion.

- ***Food stamps***: Increases in food stamp benefits are another high-impact stimulus, because every dollar increase is likely to be spent quickly and locally, and—according to Zandi—will boost GDP by $1.73 (Zandi 2008). Furthermore, the higher benefits are needed to offset the recent increase in food prices. An effective increase would likely cost $5 billion or more.[3]

- ***Homeowner assistance:*** Congress is currently considering several proposals to assist homeowners facing falling home prices, increasing mortgage payments, and foreclosure. Such assistance would help to stem the decline in the housing market, which was one of the root causes of the current downturn. Such a program, however, would need to be crafted to ensure that taxpayer resources are not used simply to reward lenders.

A down-payment on longer-term reforms

The economy needs fast stimulus now, but it also faces long-term problems that require solutions beyond the contracted time frame of a standard economic recovery proposal. Global environmental challenges offer America multiple opportunities to rebuild and grow its economy over the next five to 10 years.

Below are a few proposals that policy makers should consider when crafting a new stimulus plan. These are longer-term projects, but we cannot afford to delay them anymore:

- ***Energy efficiency:*** According to the McKinsey Global Institute, not only are energy efficiency programs the most cost-effective means of reducing pollution, but many of them provide savings that significantly outweigh their costs (McKinsey Global Institute 2008). Programs such as the Clean Energy Corps—which combines training and job placement in order to put middle- to low-income people to work auditing and retrofitting homes to be more energy efficient—would lower energy costs, help struggling communities, and create jobs.

- ***Green manufacturing:*** Over the next 50 years, the world will need and demand more and more clean energy. By developing its green technology industry, America can revive its economy by becoming a leading exporter of clean energy technology. Incentivizing automakers to build energy efficient vehicles here in the United Sates would improve our trade deficit and balance of payments, create jobs, and reduce carbon emissions. Provisions such as public-private research partnerships, research prizes, intellectual property reform, and R&D tax credits should be included to incentivize the research, development, commercialization, and mass production of clean energy technology and products. These provisions will reduce the trade deficit, reenergize the manufacturing sector, and create millions of high-paying jobs.

- ***Transportation:*** While much of our transportation infrastructure is in need of repair, more people are driving and riding than ever before. Building a modern interconnected public transit system would reduce traffic-related wasted time and fuel, expand labor markets by increasing mobility, lower the regressive transportation costs on the average household, and create high-paying jobs in construction, operation, and maintenance. Congress will consider a reauthorization of the surface transportation bill later in 2009, but setting aside additional funding for transportation projects by pre-funding the highway-trust fund with general revenues would expand the options available during reauthorization.

Comparison of stimulative effects

The $168 billion in rebates and other transfer payments that were distributed in May and June provided an immediate boost in consumer retail sales, which—along with strong exports—aided economic growth in the second quarter. However, the one-time transfer payments from the government to the private sector appear to have been only a *temporary* boost to output: retail sales have dropped for three consecutive months (U.S. Census 2008). Although the official GDP figures won't be released until October 30th, monthly estimates from Macroeconomic Advisors indicate that the economy may have contracted in July and August (Macroeconomic Advisors 2008).

Studies have suggested that as much as two-thirds of the 2001 rebates were spent back into the economy (Johnson, Parker, and Souleles 2004); however, more recent surveys find that only 20% of respondents planned to spend their current rebates, with the majority planning on paying down debt or outstanding bills (Rooney 2008). Subsequent analyses of consumer spending show a positive, but modest, boost to consumer spending.[4]

This is not to say that the cash rebates had no impact, but rather that in the current environment, rebates by themselves may not be enough to turn the economy around.

Mark Zandi of Moody's Economy.com estimates the one year economic effect of tax rebates to be $1.26 per dollar—a significantly less per-dollar economic impact than spending on infrastructure ($1.59), aid to states ($1.36), food stamps ($1.73), or unemployment benefits ($1.64) (Zandi 2008). Considering the current state of the economy, the final recovery package should be weighted toward infrastructure, state aid, and family supports. If rebates are included,

BANG FOR BUCK OF VARIOUS TYPES OF STIMULUS

First year impact on real GDP for each $1 spent.

Tax cuts	
Non-refundable lump-sum tax rebate	$1.02
Refundable lump-sum tax rebate	$1.26
Temporary tax cuts	
Payroll tax holiday	$1.29
Across the board tax cut	$1.03
Accelerated depreciation	$0.27
Permanent tax cuts	
Extend Alternative Minimum Tax patch	$0.48
Make Bush income tax cuts permanent	$0.29
Make dividend and capital gains tax cuts permanent	$0.37
Cut in corporate tax rate	$0.30
Spending increases	
Extend UI benefits	$1.64
Temporary increase in food stamps	$1.73
General aid to state governments	$1.36
Increase infrastructure spending	$1.59

Source: Mark Zandi (2008).

they should be narrowly targeted to low-income families who would be most likely to spend the money. For example, a payroll tax holiday would be well targeted and have a significant impact on the economy.

Conclusion

Our economy is in a dangerous place right now, with economic trends threatening the employment, income, and opportunities of millions of Americans. A bottom-up approach that includes infrastructure spending, state aid, and other provisions must be adopted to boost demand, create jobs, and help the millions of families who are suffering the most. In addition, a green investment plan must also be initiated immediately to ensure long-term economic and environmental health. The American economy cannot afford to wait.

Endnotes

1. The Federal Highway Administration estimates that $1 billion in construction spending creates between 14,000 and 47,000 jobs. Using the conservative lower-bound estimate, $75 billion in construction spending would create 1,050,000 jobs.
2. In fact, GDP account numbers from BEA show that in FY2008, tax revenues for state and local governments fell short of outlays by a combined $34 billion, balanced mainly with rainy day fund draw-downs and bond issuances.
3. Senate proposals have included a $5 billion boost (see http://frac.org/news/econstimulus2.htm), and other advocates support $10.7 billion worth of food-related supports. See Coalition on Human Needs "Towards Shared Recovery" September 9, 2008, at http://www.chn.org/pdf/2008/stimulus9908.pdf
4. For household level analysis, see http://www.voxeu.org/index.php?q=node/1541; and for aggregate spending perspective, see M. Feldstein, "The Tax Rebate Was a Flop. Obama's Stimulus Plan Won't Work Either," *Wall Street Journal*, August 6, 2008.

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