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Economic Stimulus Needs New Money, Fast

by Jack Hoffman

Congress and the Bush administration moved with unusual speed earlier this year to put together an economic stimulus package to try to fend off the recession. They agreed to send out more than $168 billion in income tax rebates and business tax breaks this spring. Putting money in the hands of ordinary citizens, who are expected to spend it right away, is meant to create immediate, new demand for goods and services and thus stimulate the economy.

Vermont's governor announced recently that he wanted to help pull the state out of this economic slow down with a stimulus package of his own. While some elements of the 15-point plan could benefit the state in the long run, most will not affect the immediate problems of Vermont's faltering economy.

First, the measures won't come quickly enough. "If the purpose of fiscal stimulus is to reduce the risk and severity of a recession, it would need to take effect quickly," Peter R. Orszag, the director of the Congressional Budget Office, told the U.S. Senate Finance Committee back in January. "Stimulus delayed is stimulus denied, and could even prove unnecessary and potentially counterproductive if delayed so long that it takes effect after the period of economic weakness has passed."

Second, unlike the federal rebates, the governor's plan will inject little new money into the system. The Legislature's chief economist, Tom Kavet, made that point in an analysis of the administration's stimulus plan. To produce any real net stimulus, he said, the state would have to add new spending through borrowing, using some of the existing reserve funds, or with cash from the sale of state assets. Most of the plan's funding will come from additional borrowing for highway maintenance — with an overall impact in the $40 million-to-$60 million range, Kavet concluded. This is far less than the governor's predicted $214 million in new economic activity over the next five years.

Housing assistance. The plan includes proposals to help homeowners, but it is not clear that they will produce any new demand for housing that would not have occurred without the "stimulus." The governor suggested using $17 million in teacher and state employee retirement funds to buy bonds from the Vermont Housing Finance Agency, which in turn would lend the money to low- and moderate-income homebuyers. However, this would not increase the agency's pool of mortgage money. Providing VHFA with an alternative source of funds would not, in itself, lead to new borrowing or housing sales.

The governor also has proposed mortgage counseling and a grace period for homeowners who may be having trouble making mortgage payments. He also wants the state to provide additional moral backing to VHFA bonds, and he proposed tax incentives in so-called "Urban Homestead" zones.

Business Incentives. The plan includes new and redirected tax incentives. He would target the VEGI (Vermont Employment Growth Incentive) program at environmentally friendly businesses. This would not be new money, either. There is a $10 million annual cap on this incentive, and the new program for "green businesses" would fall under that existing cap.

It's a good idea to support green business. But even if this were new money, it would be unlikely to affect the current recession. Under this program, cash incentives are paid to qualifying businesses only after they have made new investments and reached their new employment targets.

The governor also proposed deeply subsidized loans for businesses through the Vermont Economic Development Authority. Business demand for capital from VEDA has slowed to a trickle. The lower interest rates can help on the supply side and benefit those businesses that decide to invest. But what the economy needs now is help on the demand side.

Highway maintenance. The governor wants to increase state borrowing to speed up maintenance of Vermont's roads, and that should have some stimulus effect. His proposal is to borrow and extra $10 million a year for the next five years.

The roads do need repair, and the borrowing will provide additional money that would not have been available otherwise. However, the increased spending will be spread over five years. That's probably not fast enough. Kavet and the administration's economist, Jeffrey Carr, predicted in mid-April that the current recession would be short and shallow. Their latest forecast shows a turnaround starting in late 2008 or early 2009, although both conceded that the recession could last longer.

The Governor's 15-Point Plan

Housing Assistance

1. Mortgage assistance specialist/Mortgage grace period
2. Public pension funds to purchase VHFA bonds
3. Additional state moral obligation to back VHFA bonds
4. Land bank to make surplus state lands available for housing
5. Expedited housing permits
6. Urban Homestead tax incentives

Business Incentives

7. Opportunity Zones – tax-free leasing of vacant industrial facilities
8. VEGI tax incentives for environmentally friendly businesses
9. Economic Growth Subsidy program through VEDA
10. Manufacturing payroll tax credit

Highway Maintenance

11. Additional bonds for highway maintenance (five years)*
12. Reallocations from General Fund to Transportation Fund

Other

13. Weekend sales tax suspension
14. Week-long suspension of sales tax on energy-saving appliances
15. Increased timber sales on state land*

* Steps that inject new money quickly enough to mitigate the effects of the economic slow down.

The governor also wants to reallocate $50 million from the state's General Fund to the Transportation Fund gradually over the next five years. That cannot be considered new money. It will be new to the Transportation Fund, but it is money state government would have spent anyway, just on different services.

States don't have the capacity to provide economic stimulus the way the federal government can. For one thing, Washington can increase the federal deficit (and debt) to provide short-term tax rebates. Most states are constitutionally prohibited from running deficits. To cut taxes, states have to cut spending by the same amount, which ends up reducing services for people who need help the most during an economic slow down.

Vermont is the lone exception: it has no balanced-budget statute. But to do something on the scale of the federal stimulus would be unrealistically expensive, even if there were political support for deficit spending. When Congress was considering the federal tax rebate, economists said the stimulus needed to be about 1 percent of the gross domestic product — or about $150 billion. An equivalent rebate package in Vermont would cost the state about $250 million — almost 20 percent of the General Fund budget.

States can mitigate the effects of recessions, but they can't really slow them down. The Congressional Budget Office offers guidelines for fiscal stimulus. Other rational measures for states can be found in a report by Nicholas Johnson for the Center on Budget and Policy Priorities. And the March 2008 Public Assets Institute report on the governor's fiscal 2009 budget also provides suggestions for what Vermont can do to help its economy and its citizens to weather the rough times.

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