Written Testimony of Mark Zandi
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Mr. Chairman and members of the Committee, my name is Mark Zandi; I am the Chief Economist and Co-founder of Moody's Economy.com.

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I strongly support efforts for a second fiscal stimulus plan designed to help the economy by early 2009. Like the first stimulus plan, it should be temporary and not raise the long-term budget deficit. The plan should also be targeted to help lower and middle income households and smaller businesses that will use the help quickly and aggressively to stimulate the economy.

There are three principal reasons for my support for more fiscal stimulus. First, the economy continues to struggle. Most significantly, employment is falling and unemployment is rising. Over 400,000 payroll jobs have been lost since the beginning of the year and the unemployment rate has risen by more than a percentage points since its low in the spring of 2007.

The job losses have been broad-based across industries and regions of the country. Construction, manufacturing, retailing, transportation, financial services, information services and professional services are all losing jobs. Only health care, educational services and government continue to add to payrolls on a consistent basis.

There are currently nineteen states suffering very weak job markets, characterized by generally falling employment and rising employment. These states include Alabama, Arizona, Delaware, California, Idaho, Indiana, Florida, Kentucky, Maine, Michigan, Mississippi, Missouri, Nevada, Ohio, Rhode Island, South Carolina, Tennessee, Wisconsin, and Virginia. Very few states, mostly energy and agriculture-producing economies, are adding significantly to employment.

More job losses are likely in coming months. The housing downturn continues unabated, high energy and food prices are undermining consumer purchasing power, and the financial system remains under significant stress which is restricting the availability of credit to households and businesses. These economic headwinds are unlikely to abate quickly.

Second, the economic benefits of the first stimulus package passed early this year have been substantial they will fade by year's end. The tax rebate checks mailed between May and early July have provided a substantial lift to retail sales this summer and have been instrumental in offsetting the ill-effects of record gasoline prices. Indeed, the $100 billion in rebate checks will largely pay for the approximately $100 billion more consumers will have to pay for gasoline this year. Unfortunately because of the higher cost of gasoline and food, the tax rebates will not be the catalyst for a self-sustaining economic expansion as had been hoped for by policymakers. In fact, retailing is likely to weaken sharply in coming months as the rebate money is spent and the weak job market continues to weigh heavily on consumer purchasing power.

The first stimulus bill also provided business tax incentives to stimulate increased investment. This will provide a small boost to investment spending this year, but the incentives expire at the end of the year and will result in less investment in early 2009.

Third, the need for more fiscal stimulus is reinforced by the already very low interest rates. The Federal Reserve has aggressively lowered interest rates over the past year and with the current 2% federal funds rate target will be constrained from lowering rates further. Moreover, monetary policy may be less effective in stimulating growth in the current environment. The most immediate conduit between monetary policy and the economy runs through the housing market. Housing is the most interest-rate sensitive sector of the economy, and historically it would receive a quick boost from monetary easing. This boost is much more muted today given the ongoing problems in the private mortgage securities market and at the GSEs. Low interest rates are not helping to increase the availability of mortgage credit.

A second round of fiscal stimulus should include a number of temporary tax and spending items costing between $50 and $100 billion. The $50-$100 billion in proposed stimulus can also be thought of as making up some of the difference between current consensus expectations for growth in 2009 and the economy’s potential growth. According to the Blue Chip survey the consensus is for real GDP to advance by less 2% in 2009. Most economists have not assumed the passage of a fiscal stimulus plan, and most put potential growth at below 3%. If economists’ are correct about growth next year, then a $50-$100 billion stimulus plan would simply put the economy back closer to its trend. If economists are wrong, it's likely they will have erred on the side of optimism, and the economy is already in recession. In that case fiscal stimulus would be especially helpful.

An effective package of stimulus could include a gas tax holiday, expansion of the food stamp program, a payroll tax holiday, aid to state governments, extension of the investment tax incentives, and increased infrastructure spending. The biggest lift from this stimulus would go to lower income households struggling to pay for soaring gasoline and food prices, and small businesses who are getting hit hardest in the current downturn.

More specifically, extending food stamps are the most effective ways to prime the economy's pump. A $1 increase in food stamp payments by $1 boosts GDP by $1.73 (see table). People who receive these benefits are very hard-pressed and will spend any financial aid they receive within a few weeks. These programs are also already operating, and a benefit increase can be quickly delivered to recipients.

Fiscal Economic Bank for the Buck

One year $ change in real GDP for a given $ reduction in federal tax revenue or increase in spending

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	
Extending UI Benefits	1.64
Temporary Increase in Food Stamps	1.73
General Aid to State Governments	1.36
Increased Infrastructure Spending	1.59

Source: Moody's Economy.com

Another economically potent stimulus is aid to financially-pressed state governments. This could take the form of general aid or a temporary increase in the Medicaid matching rate, to help ease the costs of health coverage. Such help appears unlikely in the current stimulus plan, but this could quickly change in coming weeks if the economy's problems grow more severe and widespread as the legislation is being fashioned.

Fiscal problems have already developed in half the nation's states. Tax revenue growth has slowed sharply with flagging retail sales and corporate profits. Income tax receipts are also sure to suffer as the job market weakens. California and Florida are under the most financial pressure, but states as far-flung as Arizona, Minnesota, and Maryland are also struggling.

As most state governments are required by their constitutions to quickly eliminate their deficits, most are already drawing up plans to cut funding for programs ranging from health care to education and cutting grants to local government. Local governments are having their own financial problems; most rely on property-tax revenues, which are slumping with house prices. Cuts in state and local government outlays are sure to become a substantial drag on the economy later this year and into 2009.

On the face of it, increased infrastructure spending appears to be a particularly efficacious way to stimulate the economy. The boost to GDP from a dollar spent on building new bridges and schools is estimated to be a large $1.59, and who could argue with the need for such infrastructure. The overriding limitation of such spending as a part of a stimulus plan, however, is that it generally takes a substantial amount of time for funds to flow to builders and contractors and into the broader economy (see Table 1). *It should be noted that the economic bang for the buck estimates shown Table 1 measure the change in GDP one-year after the spending actually occurs - it says nothing about how long it may take to cut a check to a builder for a new school.* Many infrastructure projects can take years from planning to completion. Even if the funds are only used to finance projects that are well along in their planning, it is very difficult to know just when the projects will get underway and the money spent. Also complicating the use of infrastructure spending is the politics of apportioning these funds across the country in a logical and efficient way. Despite these caveats, if infrastructure projects can be identified that could be started quickly then this could prove to be an efficacious form of fiscal stimulus.

The U.S. economy will continue to struggle in coming months, but a temporary, targeted, and well-timed second round of fiscal stimulus would go along way to mitigating the severity of the economy's difficulties and perhaps even help jump-start a self-sustaining economic expansion.