Center for American Progress

Restoring Confidence in the American Economy

A recovery strategy of stimulus, investment and discipline for 2009 and beyond

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Introduction

President-elect Barack Obama and a new Congress will take office in less than 70 days amid the greatest financial market and economic challenges our nation has faced since the Great Depression. The economy is likely in a recession—one that could be a long and deep. We are engaged in two wars overseas. Skyrocketing health care costs are consuming too great a share of our economy and threatening to create an unsustainable national debt. Our continued heavy reliance on fossil fuels exposes our economy to volatile oil prices and supply disruptions as well as the potentially catastrophic costs of climate change in the coming decades.

Aggressive action is needed to restore economic confidence and growth. We need action now to stimulate the economy, starting at once and lasting as long as necessary. Immediate government investments can put us on a path to recovery while also speeding the arrival of accessible, affordable health care, an economy powered with clean, sustainable, and secure sources of energy, and an education system that prepares our children for good jobs and keeps good jobs in America. These steps will help the economy through a period of economic weakness and lay the foundation for shared economic growth in the decades to come.

These investments in economic stimulus and recovery will contribute to a higher budget deficit in the short term. But we cannot be penny wise and pound foolish. Strong economic growth will do far more to put us on the path of fiscal health than shortchanging needed investments today.

The serious economic threats facing our economy are more urgent than this year's budget deficit, but we also need start quickly to restore financial discipline and the public's confidence in government. Even as we are spending more in the short term, we must make a serious commitment to scrub the budget of inefficient and ineffective programs and tax incentives, make tough choices among competing priorities, and address the sustainability of Medicare and Social Security—the looming fiscal challenge in the coming decades—in the context of reform of the social safety net to provide retirement and health care security.

Our economy has reached these dire straits after years of mismanagement and neglect. It cannot be rebuilt overnight. We need a sustained economic agenda that focuses on building the foundation for a brighter future.

Stabilizing the economy and beginning the recovery

We face tremendous challenges getting our economy back on sound footing. Financial institutions worldwide are reluctant to lend, impeding economic activity. The United States has lost over a million jobs so far this year.[1] Housing prices have not yet fallen to pre-bubble prices and could fall even further due to an ongoing flood of foreclosures.[2] Virtually every consumer is cutting back on spending, which accounts for two-thirds of the economy.[3] A prolonged recession is likely, and the economy may not recover until 2010 or later.

We need immediate action to stabilize and stimulate the economy. Stabilization includes ensuring the solvency of financial institutions, restoring confidence to the credit and stock markets, and ending the housing crisis. Stimulating the economy by providing extended unemployment benefits and a variety of other steps will immediately help struggling families and boost confidence in the economy. Anticipating further increases in unemployment, we need to shore up health insurance programs that are more heavily used when job losses mount. As enrollment grows in Medicaid and the State Children's Health Insurance Program, state governments required to balance their budgets will feel the strain. We need to provide states with immediate fiscal relief through an increase in the federal share of the Medicaid program (the federal medical assistance percentage, or FMAP), and also provide subsidies to help families facing job loss afford their health insurance under COBRA, the federal statute that allows the unemployed to continue to pay for health insurance through their former employers.

As in the 1930s era that inspired the New Deal, the need for job creation is an opportunity to build something of lasting value. A major investment in "green" recovery—building the infrastructure of a low-carbon economy—could create up to 2 million jobs over two years, many in the hard-hit construction and manufacturing sectors.[4] Building solar arrays, wind farms, energy-efficient schools, and mass-transit projects will also set a course for greater energy independence and reduced global warming pollution. Deutsche Bank recently concluded that "energy efficiency technologies are obviously highly desirable in economies facing recession" because they let countries "climate proof" their economies while responding to the economic downturn.[5]

President-elect Obama has proposed an energy rebate for taxpayers to offset the higher cost of gasoline, home heating oil, or other costs. Both green infrastructure investments and energy rebates could be financed by higher deficits in the short run but repaid in the future from the sale of greenhouse gas emissions permits.

Health care reform

U.S. companies are struggling to offer health coverage and remain internationally competitive. The United States spends twice as much per person on health care as its closest competitor, and expenditures are expected to double by 2017.[6] Former Treasury Secretary Lawrence Summers described health care as "an imperative for our competitiveness."[7]

Uninsured American families live in fear that the next health emergency will mean bankruptcy or home foreclosure. Families with insurance see rising premiums eating up income when they can least afford it. Rising health care costs are projected to consume 95 percent of the growth in per capita gross domestic product between 2005 and 2050, including both public and private health care spending.[8]

Slowing the growth in health care costs will require an upfront investment, partly because it requires universal coverage. "Extending health insurance coverage to nearly everyone is a necessary precondition for dealing with long-term budget challenges," writes Brookings Institution scholar Henry Aaron.[9] Coverage is an essential step toward controlling health care spending because it allows a rational financing system that does not rely on inefficient and inequitable cross-subsidies to care for some Americans. Universal coverage will also facilitate early prevention and detection of disease and better management of chronic diseases, which can improve health and reduce costs.[10]

Research into the comparative effectiveness of treatments can identify treatments that provide the best results at the lowest cost. At least one-third of medical procedures have questionable benefits, according to the Rand Corporation.[11] A meaningful increase in the supply of objective medical research will likely require additional federal funding.

Greater use of electronic medical records and other health information technology could reduce errors and the need for duplicative tests, improve the quality of care, and gather data on effective treatments. As a result, it could improve quality while reducing costs. President-elect Obama proposed investing $10 billion a year over the next five years to move the U.S. health care system to broad adoption of standards-based electronic health information systems. In addition to a substantial upfront investment, changes in payment systems must be in place to encourage widespread implementation.

The effect of Medicare and Medicaid spending on the U.S. economy cannot be overstated. Federal spending on Medicare and Medicaid is projected to increase to 12 percent of the economy in 2050 from 4 percent today, creating unsustainable budget deficits.[12] The long-term federal budget outlook is dominated by spending trends in Medicare and Medicaid. These trends cannot be addressed in the long term without changes in the entire health care delivery system that slow spending increases by promoting more efficient delivery of care and better choices about incorporating new medical technologies into the system. Medicare is the nation's largest payer of health care services, and its policy changes must be at the forefront of health care reform.

To expand coverage and improve the system, the federal government may have to spend between $100 billion and $150 billion a year, not including any savings it generates.[13] The good news is there is great potential for reform to make the health care system more cost effective. As Congressional Budget Office Director Peter Orszag put it, "There do not appear to be other examples that credible analysts can identify that offer a potential efficiency gain of that magnitude for the U.S. economy."[14]

Clean energy and climate change

The United States faces an economic imperative to develop reliable, secure, affordable, and clean sources of energy and to use them more efficiently. First, our heavy reliance on oil leaves us vulnerable to higher and more volatile prices. Prices are expected to rise in coming years as China, India, and other nations develop and the most accessible oil resources are depleted.[15] Our need to purchase hundreds of billions of dollars worth of oil drives up our trade deficit and leaves our economy and family budgets vulnerable to price shocks.

Second, our reliance on oil, coal, and other fossil fuels is driving climate change, which without corrective action will cause heavy economic damage. A review by former World Bank economist Nicholas Stern concluded that because rising temperatures will inflict large economic losses, "tackling climate change is the pro-growth strategy for the longer term."[16]

Third, investment in clean renewable energy and energy efficiency has tremendous economic upside. According to the McKinsey Global Institute, there are enough profitable investments in existing energy efficiency technology to cut growth in demand for energy by half or more.[17] Using energy more efficiently makes our economy as a whole more efficient, which raises living standards. And renewable energy and efficiency are growth industries that can drive American economic leadership well into the 21st century.

Passing a recovery package quickly could jumpstart a new green energy infrastructure, create jobs now, and begin the shift to clean, sustainable energy. We also will need to cap and reduce greenhouse gas emissions across the U.S. economy. Auctioning the right to emit greenhouse gases will generate resources to accelerate the transition to a low-carbon economy.[18] The revenue could finance incentives for households to adopt energy-efficient technology and a new clean energy infrastructure. While the cost of polluting energy may go up, tax rebates could offset those increases. Families that use clean energy and use it efficiently will come out far ahead.

Education

Like energy and health care, the economic crisis cannot prevent us from focusing attention on tranforming the public education system to one that prepares our children to compete for high-quality jobs in the global economy. Our 20th century prosperity was built in part on our decisive advantage in education—an advantage allowed to wither. Long term economic growth and opportunity requires investing now in education for tomorrow.

In the early days, we must make a downpayment on ambitious education reform and start by providing free high quality early-childhood education for all low-income children, so that they arrive at schoool ready to learn. We also need to provide incentives for experimentation and innovative solutions—small investments now that show us the way forward toward expanded learning time, finding and retaining highly effective teachers and principals, and promoting national standards, higher graduation rates, accountability, and fiscal equity.

With a deteriorating economy, higher education is both less accessible and more important to providing good employment opportunities. But with family resources strapped, too many will have few choices to gain a credential of economic value to themselves and the larger economy. We must begin immediately to invest in college affordability and tackle the problem of low rates of higher education completion, so we improve the rate of return we receive on our higher education investment.

Addressing the long-run fiscal challenge

Facing the greatest financial and economic crisis since the Great Depression, we should not let short-term deficits, even large ones, prevent necessary steps to weather the storm. Yet we also have an obligation to restore budget responsibility and confidence that government is careful and uses taxpayer resources wisely and to good effect. After the period of economic weakness when deficit spending is needed to strengthen the economy, we should make the tough choices to limit the deficit so our economy is growing more quickly than the national debt, providing assurance that the federal government will be able to meet its obligations.

The federal budget is in a deep hole due to the Bush tax cuts favoring the wealthy and a costly and ill-conceived war in Iraq that consumes at least $10 billion a month. We have neglected important investments in our future, while Medicare and Social Security spending threatens our fiscal future in the coming decades. We need to reform Medicare and Social Security to make them sustainable. Those reforms should come alongside efforts to promote stronger economic growth, which would help close the programs' financial gap. Moreover, those reforms should come within the context of broader reform of health care and the retirement security system.

Putting Medicare on a sustainable path is not possible without broader health care reform as described above. Reforming health care could be the single most important step we take to restore budget discipline. According to the Government Accountability Office, "the real driver of the long-term fiscal outlook is health care spending."[19] Slowing the growth of Medicare and Medicaid is only possible if we can slow health care costs across the economy,[20] which requires comprehensive reform based on universal coverage, a focus on prevention, cost-effectiveness, and a business-like embrace of health information technology to reduce costs.

The challenges facing Social Security are smaller and further into the future. Nonetheless, Social Security faces a projected deficit equal to 1.7 percent of taxable payroll (or 0.7 percent of the economy) over the next 75 years.[21] Because Social Security remains the foundation of retirement security for most families, reforms to shore up Social Security and address inequities are needed. These reforms, however, should only be tackled alongside efforts to remedy the system of "upside down" subsidies for retirement savings, which offers the more affluent in our society the most generous incentives to save[22] and to bolster private pensions.

Proposals for consideration should include boosting savings outside Social Security with a new universal 401(k) savings plan and increasing incentives for employers to make regular contributions to their pension plans.[23] In the context of comprehensive pension reform that strengthens savings incentives for low- and middle-income families and the security of pensions, a variety of Social Security reform approaches could be placed on the table for discussion, including a tax surcharge on the highest-earning workers and slowing the growth of benefits for some better-off retirees.

Avoiding catastrophic climate change also will reduce potentially expensive demands on public budgets in the coming decades. Global warming will place "immense strains on public budgets," according to the University of Maryland, including the costs of rebuilding infrastructure as climates shift, responding to severe weather events, and providing crop and disaster insurance.[24]

Confronting these long-term budget challenges is critical, but we must be willing to make tough choices in the short term as well. In a crisis as severe as the one we face today, top priority for resources must go to investments that will promote long-term growth and competitiveness, restore America as a land of economic opportunity for all, and ensure that the benefits of our economy are widely shared.

Too often, special interests have distorted spending priorities. We should cut subsidies for insurance companies through the Medicare Advantage program, lenders of student loans, and oil companies through the tax code and sweetheart oil leases. Eliminating just these corporate subsidies would save roughly $20 billion a year. We also should eliminate unnecessary programs such as agricultural products promotions, which subsidize activities that the private sector would undertake anyway.[25]

But there are also well-meaning but comparably ineffective programs whose resources should be shifted to higher priorities. Case in point: Some schools successfully serving poor children use an extended school day to provide intensive additional enrichment.[26]At the same time, randomized experiments have found that the large federal program for community-based afterschool programs does not improve student achievement.[27] The government should tie these programs more closely to schools and focus new dollars on school-based extended day programs.

Data-driven policy decisions such as these can help maximize the efficient use of tax dollars in other areas as well.[28] New technology can often gather previously unavailable information, such as that collected by sensors embedded in bridges that help prioritize repair projects.[29]

Any discussion of the federal budget also must acknowledge that current levels of defense spending are driven by ongoing military operations in Iraq and Afghanistan, support for U.S. military personnel and their families, and the need to replace equipment consumed in combat operations. The new administration, as one of the first items in the national security area, needs to conduct a strategic review of the wars in Iraq and Afghanistan. Changes in policy may, at some point, modify current budget demands in this area.

Additionally, current law requires that the Department of Defense perform a major strategic review of U.S. military requirements—called the Quadrennial Defense Review, or QDR—in 2009. While ensuring that sufficient resources are available to support U.S. military personnel and critical missions, the QDR should review existing weapons programs, contracting out practices, government procurement policy, and other DOD practices where savings, efficiencies, and reform are possible. The QDR will likely produce significant budget realignments.

Conclusion

Serious and sustained action is needed to address dire economic straits. Today's crisis is not just the failing economy but the looming barriers to future prosperity in the form of unsustainable and growing levels of health care costs, the lack of adequate clean, dependable energy, and our inability to educate our children for the needs of our economy. Committing the resources necessary to address those problems, even at the cost of higher deficits in the short run, is in the best interests of our economy and our nation.

These efforts must be paired with a serious commitment to long-term fiscal discipline, evidenced by a new willingness to confront not only ineffective domestic and military spending, but also Medicare and Social Security programs—in the context of a broad redesign of our social safety net providing health and retirement security. If we do so, we can then address the principal economic challenges facing our country—including health care costs, sustainable energy, and our long-term fiscal future—and restore the confidence of consumers, firms, and investors, at home and abroad, in the future of the American economy.

Endnotes

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