January 8, 2008

**TO:** Interested Parties

**FROM:** Anne Kim, Director of the Middle Class Program and Jim Kessler, Vice President for Policy*

**RE:** Getting the Economy Moving—A Stimulus Package

Americans' view of the economy is at its worst since 1992.[1] And although few Americans believe the economy to be in recession, only 35% rated the national economy as good, very good, or excellent in December—versus 64% who rated it as bad, very bad, or terrible.[2] Moreover, a growing number of prominent economists, including former Federal Reserve Chairman Alan Greenspan, think the odds of a recession in the coming months to be increasing.

During past times of economic uncertainty, progressives have defaulted to a highly pessimistic message aimed at convincing Americans that the economy is bad and only getting worse or that people's well-being is at stake. We believe this to be a determination that people will make on their own. Instead, the central task should be to convince Americans that *progressives understand what it takes to get America moving forward in a way that benefits average families.*

This memo offers a menu of short-term and long-term measures aimed at restoring American confidence in the economy and in progressives' handling of the economy. This agenda has the following key pillars:

- A package of immediate measures to get the economy moving and stave off recession:
  - **Short-term middle-class tax cuts** to boost consumer spending and restart the housing market;
  - **Targeted help** to families who've hit a rough patch through no fault of their own; and
  - **Incentives for new investment** by businesses, including small businesses, to keep the economy growing.
- A long-term compact with the middle-class that puts American families back on the path to long-term prosperity and secures a solid future economy:
  - **Permanent middle-class tax cuts** and **new policies** to create middle-class wealth and help families successfully navigate the new rules of today's economy; and
  - Long-term **infrastructure investments** in schools, highways, and broadband technology, to spark innovation and create new jobs.

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* Research assistance was provided by Policy Advisor Mark Donnell and Senior Policy Advisor Scott Winship.

**The Message:**

*Today's economy is the result of seven years of failed Bush economic policies founded on the belief that the wealthy—not the middle class—are the engine of our economy. We believe the middle class are the engine of America's economy and when they prosper and have confidence in the nation's future, America succeeds.*

*Bush and his allies still think the economy is doing fine, and they are dead-set against any change. We recognize that our economy has changed and that even the basic rules for middle class prosperity and security have changed with it. We have a plan to get our economy moving and to restore middle class prosperity and confidence:*

- *Immediate, short-term middle-class tax cuts to boost consumer spending;*
- *Permanent middle-class tax cuts to help families get ahead and meet their major challenges;*
- *Immediate, temporary help for families who hit hard times through no fault of their own;*
- *Permanent help for businesses to create new jobs; and*
- *New investments in roads, bridges, schools and technology to modernize the backbone of our economy and stoke future innovation.*

In addition, this memo infuses a narrative that effectively speaks to the middle class and critiques conservative economic policy and philosophy.

## Short-term stimulus package

While traditional measures for economic stimulus are important, the heart of a short-term progressive economic stimulus package should be a middle-class tax cut agenda. Offering a package of tax cuts provides the following critical advantages:

- An efficient and immediate mechanism for providing tangible benefits to the middle class.
- A framework for delivering the message that progressives understand middle-class aspirations and challenges.
- An opportunity to pre-empt conservatives on the question of taxes and defeat the accusation of "tax and spend."
- A chance to contrast a progressive tax cut plan for the middle class with the conservative tax cut plan for the wealthy, and the potential to challenge conservatives to oppose a middle-class tax cut.

In the remainder of this section, we provide a variety of options for a stimulus package that includes both short-term middle-class tax cuts as well as more traditional forms of countercyclical response. We propose a total of $73 billion in short-term tax cuts and other measures to provide immediate help for families; we recommend, however, a pick-and-choose strategy and have structured many of the proposals below to be easily scaleable in terms of size and cost.

## 1. Short-term middle-class tax cuts to boost consumer spending

According to analyses by the Federal Reserve, equity from rising home values helped finance as much as $310 billion per year in personal spending from 2004 to 2006.[3] But since the fall of 2005, home prices have been dropping steadily, and the latest numbers released show that in October 2007, home prices saw their steepest decline since 1991.[4] Homeowners lost $240 billion in home equity in just the last nine months of 2007.[5] And with these losses, consumer confidence has been sagging.

The following measures can help to put more money into the wallets of consumers and get the economy moving again:

- **One-year homeowner property tax rebate.** Provide homeowners, including non-itemizers, with a one-time $250 tax credit toward state property taxes. *Estimated cost: $12 billion per year if made available to itemizers only; $19 billion if made available to all homeowners.*[6]
- **Seven-day sales tax holiday.** Provide states with funding to finance a seven-day state sales tax holiday. *Estimated cost: $700 million per day or $4.9 billion.*[7]
- **One-time payroll tax rebates.** Provide a $250 payroll tax rebate to all workers earning less than $102,000 a year (the current income limit for FICA taxation). *Estimated cost: $37.3 billion per year, paid from the general revenue fund.*[8]
- **First-time homebuyer credit.** Create a $1,500 first-time homebuyer credit to help restart the housing market. *Estimated cost: $3.6 billion per year.*[9]

*<u>Total estimated one-year cost: $57.8 billion</u>*

## 2. Immediate help for families in need

While the national unemployment rate remains low by historical standards, some areas are struggling. Moreover, many lower-income families who have sought a foothold in the middle class may be in dire straits due to the collapse of the housing market, which has pushed default and foreclosure rates to all-time highs, and the ever-rising cost of oil.

Americans who've worked hard and played by the rules deserve a hand to pull them through this temporary rough patch.

- **Two-year refinancing credit.** Help homeowners transition to lower-cost mortgages by providing a two-year, one-time $2,000 credit toward closing costs when they refinance into a fixed-rate mortgage. *Estimated cost: $2.5 billion over two years.*[10]
- **Foreclosure prevention loan fund.** Create a federal loan fund to provide up to $5,000 in interest-free, one-time emergency loans to families in danger of foreclosure, with priority to families in states with high foreclosure rates or high unemployment rates. *Estimated cost: Minimum of $2 billion, which can*

*partly be financed through earmarking civil penalties levied on mortgage brokers, lenders and other parties convicted of mortgage fraud or related crimes.*

- **Additional funding for non-profit housing counseling agencies.** Increase funding to HUD's Housing Counseling Assistance Program, which provides grants to non-profit organizations working to help families avoid defaults and foreclosure. *Estimated cost: $150 million.*[11]
- **Expanded LIHEAP funding.** Increase current funding for the Low Income Home Energy Assistance Program (LIHEAP) to $3 billion for the coming fiscal year. *Estimated cost: $400 million.*
- **One-year expansion of the Earned Income Tax Credit (EITC).** Provide a one-time, 20% across-the-board increase in the benefits provided to EITC claimants (thereby increasing the maximum available benefit to $5,659 for a family with two children). *Estimated cost: $7.4 billion.*[12]
- **Temporary extension of unemployment insurance (UI) benefits.** Provide a 13-week extension of UI benefits. *Estimated cost: Approximately $5 billion in federal spending for one year.*[13]

<u>*Total estimated cost: $17.45 billion*</u>

### 3. Incentives for new business investment

The housing crisis has rippled through the larger economy by drying up credit and making new investment more expensive. The following measures can help to ease the impact of the credit crunch and incentivize new business investments that will lead to job creation. In addition, increased federal investment in export promotion can boost one of the bright spots in the American economy—exports—which have risen by nearly 12% in the past year alone[14] and comprised 11% of US gross domestic product in 2006.[15]

- **Small business enterprise credit**. Increase the allowable deduction for small business start-up costs from $5,000 to $10,000.[16]
- **Expanded funding for export promotion efforts**. Restore budget authority for export promotion efforts, which has declined by more than 30% since 2002, to at least fiscal year 2006 levels. Spending for export promotion in fiscal 2006 totaled approximately $1.5 billion. [17] *Estimated cost: $300 million.*[18]

## The middle-class compact: Putting the economy and the middle class on long-term solid footing

As important as it is to get the economy moving in the short term, America's long-term prosperity hinges on the prosperity of the middle class.

In our new economy, the rules for success have changed for people, families, and business. Many of our tax policies and government programs are out-of-date and often irrelevant to the way things work now. These gaps in public policy indicate where government has so far failed to adapt to the new rules and has left the middle class on its own.

Among the new rules:

- A college degree is a necessity, not a luxury.
- People will need to upgrade their skills from time to time throughout their lives.
- Most mothers work, and the balance between work and family is difficult—families must juggle work, raising children and caring for aging parents.
- People switch jobs often but at the cost of health and retirement benefits.

Today's families need a new and modern set of policies adapted to today's economy if they are to get ahead.

## 1. Five promises to the middle class

The following package of long-term tax cuts and policy ideas will help middle-class families succeed under the changing rules and create wealth for middle-class Americans.[†]

These policies will help families reach the following goals:

- **Pay for college through a generous college tuition tax break.** Simplify and expand current tax law to create a single generous college tuition tax credit equal to 50% of college costs up to $10,000. *Estimated cost: $8.8 billion per year.*[19]
- **Upgrade job skills.**
  - Expand the availability of federal student loans to non-traditional (adult) students. *Estimated cost: Marginal.*
  - Create a mid-career tuition scholarship fund to provide grants to working students. *Estimated cost: $250 million.*[20]
- **Balance work and family.**
  - Provide more money for child care costs by doubling the Dependent Care Credit. *Estimated cost: $400 million per year.*
  - Create a "new baby tax credit" to help young families with the costs of caring for a newborn. *Estimated cost: $6 billion a year for a $1,000 credit add-on to the Child Tax Credit for each of the first three years of a child's life.*
  - Provide paid family leave for new parents through a Family Leave Benefit added to the unemployment insurance system. *Estimated cost: None. Employers would be assessed $20 per worker per year (or a total of $2.5 billion per year) to provide a $250 flat benefit for four weeks to qualified workers.*[21]
- **Create and manage retirement wealth.** Provide a 3% federal match for 401(k) contributions for workers earning up to $100,000. *Estimated cost: $3.5 billion.*[22]

[†] See our report, *The New Rules Economy*, and our memo¸ *The Middle Class Compact,* for a full treatment of what we believe the longer-term policy goals for the middle class should be.

- **Care for aging parents.** Expand the Dependent Care Credit to include care-giving expenses paid on behalf of an elderly parent. *Estimated cost: $1.4 billion per year.*[23]

  *Total estimated one-year cost: $20.35 billion.*

## 2. Creating new jobs through new infrastructure investment

In addition to providing individual families with the resources they need to meet their aspirations, government must invest in establishing a pro-growth economic environment that continues to create high-paid American jobs.

In the past, successful companies built; today's successful companies create. Our nation leads the world in talent and new technologies, and we should be doing everything possible to keep it that way. But in *2005, the federal government spent 33 times more on maintaining interstate highways than on establishing the nation's information highways via broadband.* The following measures can help to create and keep jobs here in America by helping our companies grow and thrive at doing what they do best.

- **Permanent expanded research and development (R&D) tax credit.** *Estimated cost: $42 billion over five years.*[24]
- **Broadband infrastructure investment credit.** Provide businesses with tax credits to help finance broadband infrastructure upgrades to accommodate next-generation information technologies and increased demand for capacity. *Estimated cost: $20 billion over ten years.*[25]
- **School modernization fund.** Create a federal grant fund to finance the repair and upgrade of the nation's schools. *Estimated cost: $5 billion over five years.*
- **Increased federal funding for repair and replacement of aging bridges.** *Estimated cost: $1 billion (equal to 2007 appropriation).*[26]
- **Federal Green Fund to finance the retrofitting or new construction of federal buildings with environmentally-conscious or energy-efficient materials.** *Estimated cost: $10 billion over ten years.*[27]
- **Permanent increase in small business expensing limits.** Make permanent the ability of small businesses to deduct up to $100,000 per year in costs for new equipment and other investments. *Estimated cost: $20 billion over ten years.*[28]

  *Total estimated one-year cost: $15.4 billion.*[29]

# Conclusion

In talking about the economy over the months to come, progressives must resist the temptation to portray the middle class as victims or at the precipice of poverty. They are not either of these, and this is in fact one of the major disconnects between middle income people and progressive leaders. While many in the middle class *are* struggling, as progressives say, the true economic portrait of the middle class shows that they are *struggling to get ahead, not struggling to get by*. The middle class is undoubtedly anxious, but they are also unflinchingly and reflexively optimistic.

*It is a mistake for progressives to conflate middle class anxiety with middle class pessimism*. Americans are far more optimistic about their own circumstances than they are about the overall economy. While 43% of Americans expect the national economy to worsen over the next year,[30] only 25% of Americans expect their personal financial situation to worsen over the next year as well. Thirty-six percent say it will get better, and 37% don't expect much change.[31] And even though a majority of Americans see the overall economy as in bad shape, 66% rate their own household financial situation as excellent, very good, or good, and only 33% rate it bad, very bad, or terrible.[32]

Progressives should also be mindful that Americans' belief in the American economic system is seldom shaken. Eighty percent of Americans believe it's still possible to start out poor in this country, work hard and get rich.[33] And nine out of ten Americans are generally happy with the opportunities they've had to succeed.[34]

Most Americans are not anti-business. Fifty-eight million Americans (or more than half the workforce) work for large corporations. Four in five Americans say they have strong loyalty to their companies, and two in three Americans say they believe their companies have strong loyalty to them.[35] Perhaps that is why opinion polls consistently find that the public considers "big government" to be a greater threat to the country than "big business."[36]

We are not suggesting that progressives hesitate from pointing out excesses and righting corporate wrongs, but a narrative based largely on corporate malevolence is not robust enough for the middle class.

Progressives should remember that the principal rationale for offering an economic agenda, including a stimulus package, is to create new opportunity for the middle class and lead more Americans to prosperity. It is a message of hope and optimism, not pessimism and negativity. Thus, progressives should avoid a message that relies heavily on a litany of middle-class anxieties and struggles. To some degree, American optimism is rooted in reality, and the progressive economic message must reflect that reality to be effective.

# Endnotes

[1] Gallup Poll, national survey of 1,027 adults, December 6-9, 2007.

[2] American Research Group.

[3] Peter S. Goodman, "Homeowners Feel the Pinch of Lost Equity, *New York Times,* November 8, 2007, available at http://www.nytimes.com/2007/11/08/business/08borrow.html

[4] Standard & Poor's, Press Release, "Broadbased, Record Declines in Home Prices in October According to the S&P/Case-Shiller® Home Price Indices," December 26, 2007, available at http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_Release_122622.pdf

[5] Board of Governors of the Federal Reserve System, "Flow of Funds Accounts of the United States, Flows and Outstandings, Third Quarter 2007," Table B.100. Figures for Q4 of 2007 were projected from the Q1-Q3 change.

[6] Third Way estimate. In 2006, 45 million taxpayers filed tax returns with itemized deductions. Our estimate assumes that *all* of these households will claim this credit. Likewise, our cost estimate for all homeowners assumes that each of the 76 million households living in owner-occupied housing will claim this credit.

[7] Third Way estimate. In FY2006 (generally ending June 30, 2006), state sales taxes totaled $226.5 billion. Projecting the year-to-year increase in taxes to FY2008 yields an estimate of $255.1 billion in annual tax revenues, or $700M per day.

[8] Third Way estimate and based on the assumption that every worker who earns less than $102,000 and pays at least $250 in payroll taxes receives the one-time $250 rebate (roughly 149.1 million workers).

[9] The National Association of Realtors estimates that about 40% of all homebuyers—or 3.2 million homebuyers annually—are buying their first home. This cost estimate assumes that all first-time homebuyers take full advantage of the credit. We also assume that the credit begins to phase out at $75,000 in household income.

[10] Third Way estimate based on the number of households estimated to benefit from the Bush Administration's rate freeze plan.

[11] This proposal would double funding for this program, which was appropriated $150 million for fiscal 2008.

[12] Third Way estimate based on EITC spending for FY08 from http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/receipts.pdf, Table 19-1 and maximum EITC credit for tax year 2007.

[13] Third Way estimate. This estimate assumes a full 13-week extension for all workers likely to exhaust their benefits (based on 2006 figures for the number of unemployed individuals who exhausted their benefits).

[14] International Trade Commission, "ALL MERCHANDISE -- Country Quarterly Update," http://dataweb.usitc.gov/scripts/trade_shift/trade_by_ctry_mv.asp

[15] Trade Promotion Coordinating Committee, *The 2007 National Export Strategy,* available at http://trade.gov/media/Publications/pdf/nes2007FINAL.pdf.

[16] See IRS Publication 535 for details on deduction of small business start-up expenses, available at http://www.irs.gov/publications/p535/ch08.html#d0e5397. Business start-up include expenses incurred prior to the commencement of business operations, such as advertising, travel, surveys, and training.

[17] Trade Promotion Coordinating Committee, *The 2007 National Export Strategy,* available at http://trade.gov/media/Publications/pdf/nes2007FINAL.pdf.

[18] Total budget authority for export promotion activities in fiscal 2008 was approximately $1.2 billion.

[19] Third Way estimate based on 2004 National Postsecondary Student Aid Study and IRS data. This credit would replace the Hope and Lifetime credits and the existing college tuition deduction. The credit would be available to families with up to $150,000 in annual income.

[20] This scholarship fund could be primarily targeted to providing tuition assistance for working students enrolled in community college. According to the American Association of Community Colleges, there were approximately 6.6 million community college students nationwide in 2007, paying average annual tuition and fees of $2,272. These funds could also be matched by state funding to increase the number of students who benefit.

[21] This assessment would be added to the taxes currently paid by employers under the Federal Unemployment Tax Act. Because this benefit is being structured as an add-on to UI insurance, workers must be eligible for UI to be eligible for this benefit.

[22] Third Way estimate based on 401(k) contribution data from the EBRI/ICI Retirement Plan Data Collection Project, data on active participation in defined contribution plans from the Department of Labor, and inflation adjustment figures from the Bureau of Labor Statistics.

[23] Third Way estimate.

[24] Office of Management and Budget, *Analytical Perspectives: Budget of the United States Government, Fiscal Yea 2008,* available at http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/crosscutting.pdf

[25] According to industry research reports, the country needs to invest at least $55 billion in infrastructure improvements to bridge the gap between current capacity and expected demand. See, e.g., various research reports by Nemertes Research, www.nemertes.com.

[26] The U.S. Department of Transportation estimates that repairing or replacing all obsolete bridges would cost $65 billion. http://transportation.house.gov/News/PRArticle.aspx?NewsID=389

[27] See HR 1768 for potential model legislation.

[28]Office of Management and Budget, *Analytical Perspectives: Budget of the United States Government, Fiscal Yea 2008,* available at http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/receipts.pdf. The 2003 tax law increased the small business expensing limit from $25,000 to $100,000 per year through 2009. When the provision expires in 2010, the limit will again be $25,000.

[29] This figure excludes the accelerated amortization proposal for small businesses.

[30]American Research Group, Inc, national survey of 1,100 adults, December 16-19, 2007 (monthly survey).

[31] Ibid.

[32] Ibid.

[33] New York Times Poll, Class Project, March 3-14, 2005, 1,764 respondents.

[34] Kim, A. and Kessler, J. *The Politics of Opportunity*, Third Way, May 4, 2006.

[35] Kim, A. and Kessler, J., *The Politics of Opportunity*, Third Way, May 4, 2006.

[36] Kim, A. and Kessler, J., *The Politics of Opportunity*, Third Way, May 4, 2006.