# CBO TESTIMONY

Statement of
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before the
Subcommittee on Housing and Community Development
of the
Committee on Banking, Finance and Urban Affairs
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NOTICE

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Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to discuss the possible consequences of enacting temporary increases in federal spending for local infrastructure, public services, and housing assistance through the Emergency Community Development Act of 1992. Such measures are understandably appealing as means of addressing urgent long-term needs in many urban and rural areas while also attempting to combat the recession. Nevertheless, I will offer a sobering assessment of the likelihood that the act can help significantly to end the recession or to strengthen the recovery once it begins.

## THE PROVISIONS OF H.R. 4073

The Emergency Community Development Act of 1992--H.R. 4073--would authorize increased federal spending in several areas that, by wide agreement, could contribute to the nation's long-term economic growth. In particular, additional spending for the infrastructure needs of states and local governments, if carried out carefully, can help expand the economy's productive capacity. Other provisions could help alleviate long-standing social problems that extend well beyond what is reflected in the cold figures of the national income accounts. For example, many policymakers keenly feel that affordable housing should be made more widely available to lower- and moderate-income families, as H.R. 4073 would do.

H.R. 4073 would authorize about $16 billion in grants and loans for fiscal year 1992 to provide emergency assistance for community development and housing. The bill would direct much of this aid toward groups and regions that have special needs and that are likely to be among the last to recover from the recession. For example, many of the bill's provisions are aimed at areas that are burdened with high rates of poverty, crowded or aging housing, and lagging economic growth. In addition, a significant share of the bill's benefits would go to rural areas.

The lion's share of the bill's funds--$10 billion--would be for grants to provide temporary assistance for community development activities similar to those eligible for funding under the regular Community Development Block Grants program. Such activities would include rehabilitating and constructing public works and providing public services.

A significant portion of the remaining funds would be earmarked for grants and loans to support affordable renter- and owner-occupied housing. Funds would be authorized to rehabilitate and construct rental housing for low-income families, including grants to modernize vacant public housing units and loans to construct rural housing. Other funds would help low- and moderate-income families, including eligible first-time homebuyers and rural

families, buy new and existing homes. Still other provisions in the bill would authorize grants for assistance to the homeless.

## IMPACTS OF H.R. 4073 ON THE SHORT-TERM ECONOMIC OUTLOOK

Although the provisions of the Emergency Community Development Act could well help the economy in the long run, they are less promising as means of solving the nation's short-term economic problems.

The current economic downturn has been unexpectedly severe and prolonged. Far from being the relatively mild slowdown that most economists expected to end last summer, the recession now seems likely to continue through the first quarter of 1992. The Congressional Budget Office's (CBO's) new economic forecast holds that an upturn is likely to take place only in the spring, and that even then it will be anemic by historical standards.

A variety of economic problems threaten to hold back the pace at which the nation rebuilds its prosperity. These factors include the overbuilding of commercial real estate that occurred during the 1980s, which is dampening new construction now. In addition, growth in employment and incomes is likely to be hindered by the restructuring that is under way in

several major industries as businesses strive to improve their ability to compete in the world economy. The financial fragility that plagues many banks, and the continuing budget problems of state and local governments, will hold back growth in certain areas. In the first year or two of a normal recovery, gross domestic product (GDP) might be expected to grow at a rate of 6 percent or more, but CBO now forecasts that the economy will grow at a rate of only 2.8 percent this year.

The delayed and slow recovery means, of course, that the recession-generated hardships that beset many Americans will ease only slowly. Unemployment will fall only slightly below 7 percent of the labor force by the end of 1992, and will average nearly that level for the year as a whole. Since employment and incomes are likely to recover sluggishly, households' finances will remain under the heavy stresses of recent months, and budgetary pressures will linger among state and local governments.

Under these conditions, it is understandable that many policymakers are eager to bring new fiscal weapons onto the economic battlefield. Until now, the nation has relied primarily on the Federal Reserve's monetary policy to end the downturn. The central bank began reducing interest rates significantly even before the recession started, most recently cutting both the federal funds rate and the discount rate sharply at the end of last year.

Although these measures finally seem to be arousing a few signs of economic life, it appears likely that several more months will pass before the recovery begins in earnest.

But fiscal measures intended to strengthen the short-term outlook labor under unusual handicaps. One hindrance to their effectiveness stems from the need to avoid worsening the already troublesome long-term outlook for the federal deficit. In order to have more than a trifling effect on the massive economy, budget policies aimed at hastening the recovery would have to increase the deficit significantly. Instead, however, many measures that are now under consideration would avoid increasing the deficit altogether by raising other taxes or cutting other spending, just as the Budget Enforcement Act requires. But these offsetting budgetary measures make it unlikely that the overall policy can have a significant net impact on the economy; whatever stimulus is gained through new tax or spending provisions is lost through the depressing economic effects of reductions in other programs.

A second handicap that plagues fiscal efforts to stimulate the economy is the lateness of the hour. It inevitably takes many months for new measures to be enacted and for their effects on the economy to be felt. Beginning the process this late in the downturn raises risks that the economic effects will not be felt until the most urgent need has passed and the recovery is well under

way. If their budgetary impacts are not offset through cuts in other spending or tax increases, however, new measures could add steam to the weak recovery and could bolster economic conditions in regions of the country that might otherwise be left behind. Moreover, the new measures could help ensure that the recovery does not falter late this year or next and fall into a new downturn.

Still, the Congress should recognize that new policies stand little chance of achieving the particular goal of strengthening the economy soon. By the time their effects are felt, the recovery is likely already to be under way.

Impacts of H.R. 4073

There are several reasons that H.R. 4073, in particular, might have very little impact on the recession and recovery. The first stems from the fact that the sponsors of the bill have said that they do not want to add to the federal deficit. Instead, defense spending may be reduced or revenues increased to offset the outlays generated by the bill. Although no major economic issues are involved in the way the offsets are handled, offsetting the deficit impacts in this way would require amending the Budget Enforcement Act of 1990, or

relying on the emergency provisions of the act. At present, the act requires that offsets to increases in domestic discretionary programs, like those in this bill, be restricted to other domestic discretionary accounts.

If offsetting cuts are made in other programs, H.R. 4073 would not provide significant overall stimulus to the economy. Additional funds for infrastructure or housing would stimulate construction, but increased taxes or cuts in defense would slow economic growth in other sectors.

Quite apart from the dampening effect of offsetting budget cuts, H.R. 4073 alone may have little economic impact because the amount of funding that it provides is small in relation to the economy as a whole. The roughly $16 billion in grants and loans that would be authorized would be less than one-quarter of one percent of GDP in 1992, according to CBO estimates. Even when so-called multiplier effects are taken into account--that is, the impact of the economy's automatic reactions to a change in budget policy, serving to expand its initial impact on GDP--the impact on GDP would be no more than one-half of one percent. Based on standard rule-of-thumb calculations, this increase would translate into a decline in the unemployment rate of perhaps 0.2 percentage points, or roughly 250,000 jobs. But this effect could take up to two years to realize even if all of the money were spent immediately, which would not be the case under H.R. 4073. Thus, the act

might do little to stimulate the economy by itself, although it would if it were part of a larger package of fiscal measures.

An additional factor that reduces the stimulative impact of the bill is that state and local governments might substitute the added federal spending for some of their own. If they did so, the additional federal funding might give rise, not to additional spending on infrastructure, but to cuts in state and local taxes. Another possibility is that the increased grants would work to reduce state and local borrowing--an outcome that would have little impact on the pace of recovery. To be sure, the extent of any substitution would be limited, because state and local governments typically do not undertake some of the activities that H.R. 4073 funds--particularly housing assistance--without federal aid.

For related reasons, proposals for increased federal grants could have an adverse effect on the economy if they caused state and local governments to delay planned spending on projects in hopes that they would qualify for federal aid once the appropriations are passed.

Delays in the Impact of H.R. 4073

Aside from the factors that suggest that the economic impacts of H.R. 4073 could be small, a variety of considerations imply that any impact of the bill is likely to be delayed considerably. First, as with all legislative proposals, the Congress would need time to consider and enact the legislation. These hearings, subsequent consideration by the full House, negotiations with the Senate, and full consideration of subsequent appropriation legislation are legitimate and necessary, but unfortunately time-consuming, parts of the policymaking process.

A second factor that suggests that the bill's economic impacts would be delayed is that, once the necessary appropriations are enacted, it might well take longer to modify or write the necessary regulations than the 45 days that are generally mandated in the bill. A third consideration is the time that state and local governments require to submit plans or proposals. Although some projects that had been delayed because of looming budget deficits related to the recession could be submitted quickly, they would probably not be sufficient to absorb the substantial increase in funding that is contemplated in H.R. 4073 within a short period of time. In addition, a significant portion of the grants authorized by this bill would probably be used for construction or repair of physical facilities. Spending for such activities usually does not

begin quickly and often takes a long time to complete. A final factor that is likely to delay the impact of the bill is the possibility that federal agencies might not be able to keep pace with the increased flow of applications, or that the increased funding could overload the decisionmaking process at the local level.

Certainly, funds for some of the activities that are authorized under the bill could be spent relatively quickly, especially for public services such as education, health care, and job training. The Community Development Block Grant (CDBG) provisions of the bill would allow up to 25 percent of those funds to be used on public services, compared with 15 percent in the current program. Experience suggests that this funding could begin to reach those in need relatively quickly--perhaps within a year.

CBO's preliminary estimates of the impacts of the bill on outlays over the next six years clearly indicate the importance of the possible delays in the expenditures that are authorized in H.R. 4073 (see Table 1). Even in the highly unlikely event that all legislation, including appropriations, could be enacted by April 1 of this year, little of the spending would occur in fiscal year 1992. The delays are especially important in the CDBGs and in the mandated increases in housing assistance provided by the Department of Housing and

TABLE 1. ESTIMATED FEDERAL OUTLAYS RESULTING FROM H.R. 4073
(By fiscal year, in billions of dollars)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|
| Community Development Grants | 0 | 2.5 | 4.1 | 2.7 | 0.7 | 0 |
| HUD Housing Assistance | 0 | 0.1 | 0.5 | 0.8 | 0.5 | 0.3 |
| Homeless Housing Programs | 0.1 | 0.2 | 0.1 | 0.1 | a | a |
| Rural Housing Assistance[b] | a | 0.1 | 0.5 | 0.2 | 0.1 | 0.1 |
| FHLBB Affordable Housing | a | 0.1 | 0 | 0 | 0 | 0 |
| FHA Multifamily Housing Staff | a | 0.1 | 0 | 0 | 0 | 0 |
| Total[c] | 0.2 | 3.0 | 5.3 | 3.8 | 1.4 | 0.4 |

SOURCE: Congressional Budget Office (preliminary estimates).

NOTES: Estimates assume appropriations are provided by April 1, 1992.

HUD = Department of Housing and Urban Development; FHLBB = Federal Home Loan Bank Board.

a. Less than $50 million.

b. For loan programs, outlays shown are those associated with the subsidy necessary to support the loan levels specified in H.R. 4073.

c. This bill would change single-family premium and down-payment requirements for Federal Housing Administration (FHA) mortgage insurance. These changes would result in direct costs that would not be subject to appropriations. Although CBO does not have a precise estimate of these costs at this time, they would probably be between $100 million and $200 million per year. These costs are not reflected in the total, however.

Urban Development. Overall, only about 1 percent of the new budget authority would be spent during 1992, and over 40 percent would be spent in fiscal year 1995 or later.

## CONCLUSIONS

Outside analysts have encouraged the Congress to consider new expenditures for infrastructure and other beneficial programs as means of killing two birds with one stone--that is, tending to long-term national needs and stimulating the economy during recession. That is what the Emergency Community Development Act seeks to do. Unfortunately, a number of practical problems get in the way. Offsetting the budgetary impact of the program also short-circuits its near-term economic benefits. Moreover, the very processes of planning and regulation that are needed to ensure that new expenditures are carefully and efficiently chosen make it unlikely that they can occur promptly enough to stimulate the economy quickly.