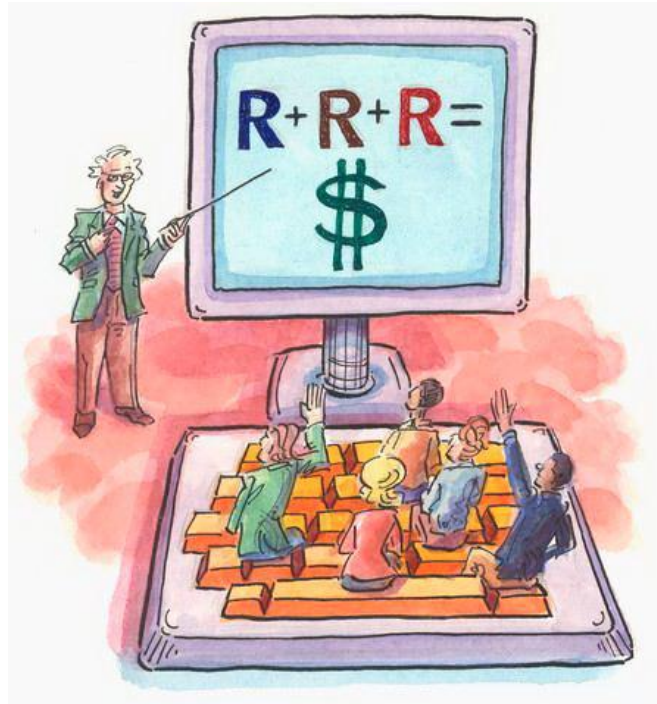


## FEATURE ARTICLE I



### **A STIMULUS PACKAGE Q&A PRIMER** **Including The Intellectual Infrastructure** BY IRA GOLDBERG, PH.D. AND JAMES C. WILLIAMS

***Where is the economy?***

The economy continues to tank with no end in sight. Credit markets remain at least partially frozen. Bankruptcies, unemployment, and loan defaults are still rising. GDP, real estate, stock markets, and commodity prices are falling. The new debate seems to be about whether we are in a severe recession or a depression. In either case, people agree that economic activity is shrinking with fewer people and resources employed. The entire situation is overwhelming due to the incredible complexity of the interconnected details and the many variants on plans to “fix the problem.” Rather than write a treatise on all of the factors and actions involved, the goal here is to look at the rationale behind why most policy makers are now focused on a massive stimulus package as well as the impact it might have for the future. In short, the intent of stimulus is to increase spending for goods and services, which in turn boosts employment and the use of other resources.

***What happened and what are we doing?***

A lot has happened since the U.S. real estate market first started deteriorating and began to drag the rest of the U.S. and world economies along. Financial institutions saw loans and investments lose value as loan defaults began to rise. Confidence in financial institutions fell

with investors increasingly concerned about the safety of their deposits and investments. Investors, therefore, wanted to move money from institutions considered less safe into the safe harbor of U.S. Treasuries. The confluence of events placed considerable pressure on financial institutions’ reserves. So far the extent of the problem appears to be worse than the Savings and Loan crisis in the 1980s. It is also more pervasive because the former crisis was impacted by inflation and the related asset-liability management issues instead of the increase in loan defaults we see now.

Frozen credit markets and the declining values of investments and liquidity problems in auction rate security markets have created significant challenges for non-profit organizations like educational institutions as well as for corporations and municipalities. For instance, according to a January 14, 2009 *Wall Street Journal* article entitled *Next Benefit to Face the Ax: Matching Gifts* by Shelly Banjo, corporations are cancelling matching gifts. There are also overall reduced donations to non-profits and other problems caused directly by the current state of the markets.

For example, many educational institutions, both public and private, have been hit with multiple whammies of

both falling investment values and loss of access to funds. Average college/university endowments fell slightly in the last fiscal year (ended June 30, 2008), with an additional estimated drop of 30% since then, according to Craig Karmin and John Hechinger's October 17, 2008 *Crisis Shakes the Foundations of the Ivory Tower* article in *The Wall Street Journal*. This estimate includes such high-flying endowments as Harvard (estimated to have dropped by more than 22% from June 30, 2008 to October 31, 2008), Yale, and Princeton as reported in additional *Wall Street Journal* articles by John Hechinger on December 17<sup>th</sup> and 20<sup>th</sup>, 2008 and on January 9<sup>th</sup> of this year.

In addition, there have been numerous instances of short-term investments losing their liquidity. At the beginning of October, almost 1,000 colleges and universities were unexpectedly notified that their accounts were frozen in a \$9.3 billion short-term bond fund offered by Commonfund of Connecticut and managed by Wachovia. The restriction on investor redemptions and the fund's liquidation helped to fuel cash crunches at some schools since many colleges used the short-term fund for payroll. A day later, Commonfund restricted withdrawals from its \$1 billion intermediate bond fund. In all, we see negative impacts on revenues, assets, available cash, and borrowing costs.

As the market maelstrom intensified, the Federal Reserve Bank stepped in with extensive unprecedented actions. These included large interest rate cuts and infusions of liquidity through direct loans and debt purchases. There have also been a number of fiscal actions.

Specific programs like TARP (troubled asset relief program), TALF (term asset-backed securities loan facility), reclassification of financial institutions as commercial banks (making Federal Reserve resources available), and various financial rescue packages are all basic attempts to maintain solvency for core financial institutions. The primary focus has been to prevent a complete financial meltdown. It is generally agreed that these actions have helped prevent much worse economic erosion, but it is also apparent that the full extent of the downturn is not yet known.

***What is the theory behind the actions?***

The basic theory behind the Federal Reserve's actions is fairly simple. Increase banks' capitalizations and cut interest rates in order to bolster reserves and keep credit and lending from dropping into a precipitous downward spiral. The ability to ensure credit throughout the economy is intended to provide businesses with liquidity to meet short term obligations, prevent overall demand from contracting faster and further, and maintain business activity.

Credit and liquidity are essential to help ensure that consumers and businesses are not forced to scale back spending and investment plans. For the Fed's actions to work, there must be ability and willingness to continue lending on the part of financial institutions in addition to the desire of firms and consumers to borrow. By strengthening bank reserves, the ability to lend is improved, but not necessarily the willingness of all.

Why? Institutions do not want to lend money if they do not believe they will be repaid. The fear of default creates an environment where investors flee to the safest investments (Treasury bills). The spreads between those safest investments and other investment options increases and credit markets can break down. The problem then becomes one of freeing up credit markets and improving economic conditions so lenders feel more confident they will be repaid.



***What is the case for fiscal stimulus?***

To date, the Federal Reserve Bank actions have strengthened financial institution reserves and somewhat improved liquidity from extremely low levels. They have not greatly improved the willingness of all banks to lend. There are questions about how much more the Federal Reserve Bank can do, especially since the interest rate charged to banks is now effectively zero. With the ongoing goal of reversing decreases in the demand for goods and services, the current environment is one where many economists believe fiscal stimulus is necessary in order to increase that demand. How well it will do so is an open question, particularly if consumers and businesses are unwilling to spend.

***Is all stimulus the same?***

Fiscal stimulus can take the form of tax cuts or government spending. Keynesian theory projects each can generate spending that will maintain business activity by putting unemployed people to work and engaging unused resources. Debate among many policy-makers revolves around the best approach or mixture of approaches in the current situation.

Tax cuts have the greatest impact when people elect to spend the money they receive. To the extent they decide to pay down personal debt or to increase their savings, the economic boost is muted. There is an

additional advantage to general tax cuts since individuals and businesses are free to spend money in areas they believe provide the most direct benefit to them.

Targeted tax incentives in the tax laws have also been used for a long time. The tax deduction for home mortgage interest geared toward encouraging home ownership is one example. Tax relief geared towards a specific good increases the financial incentive to purchase the affected good. As a result, targeted tax incentives are favorites of lobbyists for impacted industries and firms. In the current crisis, many useful ideas for tax deductions and tax credits have been mentioned as incentives to provide stimulus.

For example, Senator Barbara Mikulski of Maryland’s proposal to bring back the deduction for new car loan interest, which ended in 1991, to stimulate new car sales made it into the first version of the stimulus bill. For housing, there is the creative idea, discussed by for example Dr. Bill Wattenburg on San Francisco’s KGO-AM, to cancel all tax on rental income and capital gains for investors who buy foreclosed and abandoned houses and put them back into economic service. This action would create a strong incentive to put several million foreclosed and abandoned houses quickly back into use, particularly since there will likely be no tax revenue from these properties in their current status. These ideas will continue to be discussed and perhaps be enacted into legislation at a later time.

By comparison, government spending directly purchases goods and services and, thereby, increases production. There is no absolute relationship between government spending and consumer wants and, therefore, no guarantee of meeting those wants (although it must also be admitted that the same could be argued about the targeted tax breaks discussed above). What if we took this approach to an extreme by having government pay people to dig holes and fill them in again? It would still put money in people’s pockets and impact spending the same way as a tax cut even though no initial useful product results. Spending on useful products and services is, of course, preferred. We can also make the argument that government spending on infrastructure has an even more significant long-term impact since it provides improved future productive prospects.

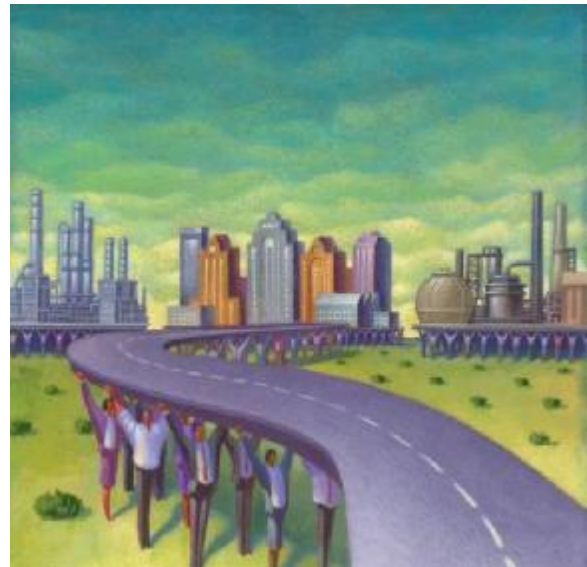
While the current financial predicament is unique in some aspects and may require prompt government action, most of the current research raises thoughtful questions about the efficacy of government spending in contrast with tax cuts. Specific attention to the amount of private spending generated after the government puts

money in people’s pockets is particularly relevant (for further reading on this topic, Harvard economist N. Gregory Mankiw’s January 10, 2009 *New York Times* article titled *Is Government Spending Too Easy an Answer?* is quite informative on GDP stimulus research).

The new stimulus package just exited Congress is around \$800 billion and is the largest such legislation in American history. This size is to be expected since it responds to the greatest shock to the nation’s economy since World War II. The package is currently comprised of approximately two-fifths tax cuts and three-fifths government expenditures.

***What is infrastructure?***

There is a lot of interest about what constitutes infrastructure and the types of infrastructure that make the best investments. Almost as soon as there was talk about economic stimulus, politicians were pushing “shovel ready” projects like roads, bridges, and airports. Most agree that the physical infrastructure is important and that successful countries must have a good core physical infrastructure. A more interesting question arises in considering whether the physical infrastructure is necessary and sufficient or just necessary as a foundation for future progress.



As industrial production has become a smaller component of the U.S. economy, emphasis has shifted to technology and the underlying innovation that drives it forward. Continuous clear technological leadership provides competitive advantages worldwide as well as the potential to improve the future. This trend is expected to continue as intellectual advances provide an ongoing edge. Examples include advances in chip designs, biotechnology, and even the internet.

Here the argument naturally turns to questions about the key elements driving technological advances and innovation. The answer is not straightforward but appears to be linked to investment in intellectual capital through research and education. We, therefore, see a great opportunity to focus stimulus toward providing improvements to the core intellectual infrastructure.

***What is the impact to the intellectual infrastructure?***

An especially unfortunate outcome of the current malaise is a decrease in financial support for the educational and research institutions that constitute the nation’s intellectual infrastructure.

The importance of this intellectual infrastructure in the development of the American economy cannot be overstated. Prior to the mid-1800s, higher education in all countries, including the United States, was reserved for a privileged few. But beginning in 1862 when President Abraham Lincoln signed the law establishing the land-grant colleges and universities in every state, the United States established a system of widely accessible higher education—with both public and private institutions—that is unique in the world.

The resulting explosive expansion of education and research, especially in science, engineering, and agriculture, supplied the intellectual infrastructure for the dramatic development of industry and science and the growth of the American economy into the world’s strongest and richest. American universities became world leaders in both education and research.

This system continues strong today. In the 2006 - 2007 academic year (the most recent U.S. Department of Education’s National Center for Education Statistics figures), there were in the United States 2,629 fully accredited 4-year colleges and universities (643 public and 1,986 private), plus another 1,685 accredited 2-year colleges. According to that same source, there are also over 18 million students currently in higher education in the country, including 600,000 foreign students from countries around the world. Maintaining and strengthening our intellectual infrastructure is more important than ever in today’s competitive global economy. Substantial funding support for that infrastructure must continue regardless of economic ups and downs.

Investment in the intellectual infrastructure will, however, likely decrease without a renewed appreciation of its importance. A loss of funding would do significant damage to institutions that would last long after the economy has fully recovered. In the current economic environment the most likely contributor is the federal government as part of the larger stimulus package.

Increased investment in higher education is vital today more than ever. Short-term education spending goes well beyond the immediate economic stimulus. It strengthens national investment in an intellectual infrastructure with long term worldwide benefits.

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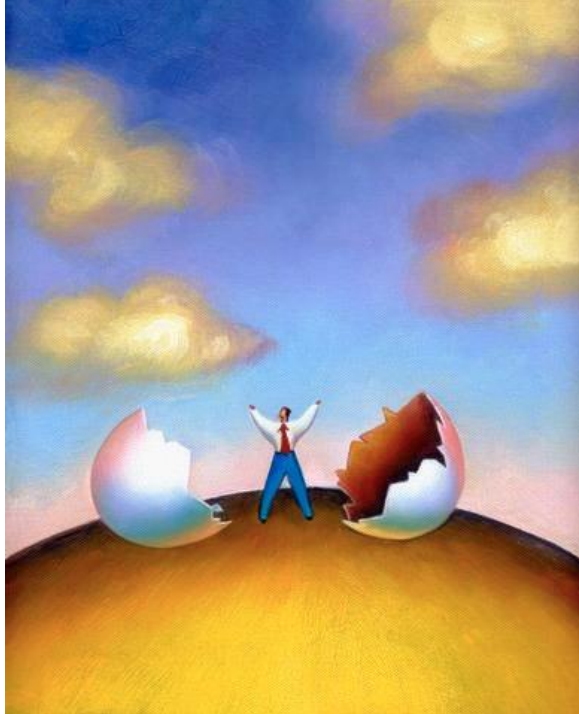
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## 2009 CAREER IMPLICATIONS

BY KATHY GRAHAM, PRINCIPAL, HQ SCRIPTS, INC.

From a career perspective, the stimulus package and the current downward spiraling economy offer some very interesting and potentially profitable developments, namely:

- Where there's money, there's opportunity. If you're in between positions, underemployed, or your business line is slow, watch where the stimulus money is allocated. Then think of ways that you can apply your skills to enhance the allocation and/or production of goods and/or services provided by the stimulus funds. Use your research skills to identify the companies distributing or receiving the funds, then introduce yourself to the top management at those firms. Or, better yet, ask someone you know that already has relationships with those individuals to introduce you. Networking is wonderful.
- How is your intellectual infrastructure? Is it sagging a little? A bit dated? Now's the time to update your education credentials

and certifications. Not only will you be helping yourself but you'll also be helping those institutions survive a year when their endowment funds have been challenged. Latest data from NACUBO states that higher education endowments reported an average rate of return of -3% for the fiscal year ended June 30, 2008 with the months July through November 2008 showing an additional 23% drop in their investment returns. Yikes!

- None of the above apply to you? Is it time for you to transform your career in a different direction? Economic downturns of all types are the perfect times to reinvent your future occupation because the opportunity cost of the change is lower than if you make a change in a boom time. Contact your college(s), your local resources, and career coaches to determine what your skill sets and interests indicate would be great choices for you.

Once you know your goal, if you're having any difficulties reaching that target, remember we created a product just for you, our *Your Career Campaign*<sup>TM</sup>. About 50% of the individuals who have used this service are happily employed but wanting to develop a bio, updated resume, and a strategy for growing their career at their current company. They've been so busy in the boom years that they haven't had the time to consider what else they should be doing or who else they should be adding to their network. They also want a safety net plan ready just in case their firm is sold or is suddenly impacted negatively by this volatile economy.

The other half using our newest product are currently unemployed. We have been so successful in helping these individuals re-create their future. Email me at [hqs1@juno.com](mailto:hqs1@juno.com) so that we can set up a time to discuss whether this service fits your situation or, if you prefer, view the program at our website, [www.hqsearch.com](http://www.hqsearch.com), for further information.