International Journal of Scientific Advances
ISSN: 2708-7972
Volume: 2 | Issue: 5 | Sep - Oct 2021 Available Online: www.ijscia.com
DOI: 10.51542/ijscia.v2i5.1

The Potential Effects of Biden's Infrastructure Bill on the American Economy

Victor Kilanko

Claremont Graduate University

*Corresponding author details: Victor Kilanko; victor.kilanko@cgu.edu

ABSTRACT
With the world still battling COVID-19 and the attendant effect on the economy, the almost new President Biden's administration proposed the Build Back Better agenda to get America and Americans working again. This paper is written to address the effect of the proposed infrastructure bill on the American economy. Comparison is drawn between the infrastructure bill and Franklin D. Roosevelt's new deal before World War II. It is understood that the bill may increase inflation because of the effect of expected inflation, but the bill may also increase aggregate demand and aggregate supply which will be of overall net benefit to the economy.

Keywords: Build Back Better; Biden Administration Infrastructure Bill; American Economy; New Deal

INTRODUCTION
Unsurprisingly, the COVID-19 pandemic turned out to be a big deal. Many economic observers, analysts, and investors were expecting an economic bust after what had been a long period of economic bubble. However, no one expected that a global pandemic would be the harbinger of economic peril. With the World Health Organization (WHO) guidelines which necessitated safe distancing and shelter-in-place, the economy practically shut down. 43% of firms were temporarily closed. The US economy shrunk by a record of 31.4% in the second quarter of 2020 which was the largest quarterly GDP drop in history [1]. Zoom calls were the closest almost anyone could get to non-family members. For businesses that are considered non-essentials, this means no source of income for the firms, their workers, and their vendors. Between January and July 2020, the unemployment rate rose from 3.6% to 10.1%, industrial production fell by 9%, and nonfarm employment fell by more than 12.5 million people [2]. The fear of infection more than contributed to the receded consumer spending and economic downturn [3]. It has also been found to be responsible for the fall in aggregate demand and aggregate supply as people avoided jobs with high risk of contracting coronavirus [4].

Something needed to be done. The government turned to fiscal policies to stimulate aggregate demand even as plans to roll out COVID-19 vaccines entered high gear. Several bills were signed to send stimulus checks directly to Americans, give loans to businesses to pay workers, and pay unemployment benefits. The CARES Act did little to raise consumer spending amidst low-income households, however it fell short to jumpstart employment [2]. The Paycheck Protection Program also had little success in keeping the economy away from recession and keeping jobs.

This paper intends to look at the infrastructure bill proposed by the Biden administration and its possible effect on the economy. An historical overview of a similar bill signed into law during a similar economic situation will be considered for perspective reasons. The aim is to consider how historical expansionary bills have faired with recessions and if the ever-present fear of inflation was a worthy concern. The next section will start with the historical example while subsequent sections will introduce the infrastructure bill and consider its possible effects on the economy.

FDR and the New Deal
When the stock market crashed in 1929, the great depression crept in. To protect the government's fiscal surplus and bottom-line, contractionary economic policies were engaged by the Federal government [5]. This, however, caused the government revenue to fall thereby turning fiscal surplus to deficit and debt. Unemployment rate rose from 3.2% in 1929 to 24.9% in 1933 with many employed workers just part-timers. Many bank depositors lost their money as banks closed. Farm income fell and non-farm mortgages were foreclosed.

These economic woes brought in President Franklin D. Roosevelt with the promise of a "New Deal" for the masses. Economic relief, industrial reforms, and financial recovery were the focus of his administration [6]. Contractionary policies were reversed to expansionary economic policies targeted at the economic, financial, and social impact of the great depression. More government involvement in the economy promoted by John Maynard Keynes heralded the era of Keynesian economic theory in the US.

Works Progress Administration (WPA) and the Civilian Conservation Corps (CCC) were set up to provide short-term government aids and jobs to Americans. CCC employed 3 million people to conserve public lands by planting forests, maintaining roads and trails, and building flood barriers. About 8.5 million people were employed to build bridges, public parks, airports, roads, and public buildings. Artists were paid to create 17,744 sculptures and 2,566 murals for the public works. The Federal Emergency Relief Act funded jobs in construction, education, arts, and agriculture [5].

The Agricultural Adjustment Administration (AAA) created farm programs to provide subsidies to farmers [7]. Emergency Farm Mortgage Act gave loans to farmers to prevent farm foreclosures. Farmers were taught modern farming techniques and practices and relocated to better farms.

Electricity infrastructure and power stations were built to electrify states, rural areas, and farms.

The government established Social Security to provide old-age benefits, disability insurances, and unemployment compensation [8]. It went further to strengthen labor unions to increase collective bargaining and improve labor conditions by establishing laws guiding minimum wages, maximum work hours, overtime pay, and outlawing child labor. The Securities and Exchange Commission (SEC) was created to protect investors from stock market fraudulent practices to prevent a repetition of the 1929 stock market crash. The Federal Deposit Insurance Corporation (FDIC) was also established to protect bank depositors and insure their deposits in member banks.

Despite how popular many of the vestiges of the New Deal like SEC, FDIC, Social Security, Minimum wage, Overtime pays, etc. are today, the New Deal received broad national opposition in the 1930s for being socialistic and too large government spending, and many of its Acts were challenged in court [9]. Some even argued that it did not end the great depression, crediting World War II as the panacea for the great depression. However, present-day economists and economic observers should not be quick to forget that by 1937 the unemployment rate had fallen to 14.3% from its height of 25% in 1933. The economy in fact grew by 10.8%, 8.9%, and 12.9% in 1934, 1935, and 1936, respectively. Though the unemployment rate finally fell to 1.9% in 1943 (4 years after the start of the war), we must remember that an upwards of $50 billions had been spent on the war barely 10 years after an economic spending of $1 billion towards alleviating the great depression could hardly pass in the US Congress.

With these expansionary actions, inflation was not a problem for the period of the New Deal between 1933 and 1939. Other than some periodic deflations which had always been the problem during the great depression, inflation was below 5.60%. However, during World War II in 1942, inflation reached a high of 13%, but by 1944 the inflation was back to about 2%.

BIDEN'S INFRASTRUCTURE BILL

On August 10, 2021, a bipartisan infrastructure bill to investment $1 trillion in the United States physical infrastructure passed the Senate. This bill is a significant part of President Biden's Build Back Better Plan to modernize, rebuild, and replace the nation's aging infrastructure and create necessary investments for more and better jobs [10]. This bipartisan bill was also supported by about 63% Americans [11]. The president's infrastructure plan would create about two million jobs annually for a decade and improve labor force participation [12]. Investments will be made in the transportation system by modernizing airports, waterways, railways, seaports, and improving access to public transit [13]. Roads and bridges will be repaired and rebuilt. Similar investments will be made in the water and waste system, high-speed internet, and clean energy through EV infrastructure and electric school buses [14].

Moreover, there is a broader bill which seeks to investment in human infrastructure. A $3.5 billion Budget Committee agreement was reached on July 13, 2021 [13]. This bill if signed into law will provide more healthcare funding, affordable childcare, free colleges, affordable housing, research fundings, loans for small businesses, investments in veterans, permanent residency to qualified immigrants, and more accessible career pathways to Americans [13]. This bill already has the support of about 52% Americans [11].

This increased government spending is spring-loaded to launch millions of jobs over the next decade and create a more prosperous nation for posterity.

THE POLITICAL ECONOMY TODAY

Just a slight peek into economic discourse today will reveal an overwhelming disdain for big government spending. Many economic observers and commentators are skeptical of expansionary fiscal policies and the oftentimes attendant rising inflation rate as they have frequently been warned. Beyond the fear of inflation is the fear of fiscal deficit. Many people understand that huge government spending come with the price of fiscal deficit as the government must finance its bill somehow. Also, there is an established contempt for welfarism and socialistic policies amongst many elites and policymakers. Policies to better living conditions for the least people in the societies are often tagged "handouts" and promoted as a discouragement to work.

EFFECT ON AGGREGATE DEMAND

The aggregate demand is often the sum of consumption, investment, government spending, and net import. Most often with big government spending, aggregate demand increases at least in the short run. As the government tries to stimulate the economy out of recession, the infrastructure bill will provide the needful jobs to people who in turn will raise their level of effective demand. The stimulus checks have done a lot to keep the economy alive and raise consumer spending, however, to get to pre-COVID economy capacity and output, sustained stimulation might be recommended for the meantime.

But does increased government spending automatically lead to increased consumption? Not necessarily! Consumers have different consumption behaviors based on their adopted consumption theory. The absolute income hypothesis believes that consumption is a function of current income. Hence, when consumers see a raise in their current income, they consume more. Though the percentage increase in consumption may not be the same as the percentage increase in income as the marginal propensity to consume often decreases with increase in income in the short run. However, the absolute value of consumption often sees an increase in practice. Those who adopt the relative income hypothesis will be happy to see their income finally increase and reach the original/pre-Covid level as they have been protecting their income level and raising their percentage of consumption relative to their income. For this people, their level of consumption often remains the same except when their associated groups raise consumption. Then, they will be forced to do likewise. For people who believe in the permanent income hypothesis, consumption is based on permanent income, not transitory income. These people will see stimulus checks as transitory hence will not increase consumption. However, new jobs or contracts may increase their consumption level as those are perceived more as permanent income.

With increased aggregate demand in the short run (as seen in accumulated stock depletion) and increased possibilities for more sales, firms can raise investments. Most investors and businesspeople will perceive an improving economy outlook and therefore create more positive business expectations. Hence, they release more capital into the economy, employ more workers, buy and upgrade facilities and equipment, and expand. Keynesians argue that business expectation is of absolute importance in determining investments. And with the already low interest rate, Classists/Neo-classists would believe that investments are going to be triggered.

Monetarists would argue that government spending on the other hand could crowd out funding for private firms and investors. As the infrastructure bill stimulates the economy, the demand for money increases which causes interest rate to increase. The interest rate then could become too high- higher than what private investors can afford. If this happens, the bill could end up reducing or not changing aggregate demand as interest rate are too high to raise investment to the desired level. In the best case, the bill would only raise aggregate demand in the short run before interest rate hikes.

However, if firms perceive an increased rate of return on investment and a reduced cost of investment, investment will surely multiply in the economy. This, of course, could raise the employment rate and further raise aggregate demand. This will continue in the short run. In the long run, with excessive demand might come a higher price level which will make aggregate demand fall as workers will no longer be able to afford the higher price level.

EFFECT ON INFLATION

It is reasonable to ask that at what point would inflation become a problem with these expansionary fiscal measures. Economists often recognize two types of inflation: demand-pull and cost-push inflation. Demand-pull inflation is caused by demand rising above supply capacity leading to firms raising price level to regulate the demand. Cost-push inflation is caused by increase in the input costs which forces firms to raise their price level. With this infrastructure bill, many economists would argue that inflation becomes a concern when the fiscal space is filled- that is when the recessionary gap has been reversed and the economy is back at the natural rate of unemployment. At the natural rate of unemployment, the economy is believed to be at full capacity hence additional expansionary measures will overheat the economy and cause inflation. The bone of contention however has always been about how to measure the fiscal space. Many disagree on how to measure the fiscal space and when to be sure it is filled. These disagreements would never help in deciding when to stop expansionary measures or how much expansionary measures are required.

Modern monetary theorists would in fact argue that inflation will almost not be a problem as the US has had a relatively stable inflation rate over the years and much of recent inflations in the US are not demand-pull inflation. Therefore, they believe that we need not worry about excessive aggregate demand. Monetarists have often called attention to the lagged effect of expansionary measures and how sustained government spending could eventually lead to inflation and undo economic growth when the delayed effect kicks in.

With the charged political economy around the infrastructure bill and lots of discussions about inflation, many Americans would expect inflation. Expecting inflation can be as bad as experiencing inflation. Anticipating inflation would cause people to bring forward purchases, negotiate higher pay and reduce savings. These will lead to the feared inflation as they would raise demand, raise input costs, or reduce money saved thereby raising interest rate. This may therefore reduce economic growth and have a reverse effect than expected on the economy. Therefore, anchoring inflationary expectations should be taken as seriously as the infrastructure bill.

EFFECT ON AGGREGATE SUPPLY

Aggregate supply is the level of goods and services produced in an economy at a particular price level. COVID-19 affected the aggregate supply through the reduction in aggregate demand, a negative shock to input supply chain, and poor business outlook. With the government expansionary fiscal measures and quantitative easing aimed at stimulating aggregate demand, aggregate supply will move in tandem. Available labor and technology will be put to good use to meet the rising demand. However, there are no substitute for a healthy workforce, hence, getting people vaccinated will be the ultimate facilitator of aggregate supply.

As discussed above, if price level happens to increase unforeseen to workers, aggregate supply will rise. In the short run, workers will not be able to renegotiate salaries as quickly as possible. So, firms take advantage of the situation for more profit. In fact, more workers can be employed at the prevailing wage to increase return on investment and in the meantime reduce unemployment. In the long run, workers can renegotiate salaries to restore their real wages. Hence, the profit potential is reduced, and aggregate supply remains unchanged in the long run.

However, until the economy returns to its full capacity at the natural rate of unemployment, aggregate supply will keep increasing with increase in demand and the economy therefore keeps growing.

CONCLUSION

The infrastructure bill when fully passed into law will reduce the percentage of unemployment, however, it might be too early to decide if the unemployment rate will get back to the natural rate of unemployment. Also, the sustained government spending built into the bill will create aggregate demand for a long time. It is noteworthy to state that the eventual increase in aggregate demand depends heavily on consumers' adopted consumption theory. However, there are still reasons to be hopeful that increased government spending may translate into increased household consumption. Moreover, until the economy gets to full capacity, it is believed that aggregate supply will increase with aggregate demand. It is however needful to anchor inflation expectations to cut inflationary trends due to Americans expecting inflations from increased government spending.

REFERENCES

[1] Thorbecke W. The Impact of the COVID-19 Pandemic on the U.S. Economy: Evidence from the Stock Market. JRFM. 2020;13: 233. doi:10.3390/jrfm13100233

[2] Chetty R, Friedman J, Hendren N, Stepner M, Team TOI. The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data. Cambridge, MA: National Bureau of Economic Research; 2020 Jun. doi:10.3386/w27431

[3] Goolsbee A, Syverson C. Fear, lockdown, and diversion: comparing drivers of pandemic economic decline 2020. Cambridge, MA: National Bureau of Economic Research; 2020 Jun. doi:10.3386/w27432

[4] Eichenbaum M, Rebelo S, Trabandt M. The macroeconomics of testing and quarantining. Cambridge, MA: National Bureau of Economic Research; 2020 May. doi:10.3386/w27104

[5] Fraser S, Gerstle G, editors. The Rise and Fall of the New Deal Order, 1930-1980. Princeton University Press; 2020. doi: 10.2307/j.ctv131bvcc

[6] Eggertsson GB. Was the new deal contractionary? American Economic Review. 2012;102: 524–555. doi:10.1257/aer.102.1.524

[7] Skocpol T, Finegold K. State capacity and economic intervention in the early new deal. Polit Sci Q. 1982;97: 255. doi:10.2307/2149478

[8] Couch JF, William F. Shughart II. The Political Economy of the New Deal (The Locke Institute series). Cheltenham, UK: Edward Elgar Pub; 1998. p. 264.

[9] White GE. The Constitution and the New Deal. 1st ed. Harvard University Press; 2002. p. 400.

[10] Pramuk J. House Democrats clear path toward passing $3.5 trillion budget bill and infrastructure plan after breaking stalemate. In: CNBC [Internet]. 24 Aug 2021 [cited 23 Aug 2021]. Available: https://www.cnbc.com/2021/08/24/house-passes-budget-resolution-advances-infrastructure-bill.html

[11] Page S, Brown M, Quarshie M. Exclusive: As Congress debates, most Americans back Biden's trillion-dollar spending bills. In: USA Today [Internet]. 25 Aug 2021 [cited 27 Aug 2021]. Available: https://www.usatoday.com/story/news/politics/2021/08/25/most-back-bidens-infrastructure-bill-and-budget-plan-poll/5577143001/

[12] The White House. FACT SHEET: Historic Bipartisan Infrastructure Deal. In: The White House [Internet]. 26 Jul 2021 [cited 28 Aug 2021]. Available: https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/28/fact-sheet-historic-bipartisan-infrastructure-deal/

[13] Conde A. Inside Biden's $4.5 Trillion Infrastructure Plan. In: Smart Asset [Internet]. 26 Aug 2021 [cited 28 Aug 2021]. Available: https://smartasset.com/financial-advisor/biden-infrastructure-plan

[14] Cochrane E. Senate Passes $1 Trillion Infrastructure Bill, Handing Biden a Bipartisan Win. In: The New York Times [Internet]. 10 Aug 2021 [cited 28 Aug 2021]. Available:https://www.nytimes.com/2021/08/10/us/politics/infrastructure-bill-passes.html