

THE REAL ECONOMY

VOLUME 77

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ABOUT THE **AUTHORS**

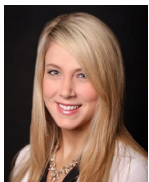
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UNDERSTANDING A \$2 TRILLION INFRASTRUCTURE PROJECT

BY JOSEPH BRUSUELAS

THE LATEST [report card](#) on the nation's infrastructure from the American Society of Civil Engineers confirms what just about everyone already knows: It's old; it's broken, and it doesn't work anymore.

To address this gap, the Biden administration [has proposed spending roughly \\$2 trillion](#) over the next decade. Among the initiatives are \$621 billion for roads, bridges and highways; \$480 billion to facilitate manufacturing growth and research, and \$213 billion for housing infrastructure. The rest would go to projects, including productivity-enhancing investment in technological infrastructure and resilient environmental infrastructure, as well as expanding access to home care.

It was of little surprise that ASCE communicated the need for a multitrillion-dollar, decadelong effort to align America's national infrastructure with its economic and social needs. In 2019, the United States spent only 2.5% of gross domestic product on infrastructure, down from 4.2% in the 1930s. This implies a shortfall of close to \$3.7 trillion over the next decade.

The economics of such a project are straightforward. A project that modernizes the national infrastructure means increased jobs, productivity and growth, all of which will result in a meaningful increase in the living standards for Americans.

In our estimation, a \$2 trillion infrastructure project would result in an additional \$6.1 trillion in economic activity over the next decade, result in an improvement in gross domestic product of 0.4% per year and add 3.2 million jobs to total employment over 10 years.

In addition, with the term structure of interest rates likely to be negative over the next year or two, now is the time to act boldly and with intent.

Understanding what such an ambitious infrastructure project entails is almost as challenging as figuring out how to pay for it. Since nothing of this scale has been attempted since the Eisenhower administration of the 1950s, such a project may require explanation.

MIDDLE MARKET INSIGHT

A project that modernizes the national infrastructure means increased jobs, productivity and growth, all of which will result in a meaningful increase in the living standards for Americans.

From our vantage point, a modern-day effort to improve America's infrastructure will create the conditions for an acceleration and transformation toward the digital future of the American economy.

The foundation of that effort will likely revolve around the concept of what might be called I²R. We would define I²R in three parts.

First component: Big I

The first part would be what we refer to as "Big I," or the repair, rehabilitation or construction of traditional infrastructure projects like roads, bridges, ports, waterways, water delivery, sewers, rail, public transit, public aviation and public sector ventilation systems at schools.

These are the big, time-consuming and expensive projects that underscore everyday life. The federal government has done these before, financing and building the national highway system, the transcontinental railroad, Hoover Dam and the Erie Canal. These are the public projects that the private sector neither has the financial depth to finance or build on its own.

Second component: Little i

The second part is what we would refer to as "Little i," or the critical infrastructure of the digital economy. This includes 5G, broadband, electric charging stations, public health and other infrastructure to support the use of data analytics, internet of things, artificial intelligence and machine learning to push the outer boundaries of productivity that can lift living standards.

This will require innovative public-private partnerships to extend broadband and 5G connectivity to every corner of the U.S. economy. The need for this and its importance in the new economy became particularly apparent during the pandemic when so many people could not go to school or work because of lack of broadband.

Third component: R

The third component of any infrastructure program will revolve around "R," or making critical infrastructure resilient. Such things as power and electrical grids

need to be brought up to code to withstand current and future shocks associated with climate change, and to ensure that geostrategic competition and conflict do not result in a widespread power, financial or communications disruptions.

The recent near-catastrophic collapse of the Texas energy grid because of a significant winter storm or the SolarWinds cyberattack that compromised private and public sector assets both should serve as a clarion call that the status quo is not sustainable. These needs demand to be addressed before the cost of doing so becomes prohibitive.

How to pay for this?

The first and most understandable question is how to pay for this. We think that the optimal path would be to provide seed capital for a national infrastructure bank and then use the broad and deep American capital markets to leverage that up to meet those needs.

Under this approach, Congress would provide \$400 billion in seed capital next year, which the national infrastructure bank would then leverage up over the next 10 years to modernize I²R so it aligns with where the economy is heading and could achieve \$4 trillion in net infrastructure investment.

The national infrastructure bank could then take proceeds from the issuance of bonds to reinvest back into the development and innovation around future projects.

This would be a legacy project that solves the issue of infrastructure once and for all. But the likelihood of such a bank being created is low.

What is more likely to happen is a mix of tax increases. Among the proposals is an increase in the corporate tax rate from 21% to 28%, but [negotiations have only just begun](#).

In addition, the Biden administration campaigned on a promise not to raise taxes on anyone earning less than \$400,000.

Whatever the case, it is critical that policymakers take advantage of the negative real rate environment. Following the shock of the pandemic, the Federal Reserve implemented a series of policies that have resulted in extremely low interest rates.

This presents the opportunity for long-term investment at negative inflation-adjusted interest rates. That is, the cost of newly issued debt will be paid in deflated dollars, resulting in investments that actually pay for themselves.

Is this politically doable?

Just as difficult as financing the project will be garnering political support in a U.S. Senate that is controlled by Democrats under a 50–50 split. Joe Manchin, Democrat of West Virginia, is thought to be a swing vote, and has indicated support for increasing the corporate tax rate to 25%.

Moreover, without any significant Republican Party support, Democrats will need to use budget reconciliation to move this legislation, which suggests that they will have to raise substantial revenue to

meet the requirements under the Byrd rule that governs reconciliation.

This implies that if revenues are raised to meet the requirements under reconciliation, then it would result in a drag on overall economic growth in 2022 and 2023. ■

MIDDLE MARKET INSIGHT

It is critical that policymakers take advantage of the negative real interest rate environment to finance a sorely needed upgrade to the nation's infrastructure.

INFRASTRUCTURE NEEDS AND BIDEN ADMINISTRATION POLICY RESPONSES

INFRASTRUCTURE NEEDS

Selected issues and costs identified by American Society of Civil Engineers

Bridges

- 617,000 U.S. bridges are at least 50 years old
- 46,1454 or 7.5% are considered structurally deficient
- 178 million trips across those bridges annually
- \$125 billion backlog in bridge repairs

Roads

- 40% of U.S. roads in poor condition
- Backlog of repairs forces consumer to pay \$1,000 in wasted time and fuel
- \$783 billion backlog in road and bridges capital
- \$120 billion for expansion
- \$105 billion for enhancement

Aviation

- 1.2 billion passengers per year (pre-pandemic)
- 10.2 million flights
- 96 million minutes of delay
- \$111 billion shortfall

Drinking water

- Water main break every two minutes in the U.S
- 6 billion gallons of treated water lost everyday
- 12,000 miles of pipes needed to be replaced in 2020
- 2.2 million miles of underground pipes that deliver safe drinking water

Broadband

- 65% of U.S. counties have below-average connection speeds
- 1 in 5 school-aged children lack high speed connection
- 4G streams at speeds between 12 and 36 mbps; full length feature film takes six minutes to download. 5G streams at speeds of 300 mbps or greater; a feature length film can be downloaded in 15 seconds

Schools

- 84,000 public schools
- 41% reported HVAC problems
- 4 in 10 schools have no long-term facility plan
- \$38 billion funding gap for public schools

Source: American Society of Civil Engineers, <https://infrastructurereportcard.org/>

POLICY RESPONSES

Biden infrastructure proposals (US\$ billions)

Rebuild transportation infrastructure	
Repair bridges, highways, roads	115
Modernize public transit	190
Invest in passenger and freight rail service	80
Invest in electric vehicles	174
Redress historical inequities and invest in future of transportation	45
Improve seaports, waterways and airports	42
Subtotal	621

Provide clean water, rebuild electric grid and provide broadband service	
Provide clean water	
Replace lead pipes	45
Modernize water systems	56
Revitalize digital infrastructure	100
100% broadband coverage	--
Promote price transparency and competition, reduce cost	--
Reduce costs	--
Reenergize power infrastructure	31
Subtotal	232

Build and modernize homes, buildings, schools and hospitals	
Schools and child care	
Public schools	100
Community colleges	12
Child care facilities	25
VA hospitals and federal buildings	
VA hospitals	18
Federal buildings	10
Affordable housing	67
Subtotal	232

Health care	
Care economy	
Long-term care under Medicaid	400

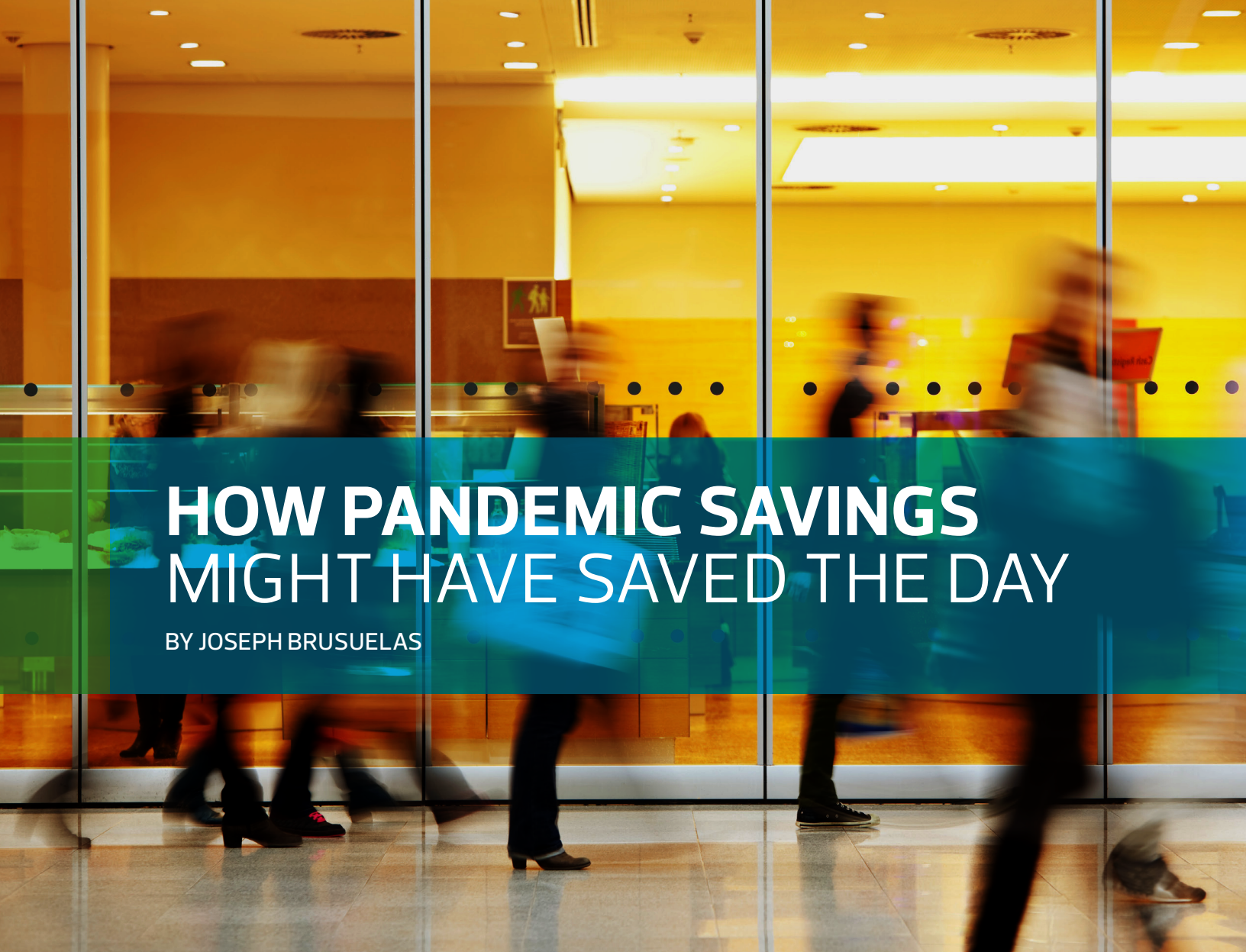
Invest in research and development, retool and revitalize manufacturing and small businesses, and training for the future	
Invest in research and development	
NSF grants for next-generation technologies	50
Research and development for jobs creation	30
Research facilities upgrades	40
Subtotal	120

Climate science research and development	
Climate science, innovation and research and development	35
Climate science	5
Energy demonstration projects	15
Subtotal	55

Retool manufacturing and small businesses	
Supply chain for critical goods	50
Semiconductor manufacturing and research and development	50
Pandemic prevention	30
Regional innovation hubs	20
NIST competitiveness	14
Capital for domestic manufacturers	52
Network of SB incubators and innovation hubs	31
Rural/tribal job creation	5
Subtotal	252

Workforce development for dislocated, underserved and existing workforce	
Training for dislocated workers	40
Training for underserved communities	12
Training for existing workforce	48
Subtotal	100

Source: Biden Administration, "The American Jobs Plan", March 31, 2021



HOW PANDEMIC SAVINGS MIGHT HAVE SAVED THE DAY

BY JOSEPH BRUSUELAS

AN AVALANCHE of spending is waiting to be unleashed by the American household. Add that to the expected investments by the corporate sector to improve productivity, and the result is a robust consensus forecast of 6.4% growth in gross domestic product—RSM predicts 7.5%—for this year. And that number will most likely be upgraded following [the blowout March retail sales data](#), as well as the robust personal income, spending and savings data to close out the first quarter.

The strong recovery will depend on the efficacy and distribution of the vaccines, as evidenced by the coronavirus outbreaks afflicting numerous states. But we are confident that the year will end with the unemployment rate as low as 4.1% and the economy growing by 7.5% on a yearly basis, which is enough to support 10-year Treasury yields at 1.9%.

People have had enough of this pandemic, and are eager to have a beer and pizza at their favorite joint or go to an NBA playoff game. The pictures of London's pubs—finally open again after the U.K. beat back the virus' resurgence—provide a more compelling narrative than the economic data perhaps ever can.

Yet with millions of people still out of work and living on limited incomes, where will the spending money come from? That simple question deserves a nuanced answer. The policy mix pursued by the fiscal and monetary authorities early in the recovery may seem to some like pushing on a string and risking inflation.

We do not agree. The mix of savings, pent-up demand for services and what we think will be an increase in productivity-enhancing investments by businesses will provide just the opposite. We see a multiyear period of above-trend growth, with two dynamics in play:

First, the trade war and the pandemic have afflicted different parts of the economy at different times. The manufacturing sector—which was in recession before the pandemic pushed the whole economy over the edge—appears to be growing once again. Employment in the goods-producing sector has already reached 95% of pre-pandemic levels.

And employment and spending among the white-collar set—those who were able to work at home—proved to be resilient with the maturation of online shopping, which has supported a segment of the service sector. Our colleagues at tracktherecovery.org think that households with more than \$60,000 in income transitioned into recovery, and we agree.

Second, the shock from the pandemic has led to a much stronger fiscal and monetary response than if the downturn had been limited to manufacturing. Income streams for low-income households have been supported and will continue to improve as expanded child care benefits begin in July. Low-income households tend to spend all of their income, and the multiplier effect of income support for those households is greater than for upper-income households. This is not only a function of accommodative monetary policy, but is also a result of nearly \$6 trillion in fiscal aid, or roughly 26% of GDP, to address the pandemic.

So we would argue that increased spending this year will come from a labor force that will be getting back to work, from government benefits that will continue to support lower-income households, and from the use of the \$1.6 trillion in excess household savings compared to the pre-pandemic average of \$700 billion.

Because savings can be a drag on the economy, we'll discuss the origins of the huge increase in household balance sheets and how that might form the basis of a sustained recovery.

Savings, income and spending

Let's start with the outsized increase in personal savings last year that, no matter how you slice it, took more than \$5 trillion off the table at the depths of the pandemic. Twelve months later, savings remain 73% higher than pre-pandemic norms.

That increase in savings is substantially lower than the 400% increase that developed in April 2020, when no one really knew if the pandemic could be contained. But note that for the next 12 months, those year-over-year comparisons will be distorted by base-year effects.

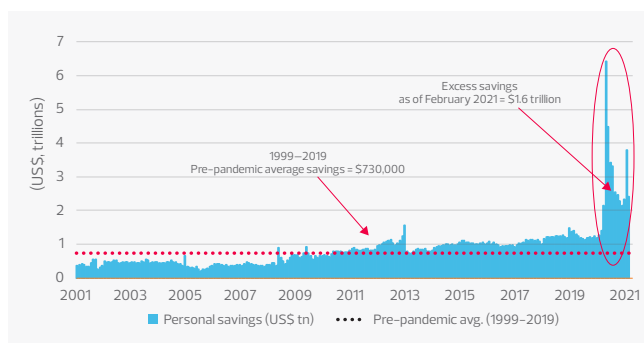
MIDDLE MARKET INSIGHT

The mix of savings, pent-up demand and an increase in productivity-enhancing investments by businesses will result in a multiyear period of above-trend growth.

Savings is what's left after a household spends its income. So perhaps the best way to judge household behavior is to look at personal savings as a percentage of disposable income. During nonrecession months before the pandemic, U.S. households saved about 6.2% of their

U.S. personal savings

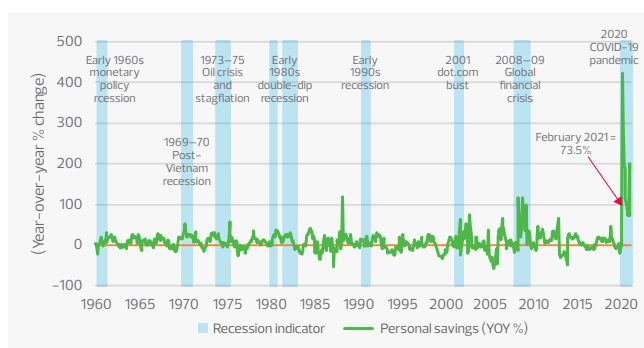
AND PRE-PANDEMIC AVERAGE SAVINGS IN TRILLIONS OF CURRENT DOLLARS



Source: BEA; Bloomberg; RSM US LLP

Growth rate of U.S. personal savings

YEAR-OVER-YEAR % CHANGES OF SAVINGS IN CURRENT DOLLARS



Source: BEA; Bloomberg; RSM US LLP

disposable income. By April 2020, households were saving 34% of their disposable income. The savings rate has receded to 13.6% as of February, but that's still twice as much as its 1970-2019 average.

The normalization of savings is important for sustainable growth. A lack of spending and the combination of an aging demographic and reduced immigration would make the United States heir to Japan's lost decade. Yet that is

exactly why the fiscal and monetary authorities pursued such unorthodox policies to address the economic shock of the pandemic.

Because of the variation of savings rates among nations, we could say that savings are part cultural. But in our economy, we've found that savings is dependent on each household's life cycle and circumstances. We tend to spend more as we're starting out and then save more as we mature.

There are also social pressures and business-cycle factors such as perceptions of employment security that determine individual savings rates. And there is the effect of income on savings—the more income you have, the more there can be saved above day-to-day expenses.

As such, savings as a percent of disposable income declined from 1975 to 2008, which is perhaps emblematic of the era of consumerism. Savings reached its low point during the housing bubble and then began to rise again after the shock of the 2008 financial crisis and recession.

Before the pandemic, savings as a percent of disposable income was just above its long-term average, perhaps emblematic of low wage growth and diminished employment choices.

To complete the determination of savings rates, personal income in inflation-adjusted terms had been in general decline from 2012 to 2020 as higher-paying manufacturing jobs were replaced by lower-paying service-sector employment.

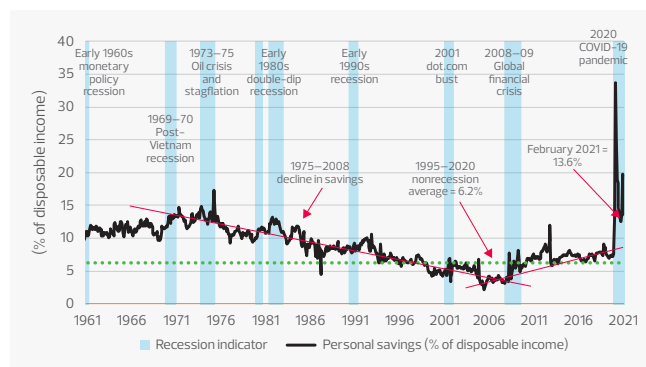
The growth rate of real personal income turned negative during the pandemic and remains about 2.5% lower as of February than before the pandemic. We would argue that diminished expectations for higher rates of income would lead to increasing rates of precautionary savings evident after the Great Recession.

Personal consumption has been in gradual decline since the go-go 1960s and 1970s, dropping lower after each major downturn and as the population has aged. Household spending remains 2.1% lower in February relative to February 2020, though much closer to normal than during the depths of the pandemic. This is a promising sign.

MIDDLE MARKET INSIGHT

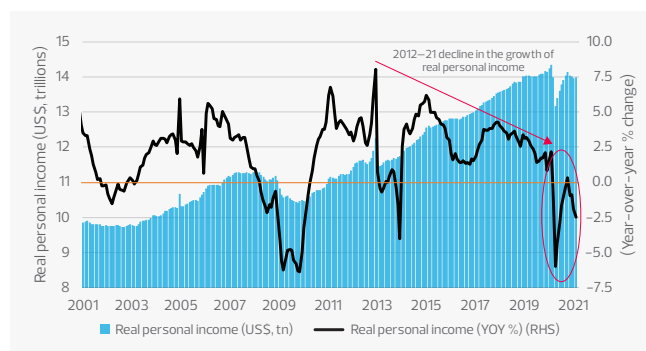
Once the economy reopens, demand for services will return with a vengeance and a look back at the monetary and fiscal policies of the pandemic will show that they paid off.

U.S. personal savings as a percent of disposable income and recession episodes



Source: BEA; Bloomberg; RSM US LLP

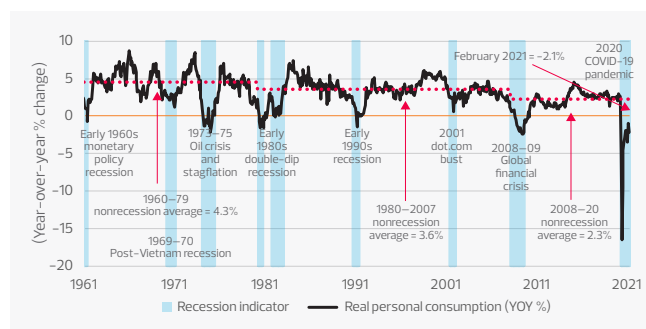
U.S. real personal income level and growth in 2012 dollars and year-over-year percent changes



Source: BEA; Bloomberg; RSM US LLP

U.S. real personal consumption

YEAR-OVER-YEAR % CHANGES IN EXPENDITURES IN 2012 DOLLARS



Source: FRED; BEA; NBER; RSM US LLP



Pandemic policy changes and the growth of savings deposits

The combination of the Federal Reserve's asset purchase program and the government's pandemic relief efforts has flooded the economy with liquidity. In fact, the amount of cash and easily accessible money (the M2 money supply) has grown at unprecedented rates during the pandemic. As of February, M2 was 27% higher than a year before, a growth rate that several years ago would have financial commentators debating how high inflation would rise.

The second figure below helps to explain why it was necessary to flood the market with liquidity and why the increase in money supply might not be a threat to inflation stability. While the monetary and fiscal authorities were busy injecting cash into household balance sheets, consumers and businesses were hoarding much of that cash in savings deposits. (And if there's low demand, there can't be high inflation no matter how much cash there might be.)

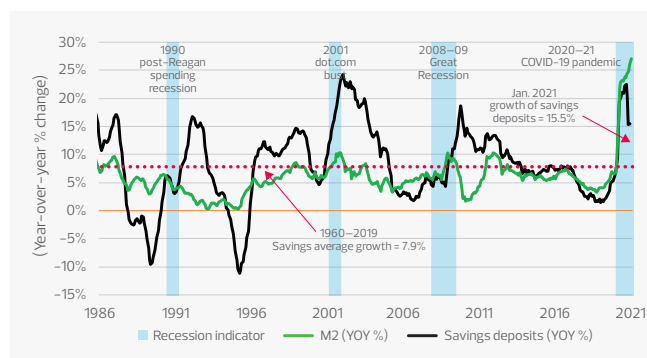
We attribute the increase in deposits to precautionary savings. Instead of going out to shop, consumers were huddled in their homes, hoping for the best but expecting the worst. And with millions of households limited to living off unemployment benefits while others were constrained by income uncertainty and limited opportunities to spend, consumption plunged. At the same time, small businesses held back on spending, more interested in how to pay the rent or meet payrolls and less willing to risk capital on investments.

So to an extent, the best efforts of the monetary and the fiscal authorities might appear to be pushing on a string. But as one takes a look at the accumulation in pent-up demand in addition to savings, once the economy reopens, demand for services will return with a vengeance and a looking back at those policies will seem nothing like pushing on a string.

With the commercial sector's willingness to invest limited during the pandemic and the consumer sector less willing to spend, the growth of savings deposits rose as high as 22.5% on a year-over-year basis, far above its pre-pandemic average growth rate of 7.9%. Though the growth of savings deposits has decelerated to a 15.5% rate—which is progress—that's still twice what might be expected within a normal economy.

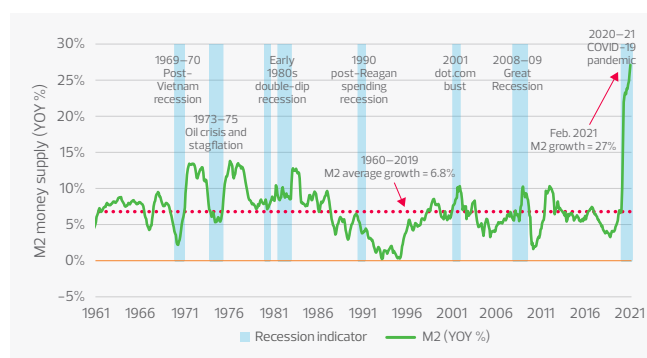
U.S. savings deposits and M2 money supply

YEAR-OVER-YEAR % CHANGES



Source: Federal Reserve; NBER; RSM US LLP

Secular stagnation/moderation in growth and inflation



Source: Federal Reserve; NBER; RSM US LLP

THE END RESULT OF ABNORMAL CONSUMER BEHAVIOR AND THE
PROMPT POLICY RESPONSE TO A SEVERE DEMAND SHOCK CAUSED
BY THE PANDEMIC IS EXCESS SAVINGS.

How excessive are savings?

The end result of abnormal consumer behavior and the prompt policy response to a severe demand shock caused by the pandemic is excess savings. A recent [Federal Reserve Bank of New York analysis](#) compares the \$1.6 trillion estimate of excess savings to the \$130 trillion in net worth of U.S. households. The analysis neatly breaks down the increase in savings and its impact on future spending as follows, along with our commentary.

Excess savings are the accounting counterpart of extra government debt. Benefits paid to households are not all spent, but are retained. We are borrowing from ourselves, and household accumulation of savings can be viewed as a cushion to repay ourselves (through higher taxes) in the future.

Excess savings are mostly held by ... savers. Though we have no way of knowing for sure what households did with government benefits during the pandemic, we can assume that lower-income households used all of their money to keep food on the table, better-off households used some of the money to pay down debt, and affluent households retained some portion of the money as precautionary savings. As a result, the Federal Reserve Bank of New York's analysis suggested that "fewer households should face financial hardship as aggregate conditions improve."

The analysis added that some of the excess savings can be attributed to a lack of opportunity to spend during the pandemic, which we argue would add at least something to the potential for increased spending financed by a drawdown of those savings.

This, however, leads to the unequal nature of the pandemic and the authors' third point regarding the pandemic's particular impact on the service sector.

Excess savings are unlikely to unleash pent-up demand for services. Note first that the authors said, "This conclusion does not rule out a strong economic recovery from the virus shock. It only implies that spending out of excess savings won't be one of its major drivers."

The authors contended that the propensity for spending has not changed dramatically over the course of the pandemic, and that consumer spending of benefits during the recession last year was much the same as during the 2008 financial crisis-induced Great Recession.

Final thoughts

The service sector will have suffered unrecoverable losses of income and employment disruptions that are likely to continue after the pandemic subsidies. Yes, we will begin going to our favorite restaurant for a meal, but that won't fully compensate waiters for lost tips over the past year. And your one visit to your hair stylist cannot make up for the 12 months of foregone or makeshift haircuts.

We would also add that although the advent of online shopping has allowed households to maintain spending levels, it's just not going to the same businesses. The damage to small businesses is substantial, and it could take a while for small businesses' investments to catch up with the public's desire to shop at a neighborhood store.

As the authors write, "The end of the pandemic in itself is unlikely to turn them from savers to immediate spenders."

Yes, precautionary savings is likely to continue for a while, but that does not diminish the likelihood of a burst of spending, especially when vaccination coverage nears completion.

We would agree that the burst of spending might not come solely from the excess savings. Rather, we expect households to hold on to some of their savings until deeper into the recovery when employment is more secure and wages begin to rise on a sustained basis. The burst of spending will arise from an all-of-the-above combination of increased employment opportunities and government benefits, backed with the added security of accumulated savings.

In our assessment, the absence of financial hardship—afforded by government benefits—and the restoration of confidence in the government's ability to respond to hardship will allow for a quicker recovery than prior shocks to the economy. ■

FIRST-QUARTER GDP: GROWTH IMPROVES AS THE RECOVERY ACCELERATES

BY JOSEPH BRUSUELAS

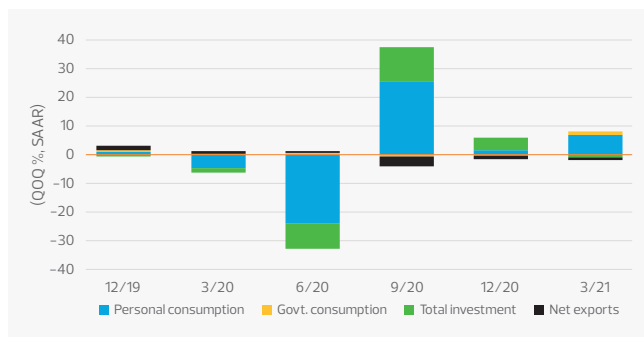
AN IMPROVED public health outlook linked to mass vaccinations and a flood of fiscal aid coursing through the American economy boosted gross domestic product by 6.4% during the first three months of the year.

The composition of growth was rock solid to kick off the year as American households increased spending by 10.7%, setting the stage for the return of economic activity to pre-pandemic levels in the current quarter—an extraordinary policy achievement.

Net exports and gross private domestic investment each subtracted 0.87 percentage points from growth as changing inventories dragged down the top-line number by 2.64 percentage points. It is clear that as the recovery improves, firms release pent-up demand for investment and inventory accumulation rises, there is room for the economy to accelerate into the second quarter.

The primary policy takeaway from this report is to stay the course. It is essential that the fiscal and monetary authorities follow through on current policy paths for the economy to return to full employment, which we expect in the second half of next year.

Contributions to GDP growth by sector
GDP NATIONAL ACCOUNTS Q4 2019 THROUGH Q1 2021



Source: BEA; Bloomberg; RSM US LLP

Until then, providing vaccinations, fully reopening the economy this summer, opening schools this fall and finding consensus in Washington on the modernization of an aging American infrastructure all support what we think will be the strongest rate of growth since the 1980s.

The household-led spending increase was fueled by a range of gains—23.6% in demand for goods, 41.4% in advance outlays on durables, 14.4% on nondurables and 4.6% in service spending.

THE COMPOSITION OF GROWTH WAS ROCK SOLID TO KICK OFF THE YEAR AS AMERICAN HOUSEHOLDS INCREASED SPENDING BY 10.7%.

Given that the economy is not yet completely open, one can look at demand for services and get the sense that the increase in government cash transfers to households will stoke further acceleration in the services-dominant American economy during the middle of the year, which underscores our 10.7% forecast for the second quarter growth.

The alternative proxies for domestic growth look even stronger than the top-line number and imply that GDP in the current quarter should look even more robust. Real final sales advanced at a 9.2% clip, gross domestic purchases increased 7.1%, final sales to domestic purchasers jumped 9.8%, and final sales to domestic private purchasers increased 10.6%. Given the increase of 61.3% in disposable personal income, investors and firm managers should anticipate a sustained consumer-led boom through 2022.

The quality of the data inside the report was quite strong. Fixed business investment increased by 10.1%, nonresidential investment jumped by 9.9% and residential investment increased by 10.8%. Productivity-enhancing investment in equipment increased by 16.7% and intellectual property by 10.1%. Government consumption increased by 6.3% on the back of a 13.95% increase in federal consumption and contributed 1.12 percentage points to overall growth.

The only real blemish in the report was the 4.8% decline in structures that underscored the 5% decline in overall gross private investment during the quarter.

As expected, net exports were a drag on growth, with imports subtracting 0.77 percentage points from growth and exports 0.1 percentage points from the top line. ■

CYBERATTACKS POSE A GROWING THREAT TO MIDDLE MARKET BUSINESSES

Hackers and other electronic criminals have continued their relentless pursuit of sensitive information from middle market businesses, leading to record levels of cyberattacks. Executives in the RSM US Middle Market Business Index survey said that cybersecurity risks are mounting and that the middle market continues to represent a sweet spot for hackers.

Read more about this growing threat to the middle market in the [RSM US 2021 Cybersecurity Special Report](#).





THE ALTERNATIVE

ALTERNATIVE ANALYSIS FOR INFORMED MIDDLE MARKET DECISION-MAKING

CLEAN ENERGY INFRASTRUCTURE IS A KEY PART OF BIDEN'S JOBS PLAN

BY ANNE SLATTERY

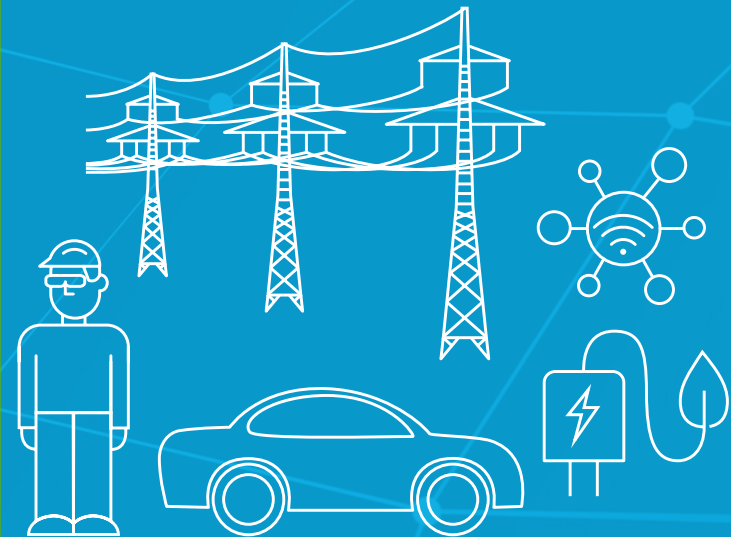
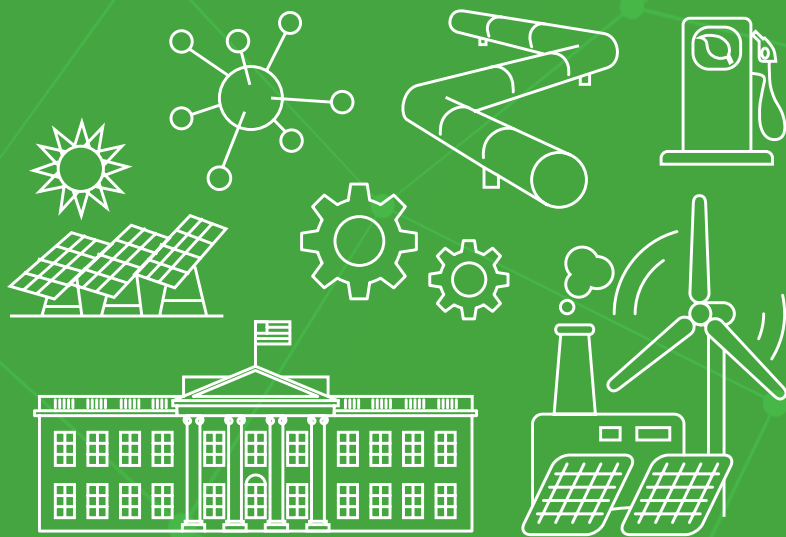
CLEAN ENERGY and climate change are central figures in the Biden administration's \$2 trillion American Jobs Plan infrastructure bill. As such, companies in the energy industry and related sectors need to pay close attention to what the bill could potentially mean for them.

If signed into law as is, the plan would be a significant step forward in the administration's efforts toward net-zero emissions by 2050. But that is a very big "if," as talks between President Biden and lawmakers have [only just started](#).

The bill addresses everything from roads and bridges to waterways and internet access to senior care and effects of climate change. In the energy sector alone, the plan would have important implications for tax incentives, the shift toward renewables, carbon capture efforts, the electric vehicle market and more.

Specifically, according to a [White House fact sheet](#) that lays out some of the details, the plan includes proposals for:

- **Establishing an energy efficiency and clean energy standard.** This new national standard would aim to reduce electricity bills and electricity pollution and better use the carbon pollution-free energy provided by sources such as nuclear and hydropower, with the end goal of moving toward 100% carbon pollution-free power by 2035.
- **A 10-year extension of tax incentives for clean energy generation and storage** (such as wind and solar power). There are several differentiators of this proposal to note, according to Bloomberg. In Biden's version, the incentives would be extended to stand-alone energy projects, which were previously excluded. Additionally, Biden's proposal includes a "direct-pay" provision that would "entitle qualifying projects to the maximum value of their credit, even if that value extends the amount of the income tax owed," according to Bloomberg. The direct-pay option is particularly attractive for developers, as tax equity financing is less available. Finally, if put into law, the 10-year length of the extension would be longer than any previous extension.



- **\$100 billion investment in the nation's electricity grid.** The backbone of this is a proposed creation of an investment tax credit to "incentivize the build-out of at least 20GW (gigawatts) of high-voltage capacity power lines." This investment is meant to push toward Biden's goal of carbon-free electricity generation by 2035.
- **"Ten pioneer facilities that demonstrate carbon capture retrofits** for large steel, cement and chemical production facilities, all while ensuring that overburdened communities are protected from increases in cumulative pollution." The plan would also change what is currently a tax credit for carbon dioxide sequestration into a direct payment, making it even more beneficial for those investing in carbon capture technologies.
- **Congress to invest \$35 billion in advanced technologies** that will position the United States as the "global leader in clean energy technology and clean energy jobs." The investment will include funding for priority projects such as utility-scale energy storage, carbon capture and storage, hydrogen, advanced nuclear, floating offshore wind, bio products and electric vehicles.
- **\$174 billion to get ahead of other nations in the electric vehicle (EV) market.** This plan includes incentives for both automakers and consumers. The plan would empower automakers to "spur domestic supply chains from raw materials to parts, retool factories to compete globally, and support American workers to make batteries and EVs." For consumers, incentives would come in the form of sales rebates and tax incentives to buy American-made EVs.

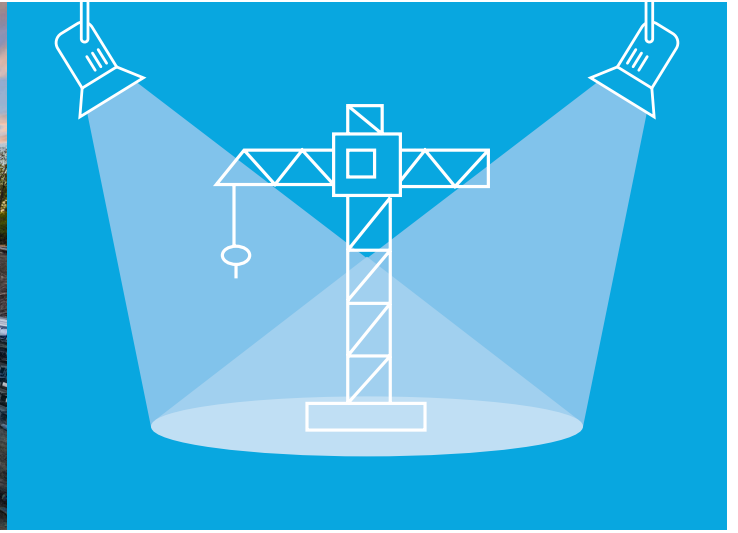
Again, it is important to note that [Congress has yet to vote on the legislation](#) and that negotiations have only just begun. But the variety of proposed changes would present both challenges and opportunities for energy

companies across the value chain. Here are some key areas of consideration for energy companies as discussions around the American Jobs Plan continue:

Tax implications: The bill, set to be funded in part by raising the corporate tax rate from 21% to 28%, also proposes the elimination of tax subsidies for fossil fuel companies. Although the plan does not specify the exact tax subsidies it will target, cutting deductions such as the one for intangible drilling costs, which allows operators to deduct the majority of costs associated with drilling a well, could significantly affect exploration and production companies. Oil and gas companies should evaluate their current tax structure and the potential effect the elimination of fossil fuel subsidies may have on their bottom line as early planning is key to mitigating unexpected losses.

Product diversification: As the energy transition matures, companies should consider their existing product portfolio and its position to evolve along with the regulatory environment. The clean energy incentives outlined in the proposal should be considered alongside diversification strategies and will open new avenues to pursue renewable energy or cleaner fuel technology investments.

Workforce evolution: Many energy companies significantly reduced their workforce in 2020 because of pandemic-related demand destruction and related industry downturn. As the industry emerges, prices recover and proposed incentives make their way through legislation, the human resources needs of energy companies will evolve as well. Organizations should consider how the proposed incentives may affect their ability to hire and what skill sets—especially related to advanced technologies—will be required in the workforce. Human capital and required subject matter expertise should be carefully considered alongside strategy to shift toward advanced technologies. ■



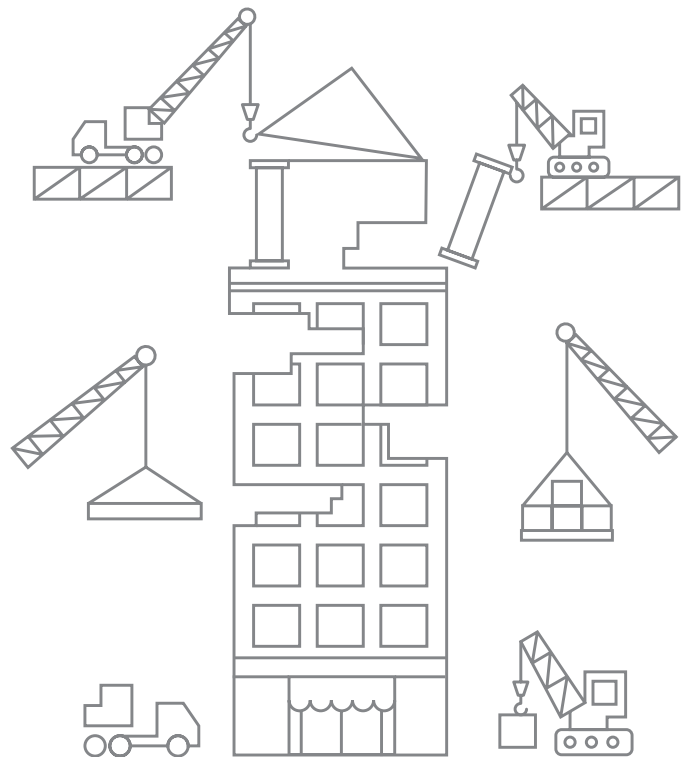
RESIDENTIAL CONSTRUCTION COSTS SURGE AMID SUPPLY CONSTRAINTS

BY NICK GRANDY

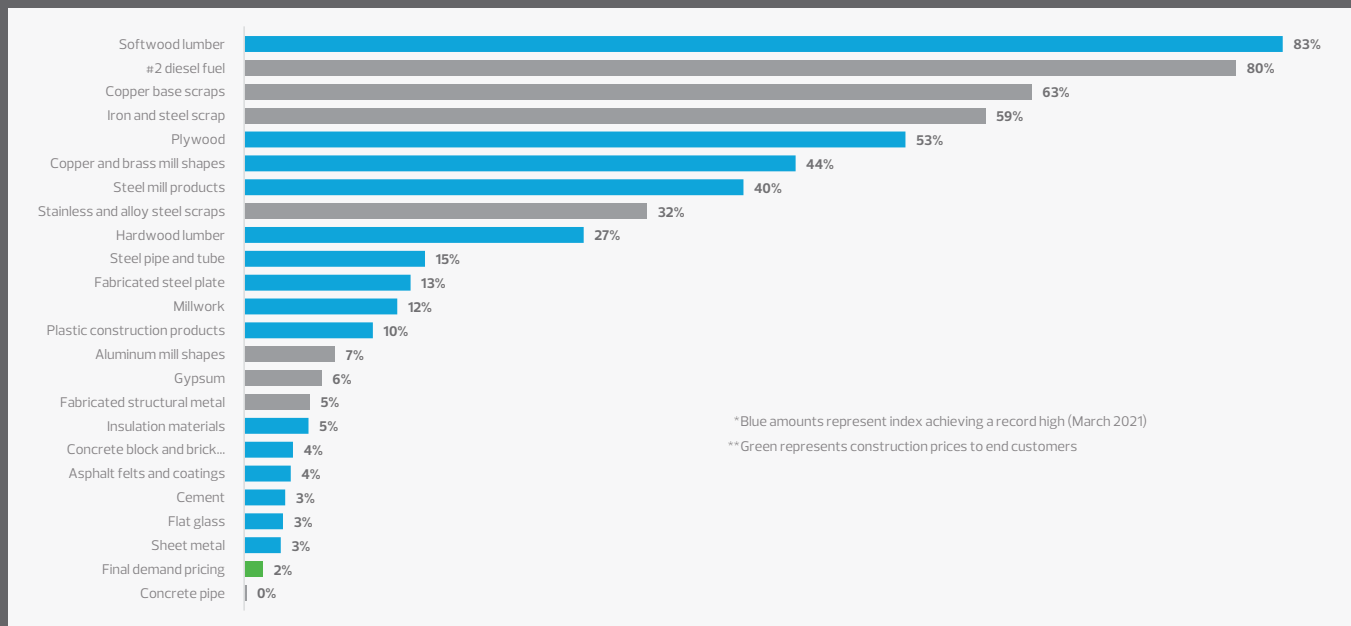
CONSTRUCTION MATERIAL COSTS have been rising since June, and the increase is having a big effect on the residential construction industry. Everything from lumber to asphalt to cement to insulation has soared in price as the homebuilding industry has heated up.

Part of the reason, in addition to rising demand, is that supplies have been constrained. At the start of the pandemic, many suppliers cut their output expecting that the subsequent economic disruption would cause severe reduction in demand. However, that drop in demand never occurred; construction was deemed essential in most parts of the country, avoiding sustained shutdowns. In fact, homebuilding and renovation have been leaders in the post-pandemic economy as people flee crowded cities and move to the suburbs in search of more space.

It has all helped fuel prices of building supplies, with three materials, in particular, leading the charge—lumber, steel and copper.



Producer price index percent change, March 2021 vs. 2020



Source: Bureau of Labor Statistics

Lumber

The price of lumber has skyrocketed over the past year, up more than 75% over pre-pandemic highs. The housing and remodeling indices from the National Association of Home Builders have both hit record highs in excess of 80 since September following initial drops at the pandemic's onset last March (scores above 50 indicate expansion).

Prices show no signs of abating amid the surge in homebuilding driven by the receipt of stimulus money and higher consumer savings because of stay-at-home restrictions. Remote work is also supporting the trend, with many individuals forced to live, work and play at home.

Adding to the squeeze on supplies, wildfires struck the Pacific Northwest last fall, burning through forests slated for market. Many construction companies and suppliers have turned to central Europe to fulfill lumber orders. Forest Economic Advisors (FEA) has stated that it expects lumber imports in the United States to rise 14% to 15% for 2021.

Meanwhile, many U.S. companies will also have to compete with demand from China, which the FEA is expecting will boost lumber imports by 14% as its appetite for lumber grows. At the same time, industry lobbyists have urged the federal government to step in to help curb costs for consumers, with proposals, including immediate remedies to suppliers to boost production and reductions on import tariffs to reduce lumber prices.

Joe Brusuelas, RSM US chief economist, said the time may be right to revisit the tariffs that remain on Canadian lumber, which were reduced from 20% in December.

"Given the 83% increase in the cost of softwood lumber, the Biden administration may want to consider removing the 9% tariff on the import of Canadian lumber product to facilitate an easing of cost pressures for both producers and consumers in the construction market."

Copper

Copper is also facing price increases because of demand growth and supply shortages and disruptions from the pandemic. Copper is a highly effective conduit used in residential and commercial electrical grids, as well as in most renewable energy systems to generate power from solar, hydro, thermal and wind energy systems.

Demand for copper is expected to remain strong, as infrastructure spending increases across the globe, specifically clean energy. With President Biden's proposed infrastructure bill hinging on green initiatives such as carbon reduction, demand for copper appears sustainable.

According to an estimate from the investment bank Jefferies, placing 500,000 electric vehicle charging stations and converting 500,000 school buses to zero emissions would require approximately 200,000 tons of copper, representing a fivefold increase. On top of U.S. consumption, China, the world's largest consumer of copper, is expected to need more of the essential metal as its economy recovers to pre-pandemic levels.

AT THE START OF THE PANDEMIC, MANY SUPPLIERS CUT THEIR OUTPUT EXPECTING THAT THE SUBSEQUENT ECONOMIC DISRUPTION WOULD CAUSE A SEVERE REDUCTION IN DEMAND. BUT THAT DROP NEVER HAPPENED.

Bloomberg estimates that additional spending of approximately \$100 billion would be needed by 2030 to close the anticipated 4.7 million metric ton gap in copper supplies. These long-term supply issues come on top of the short-term shocks caused by the COVID-19 pandemic. Chile and Peru are the two largest producers of copper, and both countries have had issues with keeping mining operations running.

In early April, Chile implemented renewed border protocols and has called on the mining sector to implement new safety measures to prevent the spread of the virus, including restrictions on special travel permits. These shocks to the global supply chain added to the rise in copper prices.

Steel

Unlike lumber and copper, steel has increased in price primarily because of supply slowdowns at the start of the pandemic. Many steel producers expected the market to become soft and idled their furnaces in March and April last year. But the slowdown never occurred, and demand for steel rebounded as the manufacturing sector led the economy out of the depths of the recession.

Even with the surge in demand, though, steel mill production capacity levels have remained below prior-year averages. Adjusted year-to-date steel production was at 76.6% of capacity through March, down 7.6% from 2020 levels, according to [data](#) from the American Iron and Steel Institute. These supply issues, coupled with steel tariffs put in place under the Trump administration, have resulted in U.S. steel prices that are significantly higher than global steel prices.

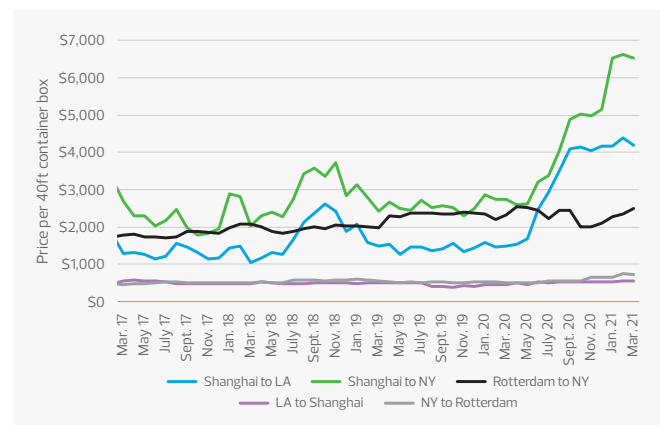
Steel-consuming manufacturers have asked Biden to reduce the tariffs to avoid having to pass these added costs on to customers. Some manufacturers have even elected to import steel despite the 25% tariff, because it is cheaper than the elevated price of domestic steel.

Shipping costs

In addition to facing higher commodity prices, domestic producers now face an increase in shipping costs for cargo headed to the United States; the logjam is centered around Americans spending money on goods fulfilled in Chinese factories. U.S. demand for goods has outstripped the availability of containers in Asia to carry them to the United States, resulting in higher shipping rates. The result has been an extended delay at American seaports like those in Los Angeles and Long Beach, as ships wait to unload their cargo and as importers scramble to find empty containers to send back to Asia.

All of these factors have created havoc among logistics companies. Construction materials are no exception as these logistic challenges layer on even more costs on top of the already-higher prices for the materials.

Shipping prices (imports to U.S.)



Source: Bureau of Labor Statistics

The takeaway

For construction companies, higher material and shipping costs are adding to margin pressures. Through the past year, final demand pricing for construction services has grown only 2% year over year through March. This means that contractors are absorbing these cost increases without passing them on to their customers, which can spell trouble for an industry that already operates on razor-thin margins. ■



CYBERATTACKS CONTINUE TO INCREASE, WITH THE MIDDLE MARKET AT RISK

When it comes to cyberthreats, the old adage held true in 2020: the more things change, the more they stay the same. Hackers and other electronic criminals continued their relentless pursuit of data and sensitive information from middle market businesses, leading to record levels of several types of attacks. The middle market continues to represent a sweet spot for hackers, with companies possessing a significant amount of valuable data, but lacking the level of protective controls and staffing of larger organizations.

The results of a recent RSM US Middle Market Business Index survey offered some insight into how middle market businesses are coping with the challenge.

28% of middle market executives said that their company experienced a data breach in the last year.

65% of middle market organizations carry a cyber insurance policy.

64% anticipate that unauthorized users will attempt to access data or systems in 2021.

80% of middle market companies that developed new workforce solutions said that security concerns with COVID-19 were either a moderate or strong influence.

For more insights on cybersecurity and the middle market, see this [special report from RSM US LLP](#).

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