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The "American Jobs Act" and its effect on US growth

- President Obama called on Congress to pass a $447bn package, aiming at stimulating economic growth, by supporting job creation, providing aid to state and local governments and promoting infrastructure development.
- If enacted in its entirety, we estimate that the proposal could boost real GDP growth by about 1.2% in 2012, turning the projected fiscal restraint of -1.0% of GDP in 2012 to a fiscal boost of +0.2% of GDP.
- We view as a more likely scenario the extension of the 2% employee-side payroll tax cut, in combination with the extension of the emergency unemployment compensation. In such a case, we estimate that it could boost real GDP growth in 2012 by about 0.6%.

In a speech to the US Congress on September 8th, President Barack Obama outlined a stimulus plan, the so-called "American Jobs Act", aimed at stimulating economic growth, by supporting job creation, providing aid to state and local governments and promoting infrastructure development. The total cost of the proposal has increased from the previously reported $300bn, i.e. 2% of GDP, to $447bn, i.e. 3% of GDP (Table 1). Although it is currently uncertain if Congress will enact the proposed program, if enacted in its entirety, it could turn the projected fiscal restraint of -1.0% of GDP in 2012 to a fiscal boost of +0.2% of GDP.

According to our estimates, fiscal restraint in 2012 would total about $300bn, i.e. 2% of GDP. This number includes the scheduled expiration of the 2% payroll tax cut ($110bn) and the expiration of the extended unemployment benefits ($50) at the end of 2011, accounting for more than half the fiscal restraint for 2012. The remaining $140bn represent spending cuts enacted from the American Recovery and Reinvestment Act of 2009 (ARRA) and the recently enacted Budget Control Act of 2011.

Based on the IMF staff calculations for the macroeconomic effects of fiscal consolidation[1], a budget deficit reduction by 1% of GDP typically reduces real economic activity by about 0.3% and 0.5% in the first and the second year, respectively. The output cost for tax-based consolidation exceeds that for spending-based consolidation by 0.3% in the first year (0.6% versus 0.3%, respectively) and by about 1% in the second year (1.3% versus 0.3% respectively). Taking these numbers into account, we estimate that a deficit reduction of about 2% of GDP would reduce US real GDP by about 1.0% in 2012 and 1.7% within two years.

However, if the "American Jobs Act" was finally enacted by the Congress (including the extension of the payroll tax cut and the unemployment benefits into 2012), around 80% ($350bn, i.e. 2.4%) of the fiscal effects of the plan would show up in 2012. Given than more than half (about 57%) of the $447bn stimulus plan include tax-based measures, which -as already stated- have a bigger net effect on economic activity than spending-based measures, we estimate that the President's

[1] *IMF (October 2010), "Will it hurt? Macroeconomic effects of fiscal consolidation", World Economic Outlook, Chapter 3, pp. 93-124.*

proposal would boost real GDP growth by about 1.2% in 2012.

A central feature of the proposal includes a tax reduction of about $253bn, mostly through reduced payroll taxes for employees and businesses. Under the plan, there would be a further cut in the portion of Social Security payroll taxes paid by employees (with wages up to $106,800/year) to 3.1% from the current rate of 4.2%. Should the Congress take no action, the payroll tax rate is set to revert to the standard rate of 6.2% at the beginning of 2012. The cost of the above mentioned tax reduction is expanded to $175bn per year from the $110bn cost of extending the existing cut to 4.2%.

As part of the stimulus measures to help businesses, the 3.1% payroll tax cut (3.1% from 6.2% currently) would also be extended to the employer's portion on the first $5mn in wages, targeting to the 98% of firms with wages below this level. Providing a more targeted incentive to employers for wage increases for existing workers or new hires, the package also includes a full employer-side payroll tax holiday on the first $50mn of a firm's payroll expenses above the previous year. Other incentives being proposed to spur hiring include a tax credit up to $5,600 for hiring unemployed veterans and a tax credit up to $9,600 for those with service-connected disabilities who have been looking for a job for more than six months. In addition, the proposal includes a $4,000 per employee tax credit for employers that hire long-term unemployed and a one-year extension of the 100% bonus appreciation allowance that is currently in place, but is supposed to fall to 50% in 2012.

Furthermore, the President's proposal includes an extension of emergency unemployment compensation (EUC) that expires at the end of 2011, at a cost of $49bn, to assist the long term unemployed in finding work. If this measure is finally left to expire at year end, it could have an immediate negative impact on personal consumption. The plan also involves a number of programs to discourage long term unemployment, including work-sharing arrangements (unemployment insurance for workers whose employers choose work-sharing over layoffs), a new "bridge to work" plan (state programs where those displaced take temporary, voluntary work or pursue on-the-job training) and wage insurance programs (which help reemploy older workers and make it easier for unemployed workers to start their own businesses).

Transfers to state and local governments and additional spending on infrastructure are also central to the proposal. In particular, the package includes a $35bn program to re-hire teachers and first-responder personnel, as well as a $30bn investment in modernizing at least 35,000 public schools and community colleges. The President's plan also includes $50bn in investment for highways, transit, rail and aviation, along with a "National Infrastructure Bank" with a capitalization of $10bn, so as to leverage private and public capital and invest in infrastructure projects. Moreover, a $15bn investment is proposed for hiring construction workers to rehabilitate vacant and foreclosed homes and businesses.

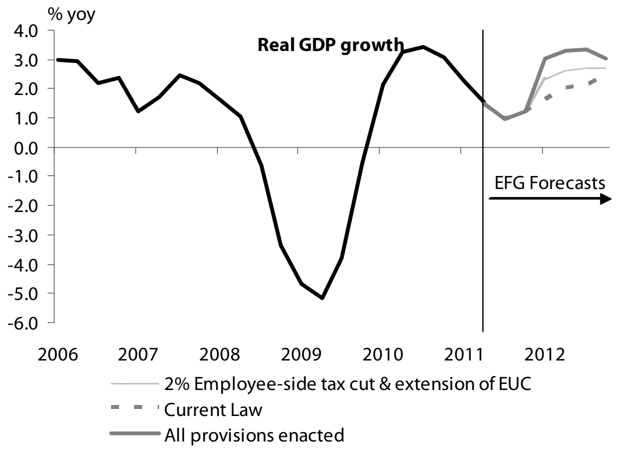
Although a mortgage refinancing proposal was absent from the package, the President indicated that the Administration will continue to work with the Government Sponsored Enterprises-GSEs (Fannie Mae and Freddie Mac) and the FHFA in order to increase the number of borrowers who can refinance at low mortgage rates.

If they were to be enacted, these stimulus measures would probably become law as part of the legislation produced by the Joint Committee on Deficit Reduction[2], because the Administration plans to offset the cost of the American Jobs Act with additional deficit reduction and still meet its deficit target. On September 12, the President sent the bill to Congress, offering some guidance to the Committee by proposing measures to raise revenues in order to pay for the American Jobs Act. Among other measures, the bill includes tax increases for upper-income taxpayers, private equity managers and oil and gas companies.

Which measures of the proposed "American Jobs Act" will finally be enacted? Given the political controversy, this is rather difficult to say. However, there appears to be much greater support in Congress for the tax-based measures than for the spending-based ones. At the same time, the recent deceleration in the labor market may exert greater pressure to extend the emergency unemployment benefits which expire at the end of 2011. Hence, if Congress were to extend but not expand the employee-side payroll tax cut (extend the current 4.2% tax on wages rather than lower it further to 3.1%) and extend the emergency unemployment compensation, we estimate that it would boost real GDP in 2012 by about 0.6% (Figure 1).

[2] The Joint Select Committee on Deficit Reduction is a bipartisan budget commission (comprised of 6 Republicans and 6 Democrats) that was created in the recently enacted Budget Control Act of 2011 to increase the statutory debt limit. The Committee is supposed to come up with a fix plan for federal finances and identify $1.5tr in additional savings and revenue increases (in cumulative terms over 10 fiscal years from FY2012) before 23 November. If the Committee achieves its savings goal and Congress approves its conclusion before 23 December, then the debt ceiling would be raised by as much. If the Committee fails to reach an agreement or the Congress does not approve its conclusions, an enforcement mechanism will be used, which would impose spending cuts of $1.2tr over 10 years (and the debt ceiling would be raised by as much).

Figure 1



Source: EFG estimates

Table 1

Proposals under the 'American Jobs Act"	$, bn
Cuts in employee's payroll taxes	175
Cuts in employer's payroll taxes	65
Extension 100% bonus expensing in 2012	5
Extension of emergency unemployment benefits	49
Rehiring of teachers and first responders	35
Modernizing public schools	30
Highways, transit, rail and airports	50
National Infrastructure Bank	10
Rehabilitation of vacant property	15
Jobs tax credit for long-term unemployed	8
Pathways back to work fund	5
TOTAL	**447**

Source: The White House

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