

The economic impact of President Obama's American Jobs Act

Key points

- **President Obama has announced a US\$447 billion stimulus program, comprising tax cuts and expenditure increases**
- **If implemented, the package is expected to boost annual average real GDP growth by 1.0 percentage point in 2012**
- **We expect Congress will only enact the proposed tax cuts (around ½ the package), which will boost growth by 0.4 percentage points in 2012**

In response to the deteriorating economic outlook, President Obama has outlined a jobs plan to inject US\$447 billion into the struggling US economy. In this note, we use NiGEM¹, a large-scale macroeconomic model of the global economy, to examine the short-term and longer term impacts of President Obama's American Jobs Act on the US economy.

Program details

The President's main proposals are outlined in Table 1 and include: cutting the employer payroll tax rate in half for businesses' first \$5 million of wages (US\$65 billion); increasing infrastructure spending and providing support to state and local governments (US\$140 billion); extending emergency unemployment compensation (US\$49 billion); and providing a larger employee payroll tax cut (US\$175 billion) by lowering the employee payroll tax rate to 3.1 per cent (from 4.2 per cent currently, which was due to rise to 6.2 per cent in 2012).

The President has committed to offset the cost of the stimulus over the next 10 years. The President's proposals are likely to create heated debate over coming months. Any stimulus is unlikely to be enacted until November and will be coupled with more detailed legislation from the Joint Committee on Deficit Reduction that was created last month to find US\$1.5 trillion of fiscal savings.

Impact on the US economy

In our simulations, we have interpreted the package as follows:

- All programs, with the exception of infrastructure spending, occur over 2012
- Infrastructure spending to occur over 2012-13
- All programs are temporary and budget settings return to base following the end of the programs
- The package is neutral on the government debt in the longer term

Table 1. Overview of Obama fiscal package

Program	\$billion
Business payroll tax cuts & extension of 100% expensing	70
Infrastructure and state & local government assistance	140
Unemployment relief	62
Payroll tax cuts for employees	175
Total	447

Source: www.whitehouse.gov

Table 2 shows the package would add 1.0 percentage point (ppt) to annual average growth in US real gross domestic product (GDP) in 2012, lifting growth from a baseline rate of 2.2 per cent to 3.2 per cent. Despite the ongoing stimulus from additional infrastructure spending in 2013, the expiration of the tax cuts and unemployment relief begin to lower growth beyond 2012.

Table 2. Impact on US real GDP from Obama fiscal package

	Real GDP growth (% average annual)		
	Base	Obama package	Difference
2012	2.2	3.2	1.0
2013	2.4	2.3	-0.1
2014	2.2	1.8	-0.4

Source: QIC

The increase in growth, as reported in Table 2, may appear to be a poor pay-off for expenditure that amounts to 3 per cent of GDP. We report growth multipliers in Table 3, which measure the ratio of the real cost of budget expenditures and tax concessions to the cumulated addition to real GDP that such stimulus measures generate. They show that after three years, the multiplier is 0.9; which means the accumulated sum of real GDP has increased by 90 per cent of total real expenditure by the end of 2014. In comparison, the growth multiplier associated with the American Recovery and Reinvestment Act (ARRA) of 2009 was estimated to be 1.26 by the end of three years. The main reason for a lower multiplier in the American Jobs Act is the greater proportion of tax cuts and transfer payments which, due to their temporary nature, are partly saved by households.

¹ NiGEM (National Institute Global Economic Model) has been developed by the National Institute of Economic and Social Research. QIC Economics & Research have developed a proprietary version of NiGEM, which has been used in this study.

Table 3. Growth multipliers of the Obama fiscal package

	Cumulative real fiscal cost (\$b)	Cumulative addition to real GDP (\$b)	Multiplier
by 2012q4	335.9	132.4	0.4
by 2013q4	379.9	256.9	0.7
by 2014q4	379.9	324.4	0.9

Source: QIC

In Table 4, we report the impact of the Obama package on the quarterly real GDP growth profile. The results show that the package has a strong impact in 2012, raising real GDP to above trend growth rates for each quarter of the year. However, Table 4 also shows the fall in quarterly growth rates from base once the programs finish. Rather than growing at a trend-like pace as reflected in our baseline forecasts, US real GDP growth slumps to a below trend pace in 2013 due to the expiration of the tax cuts and emergency unemployment compensation.

Table 4. Impact on quarterly growth profile

	Real GDP growth (% qsaar)		
	Base	Obama package	Difference
2012q1	2.2	4.3	2.1
2012q2	2.6	3.8	1.2
2012q3	2.6	4.3	1.7
2012q4	2.6	3.2	0.6
2013q1	2.1	1.0	-1.1
2013q2	2.3	1.8	-0.5
2013q3	2.4	1.9	-0.5
2013q4	2.2	1.7	-0.5
2014q1	2.1	1.3	-0.8
2014q2	2.2	2.0	-0.2
2014q3	2.2	2.1	-0.1
2014q4	2.0	2.0	0.0

Source: QIC

Implications for US monetary policy

Our results from a full implementation of the American Jobs Act pose interesting challenges to the conduct of monetary policy by the US Federal Reserve (Fed). The strong quarterly growth rates in 2012 imply that further Fed easing is probably unwarranted. However, if the Fed were to signal that further easing was on hold until US policymakers finalise the package in November, they risk disappointing financial markets and sparking another sharp sell off in equity prices.

With the Obama package only likely to boost growth in 2012, the Fed will come under pressure for a further round of monetary easing once the fiscal drag commences in 2013. Hence, should the Fed save their policy ammunition, at the risk of disappointing the current weak market sentiment, in order to provide more stimulus in 2013 when economic growth slows due to fading fiscal support?

Our view is that the Fed will need to implement modest easing now. In the current political climate, the expenditure components of the package will meet fierce resistance from Republican members of Congress and in the absence of the expenditure measures, the impact of the package on US economic growth will be greatly diminished.

A partial implementation of the Obama fiscal package

If Congress decides to exclude the expenditure items from the package, its size will be lowered from 3 per cent to 1.6 per cent of GDP. Consequently, implementation of the tax items only will greatly reduce the impact on the economy. In addition, temporary tax cuts induce a smaller multiplier per dollar than expenditure increases as households save some amount of the increment to disposable income afforded by lower taxes. Table 5 shows the impact on US annual average GDP growth in 2012 is reduced by around 60 per cent (from 1.0 ppt increase under the full package to a 0.4 ppt increase when only the tax cuts are implemented). The corresponding slowdown in 2013 and 2014 is less severe if only the tax cuts are enacted.

Table 5. Impact on US real GDP of Obama's tax cuts only

	Real GDP growth (% average annual)		
	Base	Total package	Tax cuts only
2012	2.2	3.2	2.6
2013	2.4	2.3	2.5
2014	2.2	1.8	2.1

Source: QIC

Our current view is that the package is unlikely to get through Congress in its entirety, with only the tax cuts likely to be passed. Consequently, we have upgraded our US real growth forecasts slightly to 2.6 per cent in 2012 and 2.5 per cent in 2013.

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