An Analysis of the Obama Jobs Plan

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- President Obama's jobs proposal would help stabilize confidence and keep the U.S. from sliding back into recession.
- The plan would add 2 percentage points to GDP growth next year, add 1.9 million jobs, and cut the unemployment rate by a percentage point.
- The plan would cost about $450 billion, about $250 billion in tax cuts and $200 billion in spending increases.
- Many of the president's proposals are unlikely to pass Congress, but the most important have a chance of winning bipartisan support.

President Obama’s much-anticipated jobs plan is a laudable effort to support the struggling economy. The plan would go a long way toward stabilizing confidence, forestalling another recession, and jump-starting a self-sustaining economic expansion. If fully implemented, the Obama jobs plan would increase real GDP growth in 2012 by 2 percentage points, add 1.9 million jobs, and reduce the unemployment rate by a full percentage point, compared with current fiscal policy.

The president’s plan includes a wide range of temporary tax cuts and spending increases. Among its widely anticipated provisions are one-year extensions of this year’s employee payroll tax holiday and the full expensing of business investment. Surprisingly, the plan would also increase the size of the temporary payroll tax cut and creatively expand it to employers. The president would also help state and local governments pay teacher and first-responder salaries, boost funding for unemployment insurance while meaningfully reforming the UI system, and launch several infrastructure initiatives.

The plan has its drawbacks. It isn’t cheap, costing taxpayers an estimated $450 billion. Of that, approximately $250 billion takes the form of tax cuts, while another $200 billion comes through spending increases. The president proposes paying for his plan with additional deficit reduction beginning in fiscal 2014, but he does not explicitly say how this is to be accomplished. The plan also results in weaker growth in 2013, as most of the tax cuts and spending increases are temporary and fade during the year. Presumably the economy will be strong enough to handle it by then, but that is far from certain. Moreover, the plan fails to address the ongoing foreclosure crisis and housing slump, major impediments to the recovery.

In the current political environment, it is less than likely that most of the president's plan will pass Congress. Our current baseline outlook assumes that the payroll tax holiday for employees is extended for only one more year. There is a fighting chance that broader payroll tax cuts for employees and employers could become law, but the odds aren't high enough at this time to change our baseline assumptions.

Why more support is critical

There are compelling reasons why the Obama administration and Congress should provide more fiscal support to the economy. Most obviously, the U.S. is struggling to avoid recession as confidence flags. To complicate matters, federal fiscal policy is quickly becoming a significant drag on growth; state and local governments are already a weight. The Federal Reserve has resumed easing monetary policy, but with interest rates near zero, the Fed cannot lift the economy by itself. Moreover, with the government's borrowing costs as low as they have ever been and no indication that public borrowing is crowding out private activity, there is ample room to fund more near-term fiscal support, particularly if it is paid for with additional long-term deficit reduction.

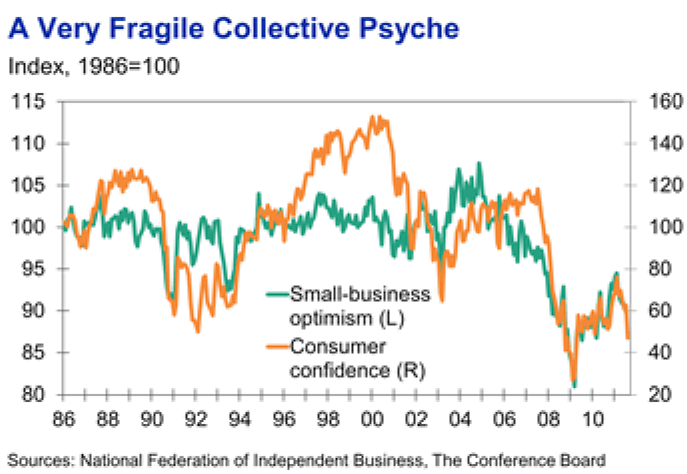
The U.S. economy is on the cusp of another recession. Businesses have stopped hiring and households are spending more tentatively. Bankers are re-evaluating whether it makes sense to continue easing credit standards and wondering if instead they should be battening down the hatches again. Declining stock prices and widening credit spreads suggest investors are also losing faith.

Crisis of confidence

Recession risks are uncomfortably high largely because confidence is low. The economy has fundamental problems, including the foreclosure crisis, a surfeit of residential and commercial real estate, and yawning government deficits. But even more serious is that investors, consumers and businesses appear shell-shocked by recent events.

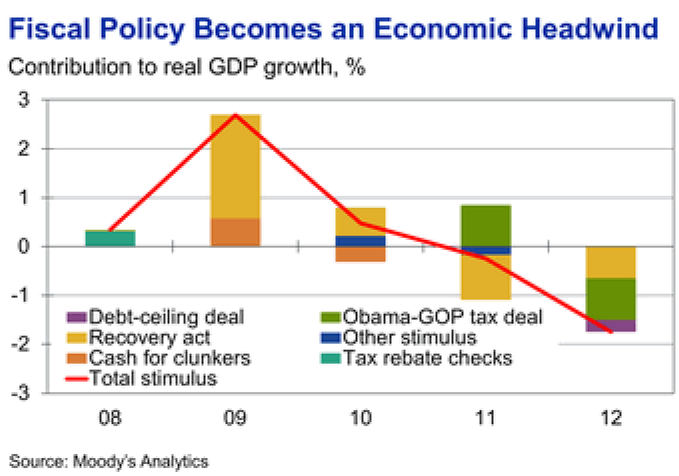
Confidence normally reflects economic conditions; it does not shape them. Consumer sentiment falls when unemployment, gasoline prices or inflation rises, but this has little impact on consumer spending. Yet at times, particularly during economic turning points, cause and effect can shift. Sentiment can be so harmed that businesses, consumers and investors freeze up, turning a gloomy outlook into a self-fulfilling prophecy. This is one of those times.

The collective psyche was already very fragile coming out of the Great Recession. The dramatic loss of millions of jobs and double-digit unemployment have been extraordinarily difficult to bear. Businesses have also struggled with a flood of major policy initiatives from Washington, led by healthcare and financial regulatory reform. The lengthy political battle over raising the nation's debt ceiling and Standard & Poor's downgrade of U.S. debt eviscerated what confidence remained. While the loss of S&P's AAA rating has little real significance—Treasury yields have fallen since the downgrade—it unnerved investors, judging by the plunge in stock prices. Consumer and small-business confidence gauges are as low as they have been since the Great Recession.



Consumers and businesses appear frozen in place. They are not yet pulling back—that would mean recession—but a loss of faith in the economy can quickly become self-fulfilling. Whether the current crisis of confidence produces a double-dip recession depends critically on how policymakers respond. Washington must act aggressively to stabilize sentiment and lift flagging expectations.

If no changes are made to current federal fiscal policy, the economic impact of that policy will shift from acting as a small drag this year to subtracting 1.7 percentage points from real GDP growth in 2012. For context, at the peak of the federal fiscal stimulus in 2009, federal policy added 2.6 percentage points to real GDP growth. Yet as the impact of federal policy shifts from a stimulus to restraint, the private sector must grow faster for the economy to simply grow at its potential. In 2012 that potential is estimated at 2.7%; to reach it, private sector GDP would need to grow well above 4%. That seems unlikely given the weak pace of recovery.



The biggest drag next year under current federal policy comes from the scheduled expiration of two stimulus measures at the end of 2011: the current 2% employee payroll tax holiday and the emergency unemployment insurance program. Not extending the programs will shave 0.9 percentage point off 2012 real GDP growth and cost the economy some 750,000 jobs. The end of other fiscal stimulus measures enacted in 2009 will further reduce economic growth.

Table 1: Fiscal Restraint in 2012 Under Current Policy

	Cost		GDP Impact	
	$ bil	% of GDP	$ bil	% of GDP
Change in Deficit, 2011 vs. 2012	-371	-2.5	-261	-1.7
Cyclical Deficit	-65	-0.4	0	0.0
Structural Deficit	-306	-2.0	-261	-1.7
2% Payroll Tax Holiday	-110	-0.7	-68	-0.5
Emergency UI	-50	-0.3	-58	-0.4
Accelerated Depreciation	-22	-0.1	-5	0.0
State & Local Government Aid	-50	-0.3	-56	-0.4
Infrastructure Spending and Other	-43	-0.3	-46	-0.3
Debt-Ceiling Deal	-31	-0.2	-28	-0.2

Source: Moody's Analytics

State and local government actions are already producing serious drags on the economy. Spending cuts and tax increases will shave an estimated 0.5 percentage point from real GDP growth this year and almost as much in 2012. The impact can be seen clearly in the job market. State and local governments have cut close to 700,000 jobs since their employment peaked three years ago and are continuing to shed workers at a stunning rate, averaging nearly 40,000 per month. Many of those losing their jobs are middle-income teachers, police, and other first responders.

The need for more federal fiscal support is increasing as the Federal Reserve's ability to respond to the weak economy diminishes. The Fed recently took a bold step by stating its intention to keep short-term interest rates near zero until mid-2013. This has brought down long-term interest rates and provided some support to stock prices. The Fed can provide even more help by extending the maturity of the Treasury bonds it owns and by purchasing more long-term bonds through another round of quantitative easing. But these ideas are not without problems, chiefly that they are becoming less effective in stimulating the economy.

The Fed can't do it alone

Acknowledging this in his recent Jackson Hole speech, Fed Chairman Ben Bernanke focused attention on fiscal policymakers. Bernanke explained that Congress and the Obama administration must follow through on plans for long-term deficit reduction but also must provide additional near-term support to the economy. Monetary policy alone may not be able to prevent another recession.

Additional fiscal help for the economy wouldn't be desirable or even possible if the federal government's debt costs were rising or if government borrowing were tightening credit for households and businesses. But there is no evidence that such crowding out is occurring. Ten-year Treasury yields have fallen below 2%, a near record. This is in part because of the Fed's actions, but the U.S. also remains the global economy's safe haven. Whenever there is a problem anywhere, the investment of choice is a Treasury bond—witness the current flight to Treasuries sparked by financial turmoil in Europe. Borrowing costs for households and businesses also remain extraordinarily low, with fixed mortgage rates closing in on a record low of 4% and Baa corporate bond yields (the lowest investment grade) nearing a 50-year low below 5.5%.

Table 2: President Obama's Jobs Plan

Budgetary cost, $ bil, calendar yr

	2012	2013	2014	2015	10-Yr Cost
Total Tax Cuts and Spending Increases	421	63	-14	-11	447
Total Tax Cuts	293	-1	-14	-11	260
Payroll Tax Holiday for Employees	175	0	0	0	175
Payroll Tax Holiday for Employers	65	0	0	0	65
Accelerated Depreciation	45	-1	-14	-11	5
Long-Term Unemployed Hiring Tax Credit	8	0	0	0	8
Veterans Hiring Tax Credit	0.1	0	0	0	0.1
Total Spending Increases	128	64	0	0	192
Unemployment Insurance Reforms	40	9	0	0	49
Infrastructure Spending	25	25	0	0	50
Infrastructure Bank	10	0	0	0	10
School Renovations	20	10	0	0	30
Aid to State and Local Govts for Teachers & First Responders	20	15	0	0	35
Neighborhood Stabilization	10	5	0	0	15
TANF Work Subsidies, Summer Job Programs, Other Spending	3	0	0	0	3

Source: Moody's Analytics

Assessing the plan's components

The president’s jobs plan includes a wide range of temporary tax cuts and spending increases. The plan would cost close to $450 billion over 10 years, with slightly more than $250 billion coming from tax cuts and $200 billion from spending increases. For context, the plan’s cost is equal to about 3% of current GDP and just over half the $825 billion ultimate price tag for the 2009 Recovery Act.

The largest tax cuts include an extension and expansion of the payroll tax holiday for employees and a creative new payroll tax holiday for employers. Employers would be able to cut their payroll taxes in half on up to $5 million in taxable wages annually. Small businesses, many of whom are cash-strapped, would enjoy a sizable albeit temporary boost in their cashflow. Businesses will also pay no additional taxes on any wages that rise from the year before, up to $50 million. This would give firms a substantive incentive to increase hiring and should result in a larger economic bang for the buck—additional GDP per tax dollar—than previous job tax credits such as last year’s HIRE Act.

Table 3: Fiscal Stimulus Multipliers

As of 2011Q2

	Bang for the Buck
Tax Cuts	
Refundable Lump-Sum Tax Rebate	1.22
Nonrefundable Lump-Sum Tax Rebate	1.01
Temporary Tax Cuts	
Child Tax Credit, ARRA parameters	1.38
Payroll Tax Holiday for Employees	1.25
Earned Income Tax Credit, ARRA parameters	1.23
Job Tax Credit	1.20
Making Work Pay	1.19
Payroll Tax Holiday for Employers	1.04
Across-the-Board Tax Cut	0.98
Housing Tax Credit	0.82
Accelerated Depreciation	0.29
Loss Carryback	0.25
Permanent Tax Cuts	
Extend Alternative Minimum Tax Patch	0.53
Make Dividend and Capital Gains Tax Cuts Permanent	0.39
Make Bush Income Tax Cuts Permanent	0.35
Cut in Corporate Tax Rate	0.32
Spending Increases	
Temporary Increase in Food Stamps	1.70
Temporary Federal Financing of Work-Share Programs	1.64
Extending Unemployment Insurance Benefits	1.52
Increased Infrastructure Spending	1.44
General Aid to State Governments	1.31
Low Income Home Energy Assistance Program (LIHEAP)	1.13

Note: The bang for the buck is estimated by the one-year dollar change in GDP for a given dollar reduction in federal tax revenue or increase in spending.

Source: Moody's Analytics

The president has also proposed a tax credit for businesses that hire people unemployed longer than six months—a group that, astonishingly, includes half the jobless. The longer these workers remain unemployed, the harder finding work becomes as their skills and marketability erode. Structural unemployment thus rises as a long-term threat; it appears to have already risen from around 5% before the Great Recession to closer to 5.5% currently.

Doing infrastructure the right way

The Obama plan's most significant spending increases, totaling more than $100 billion, are for infrastructure. Such development has a large bang for the buck, particularly now, when there are so many unemployed construction workers. It can also help remote and hard-pressed regional economies and produces long-lasting economic benefits. Such projects are difficult to start quickly—"shovel ready" is in most cases a misnomer—but since unemployment is sure to be a problem for years, this does not seem a significant drawback in the current context.

More serious concerns are the expense of infrastructure projects and their often political rather than economic motivation. A creative way to address these concerns is through an infrastructure bank—a government entity with a federal endowment, able to provide loans and guarantees to jump-start private projects. These might include toll roads or user-supported energy facilities or airports. Private investors and developers would determine which projects to pursue based on what works financially rather than politically. The infrastructure bank would take time to launch, however, and thus would not produce quick benefits.

Unemployment insurance reforms

The president also proposes more funding for unemployment insurance, but in combination with some much-needed reforms to the UI system. One idea involves scaling up a Georgia program that places unemployed workers at companies voluntarily for up to eight weeks at no charge to the businesses. Along with their unemployment benefits, workers receive a small stipend for transportation and other expenses, training, and a tryout with the employer that could lead to a permanent job. Employers can potentially abuse the program by recycling unemployed workers, but the program seems to have had some success since it began in 2003.

Another idea to reform UI is to more broadly adopt "work share" as an alternative to temporary layoffs and furloughs. Instead of laying off workers in response to a temporary slowdown in demand, employers reduce workers' hours and wages across a department, business unit, or the entire company. The government then provides partial unemployment insurance benefits to make up for a portion of the lost wages. Work share exists in 17 states and several countries overseas, including Germany, where it is credited for contributing to a relatively strong recovery.

Saving vital public jobs

Like the temporary extension of unemployment insurance benefits, work share has a large bang for the buck, since distressed workers are likely to quickly spend any aid they receive. Work share's economic effectiveness even exceeds that of straight UI benefits, because it reduces both the financial and psychological costs of layoffs. Work share can particularly help firms that expect reductions to be temporary, by reducing their costs for severance, rehiring and training.

Hard-pressed state and local governments would also receive additional relief under the president's plan. While state governments appear to be working through their near-term budget problems, local governments are still struggling with flagging property tax revenues. The biggest casualties are teachers and first responders, and Obama's plan would help with their salaries through the end of the 2013 school year.

From a headwind to a tailwind

The president's plan would provide a meaningful boost to the economy and job market in 2012. Compared with current fiscal policy, the plan adds 2 percentage points to real GDP growth, adds 1.9 million payroll jobs, and reduces unemployment by a percentage point. Federal fiscal policy would go from being a powerful headwind next year to a modest tailwind.

Table 4: Economic Impact of Obama Jobs Plan

Sources: BEA, BLS, Treasury Department, Moody's Analytics

	2011	2012	2013	2014	2015
Real GDP					
Obama Jobs Plan					
2005$ bil	13,295	13,850	14,234	14,717	15,229
% Change	1.6	4.2	2.8	3.4	3.5
Current Fiscal Policy					
2005$ bil	13,295	13,586	14,105	14,711	15,225
% Change	1.6	2.2	3.8	4.3	3.5
Moody's Analytics Current Baseline					
2005$ bil	13,295	13,652	14,118	14,717	15,226
% Change	1.6	2.7	3.4	4.2	3.5
Payroll Employment					
Obama Jobs Plan					
Mil	131	133	135	139	143
Change, mil	1.2	2.4	2.0	4.0	3.7
Current Fiscal Policy					
Mil	131	132	135	139	143
Change, mil	1.2	0.5	3.2	4.7	3.7
Moody's Analytics Current Baseline					
Mil	131	132	135	139	143
Change, mil	1.2	1.0	2.9	4.6	3.7
Unemployment Rate					
Obama Jobs Plan	9.1	8.3	7.7	6.4	5.7
Current Fiscal Policy	9.1	9.3	8.1	6.4	5.7
Moody's Analytics Current Baseline	9.1	9.0	8.1	6.5	5.7
Federal Budget Deficit, FY					
Obama Jobs Plan					
$ bil	-1,320	-1,386	-886	-766	-603
% of GDP	-8.8	-8.7	-5.3	-4.3	-3.2
Current Fiscal Policy					
$ bil	-1,320	-1,079	-880	-818	-655
% of GDP	-8.8	-6.9	-5.3	-4.6	-3.5
Moody's Analytics Current Baseline					
$ bil	-1,320	-1,164	-874	-816	-655
% of GDP	-8.8	-7.4	-5.3	-4.6	-3.5

Note: Current policy assumes that the Bush tax cuts are extended, the AMT is indexed to inflation, and the scheduled 30% reduction in Medicare payment rates for physician services does not occur. The Moody's Analytics baseline differs from current policy in a number of ways, but most importantly in the near term is that it assumes an extension of the current payroll tax holiday for employees.

Note: These results are derived from simulations of the Moody's Analytics macromodel of the U.S. economy.

Of the 1.9 million jobs added in 2012 under the president's plan, the largest contributor would be the extended payroll tax holiday for employees, which adds approximately 750,000 jobs. The payroll tax holiday for employers is responsible for adding 300,000 jobs, although this may be understated; quantifying the impact of this proposal is difficult. Infrastructure spending adds 400,000 jobs—275,000 jobs are due to additional unemployment insurance funding and 135,000 jobs result from more aid to state and local governments.

One potential pitfall of the president's plan is that the boost to growth and jobs fades quickly in 2013. Additional infrastructure spending and aid to state and local governments continue to support growth, but the benefits of the tax cuts peter out. The hopeful assumption is that the private sector will be able to hold up as government support abates. While reasonable, it is important to acknowledge that policymakers hoped for the same thing last year when they passed the one-year payroll tax holiday and extended emergency unemployment insurance through 2011.

Also needed: Help for housing

The president's plan is large, but in some key respects it is not complete. Most notably, it does not directly address the foreclosure crisis and housing slump, save for some added funding for neighborhood stabilization. The President did mention in his speech that he would be working with the FHFA (Fannie Mae's and Freddie Mac's regulator) to facilitate more mortgage refinancing; this would be a significant plus for housing and the broader economy if he is able to break the logjam in refinancing activity.

With some 3.5 million first-mortgage loans in or near foreclosure and more house price declines likely, it is hard to be enthusiastic about the recovery's prospects. A house is most Americans' most important asset; many small-business owners use their homes as collateral for business credit, and local governments rely on property tax revenues tied to housing values.

Most worrisome is the risk that housing will resume the vicious cycle seen at the depths of the last recession, when falling prices pushed more homeowners under water—their loans exceeded their homes' market values—causing more defaults, more distress sales, and even lower prices. That cycle was broken only by unprecedented monetary and fiscal policy support.

Other criticisms

The president’s plan will be criticized for many other reasons. Some will argue that he should have proposed massive public works, like the Depression-era WPA. Others will say the plan should have included broader reforms to corporate taxes or even immigration. While these suggestions may have merit as policies, they seem like steps too far given what lawmakers need to do and how quickly they need to do it.

Given the current political environment, it is unlikely that much of what the president has proposed will become law, but nearly all the proposals have some bipartisan support. An extension of the current payroll tax holiday for employees seems most likely to pass and is included in the Moody’s Analytics baseline economic outlook. The proposed expansion of the employee tax holiday and the new payroll tax holiday for employers are also possible. The president’s spending initiatives, while worthwhile, seem like longer shots.

Policymakers need to work fast

The risk of a new economic downturn is as high as it has been since the Great Recession ended more than two years ago. A string of unfortunate shocks and a crisis of confidence are to blame. Surging gasoline and food prices and fallout from the Japanese earthquake hurt badly in the spring; more recently, the debt-ceiling drama, a revived European debt crisis, and the S&P downgrade have been especially disconcerting. Confidence, already fragile after the nightmare of the Great Recession and Washington’s heated policy debates, was severely undermined.

Whether the loss of faith in our economy results in another recession critically depends on how policymakers respond. Whether they will succeed in shoring up confidence is a difficult call. The odds of a renewed recession over the next 12 months are 40%, and they could go higher given the current turmoil in financial markets. The old adage that the stock market has predicted nine of the last five recessions is apt, but the recent free fall is disconcerting. Markets and the economy seem one shock away from dangerously unraveling. Policymakers must work quickly and decisively.