PRESIDENT OBAMA’S AMERICAN JOBS ACT

• President Obama is proposing close to US$447 billion in tax cuts and new spending to create jobs and bolster the economy.

What is the problem the new act is attempting to address

• The lack of recovery in the U.S. job market is one of the biggest challenges facing U.S. policymakers. After reaching a peak of 10.1% in October 2009, the official U.S. unemployment rate has declined but currently stands at a lofty 9.1%. It is hard to believe, but prior the recession (as late as November 2007) the unemployment rate was just 4.7%.

• The slow pace of job creation following the recession is the main reason for the elevated unemployment rate. From January 2008 to February 2010, the U.S. economy shed over 8.7 million jobs. Job losses continued even in the initial stages of economic recovery. In the second half of 2009, non-farm payrolls declined by 1.2 million. Since reaching a trough in February 2010, non-farm payrolls have expanded by just under 1.9 million.

• While the official unemployment rate stands at 9.1%, this understates the amount of slack in the U.S. labor market. As the labor market captures only those who are currently employed or actively looking for work, when people give up on the job search they cease to be counted as officially unemployed. In reality, many of these “discouraged workers” will likely re-enter the workforce once conditions improve. One way of illustrating the impact of the “discouraged worker” phenomenon is to consider what the unemployment rate would be if the participation rate of each age group had stayed the same as it was entering the recession. If this were the case, the unemployment rate would be close to 11% rather than the 9.1% currently recorded. Another way of capturing the true level of slack in the labor market is to include marginally attached workers and part-time workers who would like to be employed full time. Including these workers implies an unemployment rate of 16.2%.

• The slow pace of job growth has led to a sharp rise in the duration of unemployment. Prior to the recession, the average unemployed person was out of work for a period of 17 weeks. Currently, the average duration of unemployment sits at 40.3 weeks. There is a growing gap between the median duration of unemployment and the average duration of unemployment. This implies that the very long-term unemployed have been out of work for much longer than the 40 week average.

• The rise in the long-term unemployed has led to increasing concerns that a considerable amount of unemployment has become structural in nature. Estimates suggest that the structural unemployment rate (also referred as the non-accelerating inflation rate of unemployment or NAIRU) may be up to a percentage and half higher than it was prior to the recession. Structural unemployment will not budge with simple fiscal stimulus and will require more substantial labor market reforms and retraining to bring down.

Past policies and implications

• The main policy actions to support the job market have taken the form of extended unemployment insurance (UI) benefits and payroll tax cuts. Extended UI benefits are generally thought to have two impacts on the labor market. First, they provide income support to those who would otherwise have none and in doing so shore up aggregate demand and employment. Second, extended UI benefits decrease the opportunity cost of remaining unemployed and thereby reduce the incentive to accept job offers. This likely raises slightly the unemployment rate from what it would be in absence of the benefit.

• The payroll tax cut put in place in December 2010 reduced the workers Social Security payroll tax rate to 4.2% from 6.2% for 2011 and put an extra $1,000 in average workers pocket in 2011 (WSJ). However, this benefit took place as the Making Work Pay tax credit expired, so the additional boost to economic activity was mitigated.

President Obama’s proposals under the America Jobs Act

• President Obama’s proposal for a $447 billion American Jobs Act is a mixture of tax stimulus and spending items aimed at speeding up the jobs recovery. The package
is larger than the $300 billion most analysts had been expecting. Over half of the bill will be spent on reducing
taxes, with most of this representing a payroll tax cut
for both employees and employers. In the President’s
speech, he argued that the plan should be made deficit
neutral. Obama has said that he will look to the Super
Committee to identify additional savings to pay for
the plan, on top of the $1.5 trillion it has already been
tasked with. The President also indicated that he will
be providing some budgetary proposals on September
19th.

• A key feature of the bill is a further cut in the payroll
tax rate for employees from 4.2% to 3.1% (instead of
being moved back up back up to the prior 6.2%). The
tax will save the average family $1,500 next year and
will cost $175 billion. Estimates of the impact of the
extension of the payroll tax cut for employees suggest
this will could add as much as 0.8 percentage points to
economic growth and add around 600,000 jobs relative
to if it were allowed to expire. We believe there is reason
to be cautious about the impact. In an environment of
heightened precautionary saving, the lift to consumer
spending from this tax cut should be expected to be
modest.

• The bill also includes a payroll tax rate for employers
with payrolls up to $5 million (which the White House
says would include 98% of businesses) and a full payroll
tax holiday for new hires These measures are expected
to cost around $65 billion. Last year, the CBO estimated
that a 2 percentage point cut to the employer portion of
the payroll tax would generate between 558,000 and
1,451,000 new full-time equivalent jobs. Pro-rating
this up to the 3 percentage points on offer in this jobs
bill suggests this could generate between 800,000 and
2,000,000 jobs. Given the increase in risk aversion and
uncertainty among employers, the impact is likely to be
closer to the bottom of this range.

• The bill will extend unemployment insurance benefits
to the long-term unemployed, preventing 5-million
Americans from losing benefits. It will also allow job
sharing – UI for workers whose employers choose work-
sharing over layoffs. In addition, it proposes a “Bridge
to Work” program that builds on state programs such as
Georgia Work$ that give funding for workers to under-
take on-the-job training. Finally, there is a tax credit of
up to $4,000 for employers to hire workers who have
been unemployed for more than six months.

• The bill includes an extension of the 100% depreciation
allowance for business investment.

• In terms of spending initiatives, the bill includes $30
billion to modernize schools and $50 billion on road
and bridge projects. We do not have an estimate for the
jobs impact of this. The total impact will depend on how
fast these projects are initiated and carried out.

• In addition to infrastructure spending, the bill calls for
$35 billion in state and local government aid, in the
form of $30 billion to prevent teacher layoffs and $5
billion for emergency first responders. The $35 billion
in federal aid to state and local governments could lead
to as many as 300,000 jobs relative to baseline.

• Finally, the President in his speech talked about Federal
housing agencies doing more to help people to “refinance
mortgages at interest rates that are now near 4%.” Details
remain to be seen.

The bottom line

• In terms of the total impact of the bill on real GDP and
job growth, if the bill is passed in its current form it
could provide a boost of up to 1.3 percentage points
to economic growth in 2012 and generate around 1.3
million in additional jobs. The TD Economics forecast
had built in an expectation for some of the provisions
of the bill, such as the extension of the payroll tax cut
for employees. However, it did not anticipate that the
rate would cut further. With the addition of the payroll
tax cut for employers, the extension of 100% expensing
for investment expenditures, and other spending initia-
tives in the proposal, should this bill be signed into law
in its current form, it could raise our economic growth
forecast by around 0.8 percentage points in 2012 and
add around 800,000 jobs to U.S. payrolls. Nonetheless,
while the jobs act could help to shore up job growth, it
is unlikely to be a game changer. Our forecast, which
currently calls for 2.2% growth on a Q4/Q4 basis in
2012 would be improved to 3.0%. However, the lift
to economic jobs and employment growth would be
temporary, as the expiration of the new fiscal stimulus
would then act as a greater drag on economic growth in
2013 and beyond.

• Economic growth will continue to be held back by fiscal
constraints at the state and local level, heightened risk
aversion and ongoing uncertainty about the European
sovereign debt crisis, and the continued malaise in the
With respect to the housing market, until progress is made in drawing down the huge stock of foreclosed properties, home prices are likely to continue to stagnate and consumer spending unlikely to accelerate appreciably. So, while the American Jobs Act could materially boost the economy in 2012, it does not address the long-term structural challenges facing the economy.

- A core outstanding question is to what extent the proposals are enacted by Congress in the current politically-intense environment.

James Marple
Senior Economist
416-982-2557