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WHO WOULD PROMOTE JOB GROWTH MOST IN THE NEAR TERM?

Macroeconomic impacts of the Obama and Romney budget proposals

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The most pressing economic challenge facing the United States as of September 2012 remains elevated unemployment and underemployment rates, a legacy of the Great Recession that began at the end of 2007 and from which the labor market has yet to fully recover. In the near term, boosting employment will overwhelmingly hinge on fiscal policy.

Both President Obama and Republican presidential nominee Mitt Romney contend that they have plans to accelerate job creation. This issue brief models and analyzes projected macroeconomic impacts of the candidates' respective budget plans over calendar years 2013 and 2014, relative to current budget policies. Its main findings are the following:

- The budget plans put forward by Barack Obama would lead to increased employment of about 1.1 million jobs in 2013 and 280,000 jobs in 2014, relative to current policy.

- The Obama employment gains would be driven by an increase in spending of $135 billion over the current policy baseline, which is the result of $142 billion in temporary spending under his proposed American Jobs Act.
- The budget plans put forward by Mitt Romney would lead to small job gains of 87,000 in 2013 and a loss of 641,000 jobs in 2014, relative to current policy, if his proposed tax cuts were fully deficit-financed.
- If some of Romney's proposed individual income tax cuts were revenue-neutral (he has said that they would be, but has not specified what "base-broadening" adjustments he would make to the tax code to accomplish that), his plans would instead lead to employment losses of 608,000 in 2013 and roughly 1.3 million in 2014.
- The weaker job growth and outright job losses under the Romney plan are driven by his proposal to cap government spending at 20 percent of gross domestic product (GDP), a move that implies very large cuts to overall spending.

In the following section, we provide economic background on the debate taking place over budgets, deficits, and taxes. We then describe how we analyzed each candidate's plan to arrive at estimates of the proposals' respective budgetary impacts, impacts on GDP, and likely effects on employment.

The joblessness crisis: Diagnosis and proposed cures

Today, nearly 10 million additional jobs are needed to restore prerecession unemployment and labor force participation rates, but at the rate of job growth experienced in the first seven months of 2012 it would take over a decade to fill this gap.[1] Failure to adequately address the fallout from the Great Recession is obstructing a return to full employment and damaging the economy's future productive potential. The economy is growing too slowly to close the "output gap," the difference between potential economic output—what the economy could produce with higher (but noninflationary) levels of employment and industrial capacity utilization—and actual economic output. The U.S. economy has operated at 5 percent or more below potential output since the fourth quarter of 2008, and at present the shortfall is $968 billion, or 5.8 percent (CBO 2012a; BEA 2012). These output gaps imply that the United States has cumulatively forgone over $3 trillion of national income, and the economic "scarring" caused by these long spells of idling and depreciating labor and industrial capacity has real long-run costs (Irons 2009); the Congressional Budget Office (CBO) has downwardly revised potential economic output for 2017 by 6.6 percent, or $1.3 trillion (Fieldhouse 2012). Looking further out, CBO estimates that potential GDP will be 1.5 percent lower in 2022 than it would be otherwise because of the Great Recession and ensuing economic weakness (CBO 2012b).

This paper proceeds on the correct assumption that this gap between potential and actual GDP reflects a shortfall in effective demand for goods and services; households, businesses, and governments are not spending enough to keep all resources (capital and labor) fully employed. In the jargon of economists, today's high unemployment is explained through these same "Keynesian" diagnoses. And the (again, correct) Keynesian cure is to remedy this deficient spending with policies to spur more spending.

The normal way this stabilization policy is conducted is through the Federal Reserve, which lowers the interest rates that it controls in an effort to bring down interest rates across the economy. Ideally, these lower rates then encourage businesses to undertake more investment and entice households to increase borrowing or refinance outstanding debt, thereby freeing up resources for consumption. But these so-called policy interest rates have been stuck at essentially zero since late 2008, and yet the sizable demand shortfall persists. The less-conventional policies the Federal Reserve has undertaken to date, notably asset-

backed security purchases and guidance that the primary policy rate will remain near zero through at least mid-2015, are economically beneficial but incapable of restoring full employment; if anything, they reaffirm that the Fed's conventional policy arsenal has been exhausted and more policy accommodation is needed to restore full employment. With the Fed showing little appetite for monetary policy interventions more unconventional than those it has already undertaken (e.g., announcing a higher inflation target or nominal GDP targeting), and with prospects for a depreciation of the dollar and a subsequent boost to exports seemingly remote, the pace of U.S. economic recovery—or decline—will be largely dictated by fiscal policy in the near term.

The Keynesian diagnosis and cure—particularly the emphasis on *fiscal* expansion as the key to reducing unemployment—is rhetorically contested by many of today's policymakers. But when push comes to shove, almost all of today's critics of Keynesianism adopt its broad diagnosis when it suits their narrower policy interests. For example, take the ecumenical alarm over the "fiscal cliff." At the beginning of 2013, a series of tax increases and spending cuts are set to go into effect under current law. If these policy changes all occur as scheduled, the rapid fiscal contraction—budget deficits *falling too quickly* and public debt *rising too slowly*—would indeed induce an outright recession (Bivens and Fieldhouse 2012). The CBO projects that under current law the U.S. economy will enter a double-dip recession, contracting 2.9 percent in the first half of 2013, and unemployment will again rise above 9 percent (CBO 2012b); we further project that major fiscal headwinds will shave up to 3.7 percentage points from real GDP growth for the year (Bivens and Fieldhouse 2012). Calls to avoid the fiscal cliff have become increasingly urgent from representatives of both parties, who warn that going over the fiscal cliff would harm job growth.[2] But "going over the fiscal cliff" just means "reducing budget deficits quickly," and calls to "avoid the fiscal cliff" really mean "keep deficits from closing so quickly."

This paper grades the plans of candidates Barack Obama and Mitt Romney against a "current policy" baseline, which is described in detail in the methodological appendix. The current policy baseline is contractionary, but not nearly as contractionary as the current law baseline—wherein all legislated tax increases and spending cuts take effect (i.e., the "fiscal cliff" scenario)—which would push the economy back into recession. Under the continuation of current policies, the budget deficit is projected to shrink from 7.3 percent of GDP in fiscal 2012 to 6.4 percent and 5.4 percent in fiscal 2013 and 2014, respectively. This reduction reflects a combination of expiring fiscal stimulus, notably the payroll tax cut and emergency unemployment benefits; the tightening of discretionary spending caps; increased revenues from the Affordable Care Act (ACA); and an underlying improvement in projections of the cyclical budget deficit (CBO 2011a), among other factors. While not as contractionary as the current law baseline, the current policy baseline still projects significant fiscal contraction in the near term, resulting in a marked slowdown of economic growth.

Evaluating jobs plans and near-term fiscal impacts

The most complex aspect of projecting the possible economic impact of the Romney and Obama plans is making something concrete out of each candidate's sometimes vague budget proposals. We have tried to be even-handed and consistent in determining what is actionable evidence in each candidate's plans. We believe our assumptions are likely to be accurate, but should either campaign make concrete changes to these plans, we would revise our estimates.

After constructing a budget plan for each candidate, we apply commonly used macroeconomic multipliers—measures of the impact on GDP of each dollar of spending or tax provisions—to its various components. (The multipliers used can be found in the appendix.) The major implication of the multipliers is twofold. First,

large cuts in government spending will exert a strong drag on economic activity while large output gaps persist, as recently demonstrated in the United Kingdom and across much of the eurozone. Second, tax cuts, particularly tax cuts for businesses and higher-income households, are highly inefficient at spurring growth.

With these caveats in mind, it is possible to couple high-impact fiscal stimulus (e.g., extended unemployment benefits) with low-impact deficit reduction (e.g., rescission of tax cuts for upper-income households) in a manner that will boost employment without adding to the deficit (see Bivens 2011a for a discussion of this "balanced-budget multiplier"). For more on evaluating effective job creation measures, see Eisenbrey et al. (2011).

Additionally, through the cyclical budget deficit—the portion of the deficit attributable to safety-net spending automatically rising and tax revenues falling during a downturn—expansionary fiscal stimulus is partially self-financing, and austerity is partially self-defeating. The degree to which this becomes true in practice depends on the policies' associated fiscal multipliers. For example, coupling a dollar in revenue from upper-income households with a dollar of infrastructure spending would at present both reduce the deficit and have a net positive effect on the economy (boosting GDP by $1.20). This boost to GDP would produce net deficit reduction of roughly 44 cents, as every dollar closed from the output gap reduces the cyclical budget deficit by roughly 37 cents (Bivens and Edwards 2010).[3] Lastly, it is important to note that ample evidence indicates that efficient, deficit-financed fiscal support may actually reduce the economy's debt-to-GDP ratio in the near term (DeLong and Summers 2012).

Our analysis is focused on the employment impact of the candidates' budget plans and ignores such dynamic budgetary feedback effects, but high-impact stimulus would have the added benefit of reducing cyclical budget deficits, just as high-impact deficit reduction would exacerbate cyclical deficits.[4]

President Obama's fiscal 2013 budget plan

The Obama budget request for fiscal 2013 (which begins October 1, 2012) includes a mixture of investments and short-term economic stimulus measures that would boost GDP, as well as deficit reduction measures that would modestly slow growth. On net, we project that the president's budget plan would boost GDP by 0.9 percentage points in calendar year 2013 and 0.3 percentage points in 2014, thereby increasing employment by roughly 1.1 million jobs in 2013 and 280,000 jobs in 2014 (see **Table 1**).

This boost to GDP and employment would be driven by an increase in spending of $135 billion over the current policy baseline, which is the result of $142 billion in temporary spending under his proposed American Jobs Act, or AJA.

Relative to current policies, the president's budget would increase the budget deficit in 2013 and decrease it in 2014. However, because the gross *additions* to the deficit tend to be in categories that are relatively stimulative (particularly spending and investment initiatives included in his American Jobs Act), while the gross *reductions* in the deficit are concentrated in categories that do not have very large impacts on near-term activity (tax cuts for high-income households, predominantly), the *net* economic impacts are larger and more positive than the deficit numbers might indicate. In 2014, for example, even as the mix of policies actually *reduces* deficits, we project the employment level would be slightly higher than under current policy.

The budget plan we score for the Obama administration includes an adaptation of the AJA, initially proposed in September 2011 as a $447 billion package of household and business tax cuts, public investments, safety-net spending, and aid to state and local governments. After

TABLE 1

Near-term macroeconomic effects of President Obama's fiscal 2013 budget

	BUDGETARY COST (+) OR SAVINGS (-) (BILLIONS)		GDP IMPACT (% GDP)		EMPLOYMENT IMPACT (THOUSANDS OF JOBS)	
	2013	2014	2013	2014	2013	2014
Tax policy						
*American Jobs Act tax cuts**	$57	$19	0.2%	0.1%	246	110
Upper-income tax provisions	-107	-99	-0.2	-0.1	-202	-178
Other tax provisions	-7	7	0.0	0.0	-17	17
Discretionary spending						
Net discretionary spending	$11	$2	0.1%	0.0%	117	16
Mandatory spending						
*American Jobs Act spending**	$92	$50	0.8%	0.4%	994	496
Transportation reauthorization	1	5	0.0	0.0	11	55
Health and other mandatory spending	-3	-23	0.0	-0.2	-29	-235
Total	**$44**	**-$39**	**0.9%**	**0.3%**	**1,121**	**280**

* With the exception of the payroll tax cut and emergency unemployment benefits, all American Jobs Act provisions have been shifted forward one year.

Note: All policies are scored relative to EPI's current policy baseline. This table presents the impact in calendar years 2013 and 2014.

Source: Authors' analysis of Congressional Budget Office, Office of Management and Budget, and Moody's Analytics data

the release of the president's 2013 budget, Congress enacted scaled-back versions of two major AJA proposals for the remainder of 2012: a 2 percentage-point employee-side payroll tax holiday (AJA proposed 3.1 percentage points) and a reduced extension of the emergency unemployment compensation (EUC) program. The president continues to support passage of the AJA provisions that Congress has not acted on (Krueger 2012), the budgetary effects of which have been delayed one year in our analysis to allow for feasible implementation (most tax cuts and spending initiatives were proposed for fiscal 2012, which ends September 30, 2012).[5]

The remaining tax cuts from the AJA include a temporary business payroll tax credit for hiring and wage increases, extension of 100 percent bonus depreciation, and credits for advanced energy manufacturing, among others. More cost-effective direct spending programs from the AJA, notably investments in surface transportation, school modernization, and aid to state governments for rehiring teachers and first responders, would have a much larger positive impact on employment (both gross and per dollar).

The proposals in the president's budget that most reduce deficits are allowing the upper-income Bush-era tax cuts to expire and capping the value of certain tax expenditures for upper-income households. These would have a low impact on growth per dollar, shaving an average of just 0.16 percentage points from real GDP growth in 2013

and 2014.[6] Other Obama proposals for taxes and spending, such as closing business tax loopholes and reforming Medicare payments, would be mildly expansionary in 2013 (adding 0.1 percentage point to GDP growth) and mildly contractionary in 2014 (shaving 0.1 percentage point from GDP growth).

Gov. Romney's economic and budget plan

Since it is not an official government document, Gov. Romney's economic plan, *Believe in America: Mitt Romney's Plan for Jobs and Economic Growth* (Romney 2012a), is less detailed (e.g., it lacks summary tables) than the president's budget and is thus subject to greater interpretation. The core of the plan is cutting both taxes and spending (the overall spending cut is the net result of *increases* in defense spending coupled with larger *cuts* to nondefense spending). The tax cuts would provide fiscal support while the spending cuts would be contractionary. The degree to which the Romney plan would, as a whole, spur or retard economic activity, however, is highly dependent on assumptions about the financing of its tax cuts (discussed below).

The Romney tax plan would continue all of the 2001 and 2003 tax cuts, repeal the estate tax permanently, and eliminate capital gains, dividends, and interest taxation for households with adjusted gross income (AGI) under $100,000 ($200,000 for married couples filing jointly).[7] On the corporate side, Romney proposes reducing the top statutory corporate income tax rate from 35 to 25 percent, eliminating the corporate alternative minimum tax (AMT), and permanently extending the research and experimentation credit (which is included in the current policy baseline and thus is assumed in our analysis to have no additional economic impact). After an income-repatriation tax holiday, Romney would eventually transition the U.S. international tax system to a territorial system (i.e., multinationals' foreign source income would no longer be subject to tax upon repatriation). The Romney budget plan would also repeal taxes (and spending) associated with the Affordable Care Act. As did the nonpartisan Tax Policy Center's (TPC) analysis of the Romney plan, we assume that the 2009 expansion of refundable tax credits would be allowed to expire on schedule at the end of 2012 (TPC 2012a), and this curtailment would exert downward pressure on growth relative to current policy.[8]

On the spending side, Romney has proposed cutting nonsecurity discretionary spending by 5 percent, increasing base Department of Defense (DoD) spending (i.e., spending that excludes overseas contingency operations) to 4.0 percent of GDP (up from 3.4 percent in fiscal 2013 and 3.0 percent of GDP over fiscal 2013–2022 under current policy), repealing the ACA, and block-granting and cutting federal Medicaid spending (Romney 2012a; Romney 2012b). Additionally, and crucially for this modeling exercise, Romney has proposed capping federal spending at 20 percent of GDP, which we assume will be gradually phased in over fiscal 2013 through 2016 (see the appendix). Less-detailed proposals, such as reducing the federal workforce by 10 percent, are assumed to fall under either the nonsecurity discretionary cuts or the additional (unspecified) spending cuts needed to meet the phased-in spending cap.

After the initial release of his budget plan, Romney proposed reducing all individual income marginal tax rates by 20 percent and repealing the AMT, and he said that these *additional* tax cuts (i.e., only those over and above the tax cuts previously described) would be financed with "base-broadening" (i.e., elimination of tax expenditures) so that the net effect was both revenue and distributionally neutral relative to current policy. Subsequent analysis has indicated that meeting those two objectives is mathematically impossible without eliminating the preferential tax treatment of capital gains and dividends, which the Romney campaign has explicitly pledged to maintain (Brown, Gale, and Looney 2012). Moreover, comprehensive tax reform (i.e., eliminating the tax expenditures) would take years to draft and negotiate, whereas deep tax

TABLE 2

Near-term macroeconomic effects of Mitt Romney's budget plan, assuming deficit-financed income tax rate cuts and AMT elimination

	BUDGETARY COST (+) OR SAVINGS (-) (BILLIONS)		GDP IMPACT (% GDP)		EMPLOYMENT IMPACT (THOUSANDS OF JOBS)	
	2013	**2014**	**2013**	**2014**	**2013**	**2014**
Tax policy						
Tax cuts	$466	$516	1.0%	1.1%	1,207	1,284
Expiration of refundable tax credit expansions	-10	-30	-0.1	-0.2	-92	-267
Discretionary spending						
Defense increases	$75	$113	0.7%	1.0%	793	1,145
Nonsecurity discretionary cuts	-12	-16	-0.1	-0.1	-122	-164
Mandatory spending						
Repeal the Affordable Care Act	-$6	-$29	-0.1%	-0.2%	-63	-290
Block grant and cut Medicaid	-10	-18	-0.1	-0.2	-103	-185
Government spending cap						
Additional primary spending cuts needed to phase in 20% government spending cap	-$145	-$214	-1.3%	-1.8%	-1,532	-2,163
Total	**$358**	**$322**	**0.1%**	**-0.5%**	**87**	**-641**

Note: All policies are scored relative to EPI's current policy baseline. This table presents the impact in calendar years 2013 and 2014.

Source: Authors' analysis of Romney for President, Tax Policy Center, Congressional Budget Office, and Moody's Analytics data

cuts can be enacted relatively quickly, as demonstrated by the 2001–2008 Bush-era tax cuts.

Given these considerations, we modeled two scenarios for the Romney plan. The first specification assumes that the second round of tax cuts the candidate has proposed would be entirely deficit-financed, and these estimates are presented in **Table 2**. This is our preferred specification, not only because it would be easier to implement, but because it reflects actual policy proposals of the Romney campaign. In **Table 3**, we additionally model the impact of the Romney plan if these later tax rate reductions could be achieved as revenue-neutral tax reform. (Since distribution is not our primary concern here, we drop the distributionally neutral imperative that otherwise makes this part of the Romney plan mathematically unworkable.)

In the first scenario (Table 2), in 2013 the expansionary effect of deficit-financed tax cuts and defense spending increases would outweigh the contractionary effects of cuts in nonsecurity discretionary spending and health spending, as well as other spending cuts required to meet the spending cap. However, this would not be the case in 2014. On net, we project that Romney's budget plan would boost GDP by 0.1 percentage point in 2013 and decrease GDP by 0.5 percentage points in 2014 relative

TABLE 3

Near-term macroeconomic effects of Mitt Romney's budget plan, assuming revenue-neutral income tax rate cuts, AMT elimination, and unspecified "base-broadening"

	BUDGETARY COST (+) OR SAVINGS (-) (BILLIONS)		GDP IMPACT (% GDP)		EMPLOYMENT IMPACT (THOUSANDS OF JOBS)	
	2013	2014	2013	2014	2013	2014
Tax policy						
Tax cuts	$196	$234	0.4%	0.5%	492	570
Expiration of refundable tax credit expansions	-10	-30	-0.1	-0.2	-92	-267
Discretionary spending						
Defense increases	$75	$113	0.7%	1.0%	793	1,145
Nonsecurity discretionary cuts	-12	-16	-0.1	-0.1	-122	-164
Mandatory spending						
Repeal the Affordable Care Act	-$6	-$29	-0.1%	-0.2%	-63	-290
Block grant and cut Medicaid	-10	-18	-0.1	-0.2	-103	-185
Government spending cap						
Additional primary spending cuts needed to phase in 20% government spending cap	-$143	-$208	-1.3%	-1.8%	-1,512	-2,105
Total	**$90**	**$45**	**-0.5%**	**-1.1%**	**-608**	**-1,298**

Note: All policies are scored relative to EPI's current policy baseline. This table presents the impact in calendar years 2013 and 2014.

Source: Authors' analysis of Romney for President, Tax Policy Center, Congressional Budget Office, and Moody's Analytics data

to the current policy baseline. We project that employment would rise by 87,000 jobs in 2013 and decrease by roughly 641,000 in 2014. Romney's budget plan would add substantially to the deficit in both 2013 and 2014—in excess of $300 billion in each year—with tax cuts explaining more than all of this increase.

In the alternative financing scenario (Table 3), where a second round of tax cuts is financed with tax increases elsewhere, the expansionary effect of tax cuts and defense spending increases would be outweighed in *both* 2013 and 2014 by the contractionary effects of cuts in nonsecurity discretionary spending, health care, and other domestic programs required to meet the global spending cap. Under this scenario, the Romney budget plan would on net decrease real GDP growth by 0.5 percentage points in 2013 and 1.1 percentage points in 2014. We project that employment would fall by 608,000 jobs in 2013 and roughly 1.3 million in 2014.[9] Note that even if Romney's additional tax cuts were revenue neutral, his budget plan would add to the deficit in both 2013 and 2014, trading bigger deficits for fewer jobs.

Under both scenarios, the weaker job growth and outright job losses are driven by Romney's proposal to cap govern-

ment spending at 20 percent of GDP, a move that implies very large cuts to overall spending.

Conclusion

President Obama's budget would do more to spur near-term economic and employment growth than Gov. Romney's budget plan, regardless of how Romney would finance his second round of tax cuts (see **Figure A**).

Further, because the Obama budget calls for spending increases in areas that provide efficient fiscal support for economic activity and jobs in the near term, and for tax increases that have little impact on economic activity, it generates $3.39 in GDP for every dollar added to the budget deficit in 2013 and $1.00 in GDP for every dollar of deficit reduction in 2014.

Why the balanced budget amendment is not included in our analysis

Beyond capping government spending at 20 percent of GDP, Mitt Romney's economic plan calls for a balanced budget amendment (BBA) that would make increasing overall revenues intentionally difficult:

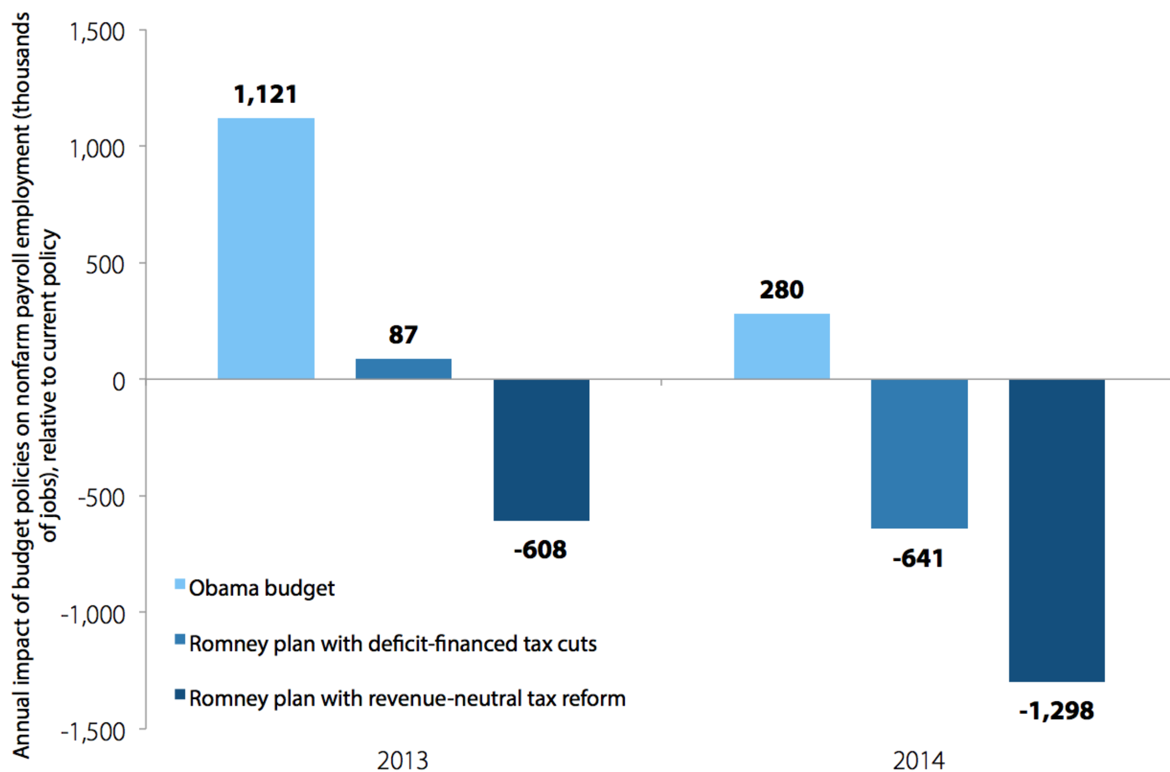
> A Balanced Budget Amendment to the Constitution is necessary to ensure that our nation embarks on a path of long-term fiscal discipline, and as president, Mitt Romney will introduce one in Congress and fight for its passage. A properly constructed amendment would guard against the use of net revenue increases to achieve balance by requiring a super-majority for the passage of any tax hike. (Romney 2012a)

Complying with a BBA (assuming that revenue levels cannot be raised, as this version would try to ensure with its supermajority vote requirement) by fiscal 2016 would require shrinking the size of the federal government from 20 percent of GDP as called for under Romney's proposed spending cap to either 14.9 percent of GDP (assuming entirely deficit-financed tax cuts) or 16.6 percent of GDP (assuming revenue-neutral individual income marginal tax rate reductions and AMT elimination). Relative to current policy, the requisite primary spending cut (i.e., non-interest) for fiscal 2016 alone would be between $932 billion and $1.2 trillion, or 5.0 percent to 6.6 percent of GDP, on a static basis. (The requisite cut would be larger on a dynamic basis, because the expanded cyclical budget deficit would force additional structural deficit cuts to align spending with lower revenue levels and to offset automatic spending increases from automatic stabilizers.) Over fiscal 2013–2016 primary spending would be cut by between $2.2 trillion and $2.9 trillion, forcing enormous output and job losses in an already depressed economy.

Government spending cuts of this magnitude would constitute an economic shock even larger than the one inflicted by the bursting of the housing bubble—a shock that led to the worst recession since the Great Depression. For this reason, we consider implementation of a BBA exceedingly unlikely and thus have not modeled it in our analysis of Romney's budget plan. For more discussion on the infeasibility of BBAs and undesirability of global spending caps, see Fieldhouse, Pollack, and Thiess (2011).

FIGURE A

Net near-term impact of Obama and Romney tax and budget policies on total nonfarm payroll employment (thousands of jobs)



Note: This figure presents the impact in calendar years 2013 and 2014.

Source: Authors' analysis of Congressional Budget Office, Office of Management and Budget, Romney for President, Tax Policy Center, and Moody's Analytics data

Using the specific policy proposals provided by the Romney campaign (which imply deficit-financing of all tax cuts, as detailed in Table 2), the Romney budget plan would generate only 3 cents of GDP for every dollar added to the budget deficit in 2013 and would actually reduce GDP by 28 cents for every dollar added to the deficit in 2014.

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—*The* ***Economic Policy Institute*** *is a nonprofit, nonpartisan think tank that seeks to broaden the public debate about strategies to achieve a prosperous and fair economy. EPI stresses real-world analysis and a concern for the living standards of working people, and it makes its findings accessible to the general public, the media, and policymakers through books, studies, and popular education materials.* ***The Century Foundation*** *conducts public policy research and analyses of economic, social, and foreign policy issues, including inequality, retirement security, election reform, media studies, homeland security, and international affairs. With offices in New York City and Washington, D.C., The Century Foundation is nonprofit and nonpartisan and was founded in 1919 by Edward A. Filene.*

Methodological appendix

All budget policy changes are scored relative to EPI's current policy baseline, allowing for an apples-to-apples com-

parison. Specifically, our current policy baseline assumes extension of the 2001, 2003, and 2009 tax cuts, the 2010 estate and gift tax cuts, the AMT patch, and business tax extenders (roughly 80 expiring tax provisions routinely extended on an annual basis). The only temporary tax policy assumed to expire on schedule is the 2 percentage-point employee-side payroll tax cut enacted for 2012. EPI's current policy baseline also assumes that scheduled reductions to Medicare physician reimbursement rates are prevented (i.e., the "doc fix" is continued), the automatic sequester from the Budget Control Act of 2011 (BCA) does not take effect, and force deployment and supplemental appropriations for overseas contingency operations gradually decrease instead of growing with inflation. Note that the current policy baseline assumes that the payroll tax cut and EUC program expire on schedule and the phase-one discretionary spending caps from the BCA remain in place, thereby exerting a drag on growth (see Bivens and Fieldhouse 2012).

All the budgetary costs of the spending proposals reflect outlays rather than budget authority (BA), and all provisions' costs exclude associated debt service (which has a negligible macroeconomic impact and small budgetary effects in the short run). Fiscal year budgetary impacts are adjusted to calendar years using a 75/25 split (i.e., calendar year 2014 reflects 75 percent of fiscal 2014 and 25 percent of fiscal 2015 impacts), except in the case of new tax policies being implemented at the start of a calendar year, in which case the weight for that fiscal year is increased to 100 percent. The budgetary cost of each policy is multiplied by its related fiscal multiplier for the projected dollar impact on GDP at the end of calendar years 2013 and 2014. The change in nonfarm payroll employment is calculated based on the percent change in nominal GDP that would be associated with each policy provision; see Bivens (2011b) for detailed methodology. The baseline for translating fiscal impulses to changes in nonfarm payroll employment is projected nominal GDP for calendar years 2013 and 2014 from CBO's August 2012 baseline economic forecast (CBO 2012c).

All fiscal multipliers are adopted or modeled from fiscal multipliers published by Moody's Analytics Chief Economist Mark Zandi, as detailed in **Table A-1** (Zandi 2011a; Zandi 2011b; Bivens and Fieldhouse 2012). While even the multipliers for specific provisions used in the various reports by Zandi change trivially over time, it is useful to note that these fiscal multipliers are comparable in scale and (even more importantly) relative ranking to the midpoint estimates of the multipliers used by CBO in evaluating the efficacy of the American Recovery and Reinvestment Act of 2009 (ARRA), as well as those used by the Council of Economic Advisors in its quarterly reports on ARRA (CBO 2012d; CEA 2011). In short, the relative ranking and the scale of impact of fiscal impulses are robust to a range of estimates of the multipliers.

Obama economic and budget plan

The economic impact of the Obama budget plan is calculated based on the president's fiscal 2013 budget (OMB 2012), with timing adjustments made for the American Jobs Act (AJA). The president's budget was released on February 13, 2012, before Congress agreed to a full-year continuation of the 2 percentage-point employee-side payroll tax cut and a scaled-back extension of the EUC program; these provisions are included in the current policy baseline only for calendar year 2012 (CBO 2011b; CBO 2012f). While the focus of this paper is 2013–2014, we include in our estimates for the Obama budget plan the difference between his proposals—a 3.1 percentage-point employee-side payroll tax cut and a full continuation of EUC benefits for calendar year 2012—and the smaller package enacted by Congress (see endnote 5). Relative to current policy, we calculate the AJA would have increased the payroll tax cut by $65 billion and EUC spending by $9 billion in calendar year 2012. Based on administration statements, we additionally assume the administration will push for continuation of the EUC at its current parameters for calendar year 2013 but no continuation of the payroll tax cut (Sparshott 2012; White House 2012b). Continuation of the EUC for calendar year 2013 at the current maximum

APPENDIX TABLE 1

Fiscal multipliers

Spending increases	
Temporary increase in food stamps	1.70
Temporary financing of work-share programs	1.64
Emergency unemployment insurance benefits	1.52
Increased infrastructure spending	1.44
General government spending	1.40
General aid to state governments	1.31
Low-income home energy assistance	1.13
Refundable tax credits (mix of spending and tax cuts)	
Child Tax Credit, Recovery Act expansion	1.38
Earned Income Tax Credit, Recovery Act expansion	1.23
Refundable lump-sum tax rebates	1.22
Making Work Pay tax credit	1.19
*American Opportunity Tax Credit, Recovery Act expansion**	1.09
Temporary tax cuts	
Payroll tax cut for employees	1.25
Hiring tax credit	1.20
Payroll tax cut for employers	1.04
Nonrefundable lump-sum tax rebate	1.01
Across-the-board tax cut	0.98
Housing tax credit	0.82
Accelerated depreciation (bonus depreciation)	0.29
Loss carryback	0.25
Permanent tax cuts	
Extend alternative minimum tax patch	0.53
Make capital gains and dividend tax cuts permanent	0.39
Make Bush tax cuts permanent	0.35
Make corporate income tax cut permanent	0.32
*Make upper-income Bush tax cuts permanent**	0.25

* Imputed from Zandi multipliers as detailed in Bivens and Fieldhouse (2012)

Sources: Zandi (2011a), Zandi (2011b), and Bivens and Fieldhouse (2012)

73-week duration of unemployment insurance benefits in high-unemployment states is assumed to cost $35 billion.[10] The employee-side payroll tax cut is assigned a multiplier of 1.25 and the EUC program a multiplier of 1.52, from Zandi's analysis of the AJA (Zandi 2011b).

For the remainder of the AJA that Congress has not acted on—which the president continues to support (Krueger 2012)—we shift budgetary effects back one year, with budgetary impacts adopted from "Temporary Tax Relief and Investments to Create Jobs and Jumpstart Growth" in OMB Table S-9 (OMB 2012). Beyond the practicality of realistic timing, this makes for a better comparison with Romney's proposals, none of which would take effect in fiscal 2012. For tax policies we adopt Zandi's policy-specific fiscal multipliers for extending 100 percent first-year accelerated depreciation (0.29) and the hiring tax credit (1.20), while using the lump-sum nonrefundable tax rebate multiplier (1.01) for advanced energy manufacturing credits, energy efficient building credits, and Build America bonds—none of which has policy-specific multipliers. Proposed investments in immediate surface transportation projects, an infrastructure bank, and school modernizations are assigned Zandi's multiplier for infrastructure spending (1.44). Proposed funds for rehiring teachers and first responders as well as neighborhood stabilization are assigned Zandi's multiplier for aid to state budgets (1.31). The Pathways Back to Work fund is assigned the multiplier for unemployment insurance (1.52), and continuing the temporary expansion of the Supplemental Nutrition Assistance Program (SNAP) is assigned Zandi's SNAP multiplier (1.70). All other mandatory spending initiatives are assigned the lump-sum nonrefundable tax rebate multiplier (1.01), conservatively below Zandi's most recent general government spending multiplier (1.40). In addition to the immediate surface transportation projects proposed as part of the AJA, the president's budget proposed a surface transportation reauthorization bill increasing funding relative to current policy; these outlays are also assigned the 1.44 increased infrastructure spending multiplier but are not shifted (these outlays begin in fiscal 2013 rather than fiscal 2012).

The impact of allowing the upper-income Bush-era tax cuts to expire—specifically, reinstating the personal exemption phaseout, the limitation on itemized deductions, and the 36 percent and 39.6 percent brackets; taxing qualified dividends as ordinary income; and taxing capital gains at 20 percent for households with AGI above $200,000 ($250,000 for joint filers)—is calculated from OMB's cost estimate relative to current policy (OMB 2012).[11] Beyond letting the upper-income Bush tax cuts expire, the administration also proposed capping the value of itemized deductions and other select tax preferences at 28 percent (the values of deductions and exclusions are determined by a filer's marginal tax rate). A multiplier of 0.25 is assigned to these upper-income tax provisions, which is the weighted multiplier for the upper-income Bush-era tax cuts we previously imputed from Zandi's multipliers and 10-year Bush tax cut revenue estimates (see Bivens and Fieldhouse 2012). Consistent with most macroeconomic models and economic theory, the president's proposed reversion of the estate and gift tax from 2011–2012 parameters to 2009 parameters is assumed to have zero macroeconomic impact (Bivens and Fieldhouse 2012). Many tax cut proposals in the president's budget, such as making permanent the research and experimentation credit or maintaining the 2009 expansions of the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the American Opportunity Tax Credit (AOTC), are built into the current policy baseline and are thus excluded from our modeling. Other tax provisions with budgetary impacts relative to current policy, almost entirely business tax provisions, are assigned a multiplier of 0.32, Zandi's multiplier for a cut in the corporate income tax. Tax reforms and revenue raisers with budgetary impacts relative to current policy include reforming the international tax system, reforming treatment of financial and insurance industry institutions and products, eliminating fossil fuel preferences, reducing the tax gap, and simplifying the tax code (OMB 2012). Addi-

tionally, a handful of business tax credits and cuts are included with the other tax provisions and assigned the 0.32 multiplier, specifically automatic individual retirement account enrollment incentives for small businesses, tax incentives for locating business activity in the United States, tax credits for production of advanced technology vehicles and alternative-fuel commercial vehicles, doubled expensed start-up expenditures for small businesses, small business tax credits for contributions to employees' health insurance, and designated growth zones.

Discretionary spending policies are taken as the sum of BCA disaster relief cap adjustments and outlay effects of discretionary policy from OMB Table S-2 (OMB 2012). Health and other mandatory spending changes are also taken from OMB Table S-2. Both are assigned the 1.40 general government spending multiplier. The president's budget would additionally replace the automatic BCA sequester with deficit reduction proposals from his 2013 budget, but the current policy baseline assumes the sequester will be deactivated, so no macroeconomic adjustment is made.

Romney economic and budget plan

The economic impact of the Romney budget plan is calculated two ways based on a major difference in assumptions about tax policy. The cost of the Romney tax plan is modeled from the Tax Policy Center's distributional analysis of Romney's tax proposal scored relative to current policy for calendar year 2015, both with and without the additional 20 percent reductions to marginal ordinary income tax rates and elimination of the AMT (TPC 2012b; TPC 2012c). Note that the current policy baseline used by the TPC also assumes that all temporary tax provisions—excluding the payroll tax cut—are extended.

In our first (and preferred) modeling of the Romney plan, we explicitly assume that those additional 20 percent rate reductions and AMT repeal are entirely deficit-financed (Table 2). If the tax cuts were deficit-financed, there would be no net adverse effect on employment in 2013. It is also worth noting an oddity of Romney's call for a "global" cap (including debt service costs) on federal spending: Under such a rule, the expansionary effect of deficit-financed tax cuts would shrink over time because the associated interest costs (which do not appreciably affect aggregate demand) would increasingly crowd out primary government spending.

To make the TPC estimates based on 2015 applicable to 2013 and 2014, the total number of tax units and average federal tax change per tax unit are used to impute their cost for 2015, which is held constant as a share of nominal GDP and applied to these earlier years, with the tax cuts assumed to take effect on January 1, 2013. As such, our economic projections of the Romney tax plan do not include any additional near-term revenue loss from the temporary repatriation holiday Romney has endorsed, but we would not expect any stimulative demand effects from another repatriation holiday (Fieldhouse 2011).[12] TPC's distributional analysis of the Romney tax plan accounts for repeal of the Medicare hospital insurance (HI) surcharges for upper-income households included in the Affordable Care Act (ACA), but ignores other revenue provisions, notably the excise tax on expensive insurance plans; penalties on employers; reinsurance and risk adjustment collections; and fees on pharmaceutical manufacturers, certain medical device manufacturers, and health insurance providers, among other provisions.[13] Accordingly, we add the revenue loss from ACA provisions net of the upper-income HI surcharges to the cost of the Romney tax plan imputed from TPC's distributional analysis.

The economic impact of the expiration of the 2009 expansion of refundable tax credits is treated separately from the tax cut proposals, with associated revenue savings netted out of the Romney tax plan's cost imputed from TPC's distributional analysis (increasing the revenue loss from the tax rate cuts by an equivalent amount). The budgetary impact of allowing these refundable credits to expire is calculated from CBO's August 2012 revenue

estimates of expiring tax provisions (CBO 2012g). ARRA-specific multipliers of 1.38 and 1.23 are used for the CTC and EITC provisions, respectively (Zandi 2011b). A multiplier of 1.09 is used for the AOTC, which is the weighted average of a 1.22 multiplier for refundable lump-sum tax rebates (40 percent) and a 1.01 multiplier for nonrefundable lump-sum tax rebates (60 percent), reflecting that up to 40 percent of the AOTC is refundable. Just as Obama's proposed reinstatement of the 2009 estate and gift tax parameters is assumed to have no adverse impact, Romney's proposed repeal of the estate tax is assumed to have zero effect on near-term demand. The remainder of the Romney tax cuts are assigned a fiscal multiplier of 0.35, which is Zandi's multiplier for permanent extension of the Bush income tax rate cuts. The 0.35 multiplier also seems like a reasonable midpoint for non-individual income rate provisions; the corporate tax rate cut would have a multiplier of 0.32, and the repeal of the AMT, which is more targeted to higher-income households than the AMT patch (which has a multiplier of 0.53), would likely be near 0.35. Note that 82.4 percent of the benefit from the first phase of tax cuts and 67.1 percent of the benefit of the expanded tax cuts would be conferred to households with a relatively low marginal propensity to consume, those earning over $200,000 annually (TPC 2012d; TPC 2012e), a more regressive distribution than the Bush-era tax cuts; the 0.35 multiplier thus likely overstates the economic benefit of these tax cuts.[14]

We calculate the 5 percent nonsecurity discretionary (NSD) cut relative to current policy NSD outlays (i.e., phase one BCA discretionary spending caps remain in effect but the sequester does not take effect), which are lagged from our NSD BA baseline. For defense spending, we assume that annual base DoD BA will be increased so that outlays hold at 4.0 percent of GDP, up from 3.4 percent of GDP in fiscal 2013. The defense increase is calculated as the difference between 4.0 percent of GDP and base DoD spending under current policy (again excluding the sequester) from Table 1-3 of CBO's *An Update to the Budget and Economic Outlook* (CBO 2012b). A fiscal multiplier of 1.40—Zandi's most recent general government spending multiplier (Zandi 2011a)—is applied to both the NSD cut and DoD increase.

With regard to mandatory spending, the net budgetary impact of repealing the ACA is taken from CBO's analysis of H.R. 6079, the Repeal of Obamacare Act (CBO 2012e), an analysis that postdates the court's ruling on the Affordable Care Act.[15] The Romney campaign has also proposed converting federal Medicaid spending into block grants to states, capping total annual Medicaid growth at 1 percentage point above inflation (Romney 2012c). CBO's baseline for Medicaid spending includes increased outlays from the ACA, which we first net out in order to calculate the impact of block-granting Medicaid above and beyond ACA repeal. We also treat the Children's Health Insurance Program (CHIP) as part of Medicaid, both for ACA repeal baseline adjustments and residual cuts from block grants. For the Romney trajectory for Medicaid and CHIP expenditures, we index fiscal 2012 expenditures to CBO's projections for CPI-U (CBO 2012c) plus 1 percentage point. Note that assuming CHIP is block-granted along with Medicaid has zero effect on the net employment impact; the budgetary and economic effect of block-granting CHIP would otherwise show up in larger job losses from the global spending cap, as discussed below. Again we apply Zandi's most recent 1.40 general government spending multiplier to all mandatory spending changes.

Lastly, the global spending cap is calculated assuming a four-year linear phase-in as a share of GDP so that total federal outlays reach 20 percent of GDP by fiscal 2016 (from 22.9 percent in fiscal 2012). Under both assumptions regarding tax cut financing, the fiscal impulse of tax changes and other primary spending adjustments relative to current policy is run through a debt service matrix to calculate the net interest cost of specific policy proposals (i.e., excluding the spending cap). Specific budget proposals and associated debt service are then used to

adjust current policy outlays to calculate total outlays for specified proposals in the Romney economic plan, again under both assumptions regarding tax cut financing. The difference between outlays for specific proposals in the Romney economic plan and the path of permissible spending under the phased-in global spending cap is then run through a reverse debt service matrix to calculate the additional cut to primary spending required by the global spending cap. Beyond assumptions about how tax rate cuts are financed, the net employment impact of the Romney economic plan essentially does not depend on the magnitude of specific policy provisions calculated before the global spending cap. (If tax cuts or additional proposals are deficit-financed, greater net interest costs increase the primary spending cuts required by the global spending cap, but net interest effects are very small in the near term.) Note that we explicitly assume the global spending cap is the binding factor for federal outlays under the Romney plan rather than the balanced budget amendment (BBA) Romney has endorsed; if a BBA were the binding factor in fiscal 2015, federal outlays would have to be reduced to between 16.6 percent of GDP (assuming revenue-neutral tax reform) and 14.9 percent of GDP (assuming deficit-financed tax cuts). Cutting government spending to such low levels in an already deeply depressed economy seems an implausible outcome (see **Box 1**).

Endnotes

1. Sustaining trend growth of roughly 150,000 jobs added to nonfarm payrolls over January through July 2012, it will be roughly a decade before the economy returns to full employment (Shierholz 2012).

2. Keynesian diagnoses have also surfaced from both presidential campaigns. For instance, Mitt Romney has stated with regard to federal spending cuts that "if you take a trillion dollars, for instance, out of the first year of the federal budget, that would shrink GDP over 5 percent. That is by definition throwing us into recession or depression," and, "If you just cut, if all you're thinking about doing is cutting spending, as you cut spending you'll slow down the economy" (MacGuillis 2012). Similarly, President Obama advocates for greater government spending to increase employment, recently saying on the campaign trail that "we could create a million additional new jobs if this Congress would pass the jobs bill I sent them a year ago—jobs for teachers and construction workers and folks who have been out there looking for work for a long time" (White House 2012a).

3. \$1 x 1.44 (the infrastructure multiplier) – \$1 x 0.24 (the upper-income tax cut multiplier) = \$1.20. By moving GDP \$1.20 closer to potential output, the cyclical deficit falls by \$1.20 x \$0.37 (the historical relationship between the output gap and the cyclical deficit) = \$0.44 (Bivens and Edwards 2010).

4. The one policy that would be heavily affected by dynamic feedback accounting would be Romney's proposed global spending cap. Spending cuts to meet the cap would depress economic activity and raise cyclical outlays, forcing even deeper structural budget spending cuts to meet targeted spending levels.

5. While the enacted 2012 payroll tax cut and EUC benefits are built into the current policy baseline (and hence are not "credited to" the employment impact we calculate for Obama's plan), it is worth noting that we project these measures will have boosted real GDP growth by 1.3 percentage points by the end of 2012, roughly increasing payroll employment by 1.5 million jobs. Enacting the larger versions proposed in the AJA would, however, have boosted the economy by an additional \$95 billion (0.6 percent), increasing employment by roughly 726,000 additional jobs by the end of 2012.

6. Both the budgetary cost and economic drag from the Obama administration's proposed upper-income tax provisions exceed the impact of just letting the upper-income Bush tax cuts expire (see Bivens and Fieldhouse 2012), because the administration's proposal additionally includes capping the value of itemized deductions at 28 percent for households with adjusted gross income above \$200,000 (\$250,000 for joint filers). See the appendix.

7. As part of the Bush-era tax cuts, the preferential 15 percent rates for capital gains and dividends would be maintained for households above these thresholds.

8. The American Reinvestment and Recovery Act of 2009's expansion of refundable tax credits includes marriage penalty relief for the Earned Income Tax Credit (EITC), a third EITC tier for families with three or more qualifying children, a lower income threshold for the refundable Child Tax Credit (CTC), and the replacement of the HOPE tuition tax credit with the larger, partially refundable American Opportunity Tax Credit. These provisions were later extended through December 31, 2012, by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

9. The outcome is likely to be worse in terms of GDP and jobs. If Romney's additional tax cuts are revenue neutral and the tax preference for capital gains and dividends is preserved, the incidence of income taxes would necessarily shift away from upper-income households toward lower- and middle-income households with higher marginal propensities to consume. As income is transferred toward households more likely to save it than spend it, the expansionary effect of the Romney tax plan would be reduced. However, we make no adjustment for such effects.

10. This is a preliminary CBO cost estimate of maintaining current EUC policy; it was provided by House of Representatives Committee on Ways and Means staff.

11. OMB's current policy baseline, or "adjusted baseline," assumes that the AMT patch is continued, the 2001 and 2003 tax cuts are continued, and the estate and gift taxes are continued at 2011–2012 parameters. As opposed to our current policy baseline, the business tax extenders are not assumed to be continued, and we have tried to score only the other tax provisions that have savings or costs relative to our current policy baseline, rather than OMB's adjusted baseline.

12. Moral hazard concerns associated with a repeat of the 2004 repatriation holiday would likely encourage more offshoring and less domestic investment. Dharmapala, Foley, and Forbes (2009) estimate that every dollar of repatriated foreign earnings from the 2004 tax holiday was associated with a 92 cent payout in stock repurchases and dividend payments—*even though these were explicitly prohibited*—responses that would have a negligible impact on demand (at best a small wealth effect). Furthermore, many of the firms that took advantage of the 2004 tax holiday actually laid off thousands of American workers shortly after repatriating billions of dollars at the lower rate (Marr and Highsmith 2011).

13. The ACA included a 0.9 percent surcharge on wages and salaries and a 3.8 percent surcharge on capital income for households with AGI above $200,000 ($250,000 for joint filers).

14. TPC distributional analyses of the Romney tax plan are measured by tax units for calendar year 2015 in 2011 dollars relative to current policy. The Bush tax cuts conferred 48.0 percent of their benefit to households earning over $200,000 if the AMT were patched and 51.4 percent if the AMT were not patched (TPC 2008a; TPC 2008b). TPC distributional analyses of the 2001–2008 Bush-era tax cuts are measured by tax units for calendar year 2010 in 2008 dollars relative to then-current policy.

15. The score for repealing the ACA comes from a CBO estimate postdating the Supreme Court's ruling on the Affordable Care Act and takes into consideration states opting out of the largely federally financed Medicaid expansion up to 138 percent of the poverty line.

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