Obama's Best Jobs Idea

Congress should continue to allow small businesses to expense capital equipment purchases.

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In the hunt for private-sector jobs that don't depend on government subsidies, President Obama has done one right thing. He's asked Congress to continue to permit small businesses to expense capital equipment purchases and large businesses to deduct 50% in the first year. If these write-offs are allowed to expire at the end of the year, the after-tax cost of business equipment would rise and tend to stifle the nascent economic recovery.

Better yet, Mr. Obama and the Democratic Congress should make the write-offs permanent, 100%, and across the board for all companies. Capital investment is a sure-fire way of creating jobs and income, and more of it is badly needed.

As we showed in a study for the Institute for Policy Innovation, each $1 of tax cut from first-year expensing typically eventually produces about $9 of additional GDP growth. That's because to receive the tax cut a business must invest $3 to $6 in new equipment. The added investment leads to a $2 to $4 increase in labor compensation as well. The resulting increase in GDP compounds over time.

Expensing, in one form or another, has worked every time it has been tried-four times in the 1960s and 1970s, again in 1981-1982, again in 2002-2004 and, most recently, in 2008-2009. And it is not an emergency stimulant; it is the correct way to treat capital investment and a key component of all mainstream tax-reform proposals.

Because of the time value of money, a business that can't expense equipment right away never is able to deduct the full replacement cost of its purchases. This makes capital equipment more expensive and less affordable. Expensing in effect reduces the cost back to where it should be. Businesses won't buy equipment that they don't need, but, at a lower price, they will buy a larger volume more quickly.

Expensing is especially important now. Since 2007, the decline in nonresidential capital goods investment has been 18 times greater than the decline in consumption (a 19.9% decline for investment compared to a 1.1% decline in consumption).

First-year expensing is not without cost from a budget-accounting standpoint in the short run. (In the long run it evens out-companies deduct more of its equipment costs early on and pay less tax, but later deduct less and pay more tax.) But surely, with a $3.6 trillion budget and a $1.4 trillion deficit, there's room for a tax cut that has no peer as a proven job-creating machine in the private sector.

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