

A Cost-Effective Policy for Creating Jobs

by Timothy J. Bartik

At this writing (May 2003), the U.S. labor market is sluggish. Unemployment is hovering at or around 6 percent. Even if a vigorous recovery begins, unemployment will remain significantly higher than the low levels of the late 1990s for the next two years, because unemployment is a “lagging indicator” of the economy. Furthermore, as the Federal Reserve acknowledged on May 6th, the U.S. economy faces some downside risk of persistent stagnation and deflation, in which falling wages and prices would increase real debts and interest rates, depressing consumption and investment.

Policies to reduce unemployment deserve serious consideration. Monetary policy has driven down the federal funds rate to 1.25 percent, which suggests further stimulation of the economy by monetary policy may be difficult. Fiscal policy may be more effective in stimulating the economy. However, given the long-term budget deficit problems of the federal government, any such fiscal policy should avoid excessive budget costs.

One fiscal policy alternative that should be considered, but has not been, is a revival of the New Jobs Tax Credit (NJTC). The NJTC, in effect during 1977 to 1978, provided tax credits to employers who expanded employment. A revised NJTC could encourage employment expansion at a relatively low cost per job created.

A revised New Jobs Tax Credit would be cost-effective because it is targeted. For example, the 1977 version of the NJTC gave employers a tax credit of 50 percent of the first \$12,000 (year 2003 dollars) of wages per employee for increases in employment of more than 2 percent over the previous year. This design avoids the expense of subsidizing all employment. The NJTC reduces the

net costs to employers of employment expansions. These marginal decisions about employment are the most likely to be affected by incentives.

The original New Jobs Tax Credit was a credit against income taxes, and therefore only encouraged employment expansions at profitable businesses. To encourage employment expansion at all employers, a revised NJTC could be a refundable tax credit against payroll taxes. This allows credits to be received by start-up businesses, non-profits, and state and local governments. Revenue foregone by Social Security and Medicare could be reimbursed from general revenues.

Although inflation is not a big concern at present, a poorly designed fiscal policy could create long-term inflationary pressures. To reduce the risk of inflation in the long-term, a fiscal stimulus should be targeted at employment expansions at times and places with high unemployment rates. To accomplish this, the revised New Jobs Tax Credit should be designed to only be in effect when the unemployment rate is high in a local labor market. As the national economy expands and unemployment rates drop in more areas, an NJTC's fiscal stimulus will automatically decrease. This minimizes increases in inflation and federal debt.

One key detail is how to define local labor markets. In rural areas, the official labor market areas used by the U.S. Bureau of Labor Statistics could be used to define labor markets. Smaller metropolitan areas would comprise a single labor market. For larger metropolitan areas, empirical research suggests that suburban jobs may be difficult for city residents to access in metropolitan areas above 800,000 in population. This suggests that cities above some population cut-off, say a half million, should have the option of using the city unemployment rate to qualify for the revised NJTC.

With this design, the revised NJTC becomes more than an anti-recession tool. A revised NJTC could also help distressed central cities, as well as other distressed local labor market areas.

Research has estimated how many jobs were created by the New Jobs Tax Credit, which was inevitably fewer than the jobs for which tax credits were paid. The evidence suggests that the original NJTC created about 700,000 new jobs at a cost of about \$10 billion (2003 dollars), or \$14,000 per job created. This cost per job created is much lower than for many other fiscal policies. Evidence further suggests that the original NJTC could have created even more jobs if it had been better publicized. In today's larger economy, and with an NJTC that applies to more employers, the revised NJTC would create considerably more than 700,000 jobs.

Reviving the New Jobs Tax Credit may be politically difficult. The NJTC's immediate benefits go to the minority of employers that create jobs and the workers they hire, which are not organized interests with political clout. However, given the sluggish economy and a federal government struggling with budget deficits, we need a stimulus policy to create jobs that is cost-effective. A revised NJTC should be seriously considered.

References:

More discussion of the New Jobs Tax Credit, and a review of the research literature, can be found in my book *Jobs for the Poor* (Russell Sage Foundation and Upjohn Institute, 2001), particularly in chapter 8. Other sources for information and research on the New Jobs Tax Credit and related wage subsidy approaches for reducing unemployment include:

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