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The U.S. Economic Crisis and a Revised New Jobs Tax Credit

Timothy J. Bartik
W.E. Upjohn Institute for Employment Research, bartik@upjohn.org

Upjohn Author(s) ORCID Identifier:
https://orcid.org/0000-0002-6238-8181

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Timothy J. Bartik, Senior Economist
W.E. Upjohn Institute for Employment Research
e-mail: bartik@upjohn.org

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Abstract

An efficacious economic stimulus to help the U.S. economy recover from its current recession is the revival of the New Jobs Tax Credit. Unlike the original credit utilized by the federal government in 1977–1978, the new version should be a refundable credit but at a lower current dollar value. My 2001 book, *Jobs for the Poor: Can Labor Demand Policies Help?* proposed a permanent version f the New Jobs Tax Credit that would be automatically triggered when the unemployment rate is high. My estimates, updated to 2008, suggest that such a revised credit might increase aggregate U.S. employment by 1.3 million jobs per year at a public cost of less than $20,000 per job. Prolonged unemployment poses a serious social problem that could be addressed with a revised New Jobs Tax Credit.

Key Words: labor demand policy, tax credit, wage subsidy, employment creation

W.E. UPJOHN INSTITUTE FOR EMPLOYMENT RESEARCH
300 South Westnedge Avenue | Kalamazoo, Michigan 49007 | Ph. 269-343-5541

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by Timothy J. Bartik, Senior Economist, W.E. Upjohn Institute for Employment Research
bartik@upjohninstitute.org

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Because of the current worldwide economic crisis, there is a renewed interest in fiscal stimulus proposals. It seems likely that the U.S. economy is already in a recession, which may be severe and prolonged. Because of the problems in the financial sector, expansionary monetary policy does not appear to be the best method to stimulate the aggregate economy.

Such a situation is a textbook case for some sort of fiscal stimulus. Either tax cuts or spending increases could be used to stimulate the U.S. economy.

One type of stimulus that would particularly target job creation is a revival of the New Jobs Tax Credit utilized by the federal government in 1977 and 1978. The New Jobs Tax Credit provided a tax credit to businesses for additions to their overall employment. The program at its peak provided such subsidies to 1.1 million businesses for adding over 2.1 million workers, at an annual cost of a little less than $4 billion, which, in today's dollars, is around $13 billion.

Presidential candidate Barack Obama proposed a revised version of the New Jobs Tax Credit on October 13, 2008. Although this "New American Jobs Tax Credit" is similar to the New Jobs Tax Credit, it differs in some important details. In particular, this new proposal is a refundable credit, whereas the original New Jobs Tax Credit could only be utilized by businesses to offset existing tax liabilities. This revision is likely to make the program more useful to businesses without taxable profits, with, of course, the implication of some increase in costs. In addition, this new proposal is a somewhat smaller wage subsidy than the original New Jobs Tax Credit—$3,000 compared to as much as $7,000 (in 2008 dollars). A smaller wage subsidy would probably lower both budgetary costs and job creation impacts.

In my 2001 book, *Jobs for the Poor: Can Labor Demand Policies Help?* I proposed enacting a permanent version of the New Jobs Tax Credit. This credit would be automatically triggered when overall national unemployment is high, or when unemployment is high in a particular metropolitan area. This credit would also be refundable. In addition, however, the revised New Jobs Tax Credit outlined in my book would also be applicable to expansions of employment by nonprofit employers or state and local governments.

My estimates, updated to 2008, suggest that such a revised New Jobs Tax Credit might increase aggregate U.S. employment by about 1.3 million jobs per year due to incentive effects on the subsidized employers. This is the net increase in jobs, compared to what these employers would have done in a world without this tax credit; the gross number of subsidized jobs would be greater. In addition, there would be some multiplier effects on job creation of simply spending the additional funds on the revised New Jobs Tax Credit. Therefore, total job creation would likely be greater than 1.3 million jobs. The estimated annual budgetary cost of this revised tax credit would be $26 billion.

My estimates of the job creation effects of a revised New Jobs Tax Credit are based on several evaluations of the job creation impact of the original credit program. A 1979 study by Jeffrey Perloff and Michael Wachter suggests that businesses that knew about the New Jobs Tax Credit increased their employment by 3 percent more than firms that did not know about it. This implies an economywide increase in employment of 700,000 jobs in 1977. A 1981 study by John Bishop, which looks at employment in construction, retail trade, wholesale trade, and trucking, and its relationship to business knowledge of the New Jobs Tax Credit, estimates employment increases in these industries of between 225,000 and 585,000.

Of course, the employment impact of a revised New Jobs Tax Credit program might be different in the current economic environment with credit constraints. It is unclear whether the impact would be higher or lower. Credit constraints could prevent some companies from expanding even with wage subsidies. On the other hand, providing cash wage subsidies on a timely basis might help to avoid those constraints.

Any such wage subsidy program would to some extent provide subsidies for employment expansions that would occur anyway. This is unavoidable. Empirical estimates suggest that about two out of the three jobs subsidized by the original New Jobs Tax Credit would have been created even without the credit (Bartik 2001, p. 226).

However, one of the three jobs subsidized would be a net addition to national employment. It seems likely that the social benefits of the new jobs created would exceed the budgetary costs. Under my 2001 proposal, the total costs per job created through these incentives would be less than $20,000 per job in today’s economy ($26 billion in annual subsidies divided by job creation of over 1.3 million jobs). This is considerably less than the average one-year compensation for a full-time equivalent job. Furthermore, it seems likely that many of these jobs will continue beyond the subsidy period, which increases the social benefits of the additional employment. Finally, the social benefits of reducing unemployment go beyond the immediate economic benefit to the newly employed; they include positive effects on families, friends, and neighbors.

The likely prolonged rise in unemployment due to the current recession poses a serious social problem. Fiscal stimulus measures should address job creation and unemployment reduction as directly as possible. A revised New Jobs Tax Credit could play an important role in a fiscal stimulus package focused on reducing the social costs of unemployment.

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