Statement of

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Mr. Chairman, Congressional concern about improving employment opportunities for disadvantaged groups is longstanding. Currently, the Congress authorizes both direct spending and tax expenditure programs to aid disadvantaged workers. One of these--the Targeted Jobs Tax Credit (TJTC, hereafter referred to as the tax credit)--is a tax expenditure that will expire at the end of 1984, unless it is reauthorized by the Congress.

My remarks today cover three topics:

- o Background information about the tax credit;
- o Evidence concerning its effectiveness; and
- o Options the Congress may want to consider as it debates reauthorization of the credit.

BACKGROUND

The jobs tax credit is a nonrefundable employer tax credit. By reducing the cost of hiring workers from certain disadvantaged groups relative to unsubsidized job seekers, the credit seeks to induce private-sector employers to try workers from certain high-risk groups that they might not otherwise choose to hire. Although employers may simply shift their hiring toward targeted workers in response to the credit, without an expansion in overall employment, economic theory suggests that the credit should result in some increased employment because it lowers the cost of labor. While there is no explicit training requirement under the credit, it may benefit disadvantaged workers who are ready to hold jobs by enabling them to demonstrate their competence and to build a work history that will make it easier for them to find other jobs later.

Under current law, employers may claim a tax credit for two years—50 percent the first year and 25 percent the second year of the first $6,000 earned annually by newly hired eligible employees. 1/ Workers eligible for this credit include low-income youth aged 18 to 24, low-income youth aged 16 to 19 in cooperative education (work-study) programs, public assistance recipients, disabled workers in rehabilitation programs, low-income Vietnam veterans, and low-income ex-convicts. In addition, employers may claim a credit of 85 percent of the first $3,000 earned by low-income youth aged 16 or 17 hired for the summer months. Two-thirds of workers claimed for the year-round program are from youth categories. This group is the focus of my testimony today because there is little evidence about the effect of the credit for other groups.

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1. The dollar value of savings to employers varies by tax bracket, because the employer's tax deduction for wages paid is reduced by the amount of the credit. In the first year, for example, an employer receives a tax credit equal to $3,000 for an eligible employee earning $6,000. With the credit, however, only $3,000 of the employee's wages may be deducted as a business expense. Hence, at a 25 percent tax rate, both the value of the subsidy and the employee's after-tax cost to the employer are $2,250 ($3,000 times /1-tax rate/). The rate of subsidy for after-tax wage costs is 50 percent in the first year regardless of the employer's tax bracket, though.

The tax credit program has been changed substantially since its initial authorization in 1978, probably increasing its effect on employers' hiring decisions. In its early years, it was widely believed that the program was not providing the intended employment benefits for targeted groups. Instead, it seemed likely that most of the program's benefits accrued to employers for whom the credit was a windfall benefit that did not alter their hiring decisions. There were two reasons for this belief. First, about half the workers certified for the credit were youth in cooperative education programs--a group that employers were generally willing to hire without the credit as an inducement. 2/ Second, two-thirds of other workers claimed for the credit--from economically disadvantaged groups--were certified retroactively. That is, first they were hired and only later did their employers determine their eligibility for the credit. In this instance, too, it seems unlikely that the credit shifted hiring preferences.

To increase the effectiveness of the program, the Economic Recovery Tax Act of 1981 eliminated both eligibility for cooperative education students, unless they were also economically disadvantaged, and retroactive certification. Following these changes, certifications declined in 1982 by about 40 percent, with three-quarters of the decline due to the restriction

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2. Although some employers who had previously participated in cooperative education programs may have refused to continue when eligibility for the credit was reduced, there is no evidence that this was widespread.

imposed on eligibility for cooperative education students. The rest of the decline was due, in unknown proportions, to the elimination of retroactive certification and to the recession, which resulted in lower overall demand for workers. By 1983, however, use had returned to its 1981 level of more than 400,000 certifications, reflecting renewed economic growth and greater efforts by the Employment Service to implement the program. Still, only about 10 percent of employers have used the credit, and employers have claimed the credit for fewer than 10 percent of the eligible workers they have hired.

EVIDENCE ABOUT THE PROGRAM

There are two key questions about the jobs credit. First, is it effective? That is, does it generate jobs at a reasonable cost for targeted workers that they would not have had without the subsidy? Second, if it is effective, how can employer participation be increased?

What Effect Does the Program Have on Target Groups and Other Workers?

The poor employment prospects for disadvantaged youth--the only group for which much is known about the credit's effects--have long been a major concern. Unemployment rates among minority youth are generally more than double the rates for white youth (see Table 1). Unemployment rates for black teenagers averaged nearly 50 percent in 1983 and rates for

TABLE 1. UNEMPLOYMENT AND EMPLOYMENT RATES FOR YOUTH, 1983

	Unemployment Rates (in percents)	Employment/Population Rates (in percents)
All Youth		
16-19	22.4	41.5
20-24	14.5	66.0
White Youth		
16-19	19.3	45.9
20-24	12.1	69.4
Black Youth		
16-19	48.5	18.7
20-24	31.6	46.8

SOURCE: Employment and Earnings, Bureau of Labor Statistics (January 1984).

blacks aged 20 to 24 were 32 percent, while the overall unemployment rate was less than 10 percent. 3/

Although the general youth employment problem will moderate in future years because of demographic trends, exceptionally high unemployment among disadvantaged youth will likely continue. Because this problem has been so intractable, any approach that may help merits careful consideration if the Congress remains committed to assisting the

3. Employment differences between black and white youth are only an approximation to differences between targeted youth and other youth, since many youth eligible for the credit are white and many black youth are ineligible for the credit.

disadvantaged to find employment. I review current evidence about the effectiveness of the jobs credit here, but some important questions about its effects remain unanswered at this time.

Based on evidence from an employer survey, it appears that from 1980 to 1982 the credit induced a shift in employers' hiring toward targeted youth workers, but it was less clear how much overall employment increased due to the credit. In a 1982 survey, about 34 percent of employers who had used the credit said that it substantially influenced their choice of which workers to hire. The proportion of workers who were under age 25 increased by at least 6 percent, on average, in firms that had used the credit over the previous two years compared to similar firms that had not used it. The proportion of new jobs for youth that were net additions to overall employment is unknown. To the extent that new job opportunities provided to targeted workers because of the credit were net new jobs, targeted workers benefited with no adverse effect on other workers. If overall employment effects were small, however, then gains for targeted workers were at the expense of other workers who were displaced.

Even if displacement is substantial, the credit may nevertheless be desirable because it reduces the concentration of unemployment in disadvantaged groups. Any employment losses that untargeted groups experience because of the credit are likely to be widely distributed and small for any particular individual, although in some specific cases substantial costs may be shifted to untargeted workers.

For low-income youth, the Congressional Budget Office (CBO) estimates that the credit generates private-sector jobs they would not otherwise have had at an estimated average federal cost of $2,500 per job. 4/ To put this in perspective, the average cost per participant in local training programs under the 3ob Training Partnership Act (3TPA) is about $5,400 in 1985. 5/ Disadvantaged youth who have difficulty finding a job may be enrolled in these programs even though they have job skills. Although these programs generally provide some formal training, accounting for their higher cost, it would not be cost-effective to provide such services to job-ready youth unless they led to greater gains in later employability than private-sector work experience would.

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4. This assumes--based on evidence from an employer survey--that two-thirds of the youth in subsidized jobs would have gotten jobs without the subsidy.

5. Another comparison would be the cost for try-out programs under the 3TPA, but these are new and largely unused as yet, so there is no evidence on their cost or effectiveness. In 3TPA try-out programs, a limited number of youth may be placed with private-sector employers for a "try-out" period, limited to 250 hours, at no cost to the employer.

It seems likely that one of the original premises of the tax credit program--that target group members can effectively use a voucher verifying their eligibility as a self-marketing aid in their job search--is wrong. In experiments where public assistance recipients informed potential employers about their eligibility for the credit, they had significantly lower placement rates than similar job seekers who did not. Although there is no comparable experimental evidence for other target groups who might be less stigmatized, there is anecdotal evidence that they are reluctant to advertise their eligibility because they believe they would be presenting themselves in a bad light. Most credit certifications result from third-party efforts, such as Employment Service personnel either seeking out or responding to employers who will accept referrals of credit-eligible job seekers.

Which Employers Use the Tax Credit Program?

Large employers--primarily in the service, retail trade, and manufacturing industries--are far more likely to use the credit than small employers (see Table 2). While only about 10 percent of firms have used the credit, those employers often use it heavily, with about 20 percent of their employees subsidized, on average. This suggests that the subsidy is probably more than enough to compensate for any productivity differences between eligible workers and unsubsidized applicants. Based on employer perceptions in 1982, credit-eligible workers were at most 12 percent less productive than unsubsidized workers during their first few weeks on the job.

TABLE 2. ESTIMATED USE OF THE TJTC BY EMPLOYERS, 1982

Type of Employer	Percent of Employers Who Have Used the TJTC	Percent of Employees Subsidized in Firms That Used the TJTC
Number of Employees		
1-4	4	17
5-19	10	25
20-49	12	8
50-199	21	21
200+	44	14
Industry		
Mining	2	1
Construction	8	10
Manufacturing	13	17
Transportation and Utilities	6	15
Wholesale and Retail Trade	11	31
Finance	5	7
Other Services	10	10
Total	10	20

SOURCE: 1982 Employer Survey funded by the National Institute of Education and the National Center for Research in Vocational Education. This survey is not nationally representative, but is representative of both urban and rural sites in three regions--South, North Central, and West. In all, 3,710 employers responded to the survey.

A substantial proportion of employers are unlikely ever to use the credit. For example, employers who don't pay taxes--about 30 percent of firms--can't benefit from the credit. Further, employers whose products or services can't be produced with low-skill labor won't use the credit, since they can't use the kind of workers who are eligible for it. In addition, small employers may be reluctant to use the credit for at least two reasons. First, they are less able than larger firms to recover the perhaps sizable fixed costs of participation--learning about the program and then modifying hiring practices to take advantage of it. Second, they are less able to absorb the additional costs that an unsuitable employee could impose on the firm.

Outreach efforts could significantly increase the probability of employers participating in the tax credit program, however. If firms not now using the credit were contacted by the Employment Service, told about how the program works, and asked to accept program referrals, CBO estimates that up to a third could be persuaded to do so. For reasons already discussed, success rates would probably be highest in large firms with a high proportion of low-skill jobs, and lower in small firms or firms with few low-skill jobs. Once persuaded to participate, however, firms might refuse to continue if they found that the credit-eligible applicants referred to them by the Employment Service were often unsuitable. Employers seem to be especially dissatisfied if the Employment Service sends an applicant who is an ex-convict without informing them of this status.

OPTIONS

The Congress has two broad alternatives--either allow the tax credit program to expire or extend it, perhaps with some modifications.

Allow the TJTC Program to Expire

One option is to allow the credit to expire as now scheduled at the end of 1984. This would contribute to simplifying the tax code, while federal programs to facilitate private-sector employment of disadvantaged groups would still exist under the Job Training Partnership Act. Costs can be tightly controlled under this program, whereas the Congress has less control over the costs of the tax credit program since it is an entitlement. Allowing the program to end would avoid an estimated additional revenue loss of $163 million in 1985 and a total loss of $2.9 billion from 1985 through 1989, compared with extending it in its present form. 6/

Reauthorize the TJTC Program

Alternatively, the Congress could reauthorize the credit. Since the Department of Labor is currently planning a study of the tax credit program, reauthorization for two or three years would provide the opportunity for evaluation of the program's effectiveness, giving the Congress a better basis on which to assess whether it wants to continue assisting disadvantaged workers in this way. Eliminating the credit without careful evaluation may be premature and counter-productive.

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6. The Joint Tax Committee estimates that losses from the TJTC, if extended, would total about $548 million for fiscal year 1985. Revenue losses would total $385 million even if it were not extended, however, since employers may claim the credit for up to two years' wages paid to eligible employees hired before January 1, 1985.

If the credit is reauthorized, the Congress may want to consider altering the definition of "economically disadvantaged," which is an eligibility criterion for most target groups. Under current law, the definition is based on the Lower Living Standard, a set of income guidelines varying by family size and location that are in turn based on the lower family budget developed by the Bureau of Labor Statistics (BLS). BL5 has not revised the lower family budget since 1981, however. Consequently, economic eligibility conditions for the tax credit have become increasingly stringent because of inflation. While the Employment and Training Administration may soon assume responsibility for updating the Lower Living Standard, the outdated market-basket information on which it is based, if not supplemented with new survey information, makes its use questionable.

The Congress could replace the Lower Living Standard with the poverty guidelines used by the Office of Management and Budget (OMB), which are readily available and regularly updated. They are also based on outdated market-basket assumptions, though, and they do not vary by location. Further, substitution of current poverty guidelines would reduce the size of the eligible population somewhat.

An alternative would be to refer to whatever criteria are used to define "economically disadvantaged" under the job training program.

Currently to qualify, participants must receive cash welfare payments or food stamps, or belong to families with income less than the OMB poverty guidelines or 70 percent of the Lower Living Standard. Although each currently allowable criterion can be criticized, use of the same criteria would make it easier for the Employment Service to establish eligibility for the two programs, which are intended to address the same ultimate goals in any case. It would also expand eligibility for the tax credit, however, and could increase revenue losses by 15 to 20 percent.

CONCLUSION

Changes authorized by the Congress in 1981 probably increased the effectiveness of the tax credit program by reducing--but not eliminating— the potential for employers to benefit without altering their hiring practices. In addition, use of the program is increasing as a result of growing familiarity with the credit, an improving economy, and more active marketing by the Employment Service. If the Congress wants to continue federal efforts to assist disadvantaged groups to find employment, it may want to reauthorize the credit program in order to permit rigorous evaluation of the current program relative to alternative approaches. Reauthorization would, however, reduce tax revenues.